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UNIT I

LESSON 1

ACCOUNTING: ITS CONCEPTS AND CONVENTIONS

STRUCTURE

1.1 LEARNING OBJECTIVES

- To know the basic concepts of accounting
- To identify the role of accounting as an information system

- To know the role of AI in accounting
- To explain the functions of accounting
- To identify the various branches of accounting
- To apprise the accounting concepts and conventions.

1.2 INTRODUCTION

Definition of Accounting: Before attempting to define accounting, it may be added that there is no among unanimity accountants as to its precise definition. However, some of the definitions are as given below.

According to L.C. Copper, "Book-keeping may be described as the science of recording transactions in money or money's worth in such a manner that, at any subsequent date, their nature and effect may be clearly understood, and that, when required, a combined statement of their result may be prepared".

R.N. Carter defines Book-keeping as "Book-keeping is the science and art of correctly recording in books of account all those business transactions that result in the transfer of money or money's worth"

Yet another definition is given A.H. Rosenkampff. According to him, "Book-keeping is the art of recording business transactions in a systematic manner"

Out of the above and many more others, the most acceptable one is that given by American Institute of Certified Public Accountants (AICPA) Committee on Terminology. According to AICPA "Accounting is the art of recording, classifying and summarising in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character and interpreting the results thereof".

Book-keeping is a subject of profound importance to all kinds of business enterprises.

It is of great importance, for example, to manufacturing concerns, trading concerns, banks, transport companies and insurance companies. They have to follow a proper accounting system if they want to know as to whether they are earning, profits or incurring losses and how much; whether or not all the transactions have been recorded fully and accurately; the amount they owe to their creditors as well as the amount owed to them by their debtors.

Thus, the objects of accounting are to enable the businessman to ascertain accurately and easily.

1. The amount of gain or loss during a particular period, and
2. The amount of his assets and liabilities and capital in the firm at a particular point of time.

Double Entry Principle: In the present era double entry system of book-keeping is considered to be the best, common and universal system, because it is modem, scientific, and complete. It fulfils all the objects of a businessman. It originated in western countries and so it is also called western system of accounting. It is also called mercantile system of accounting because according to this system cash and credit transactions can be recorded.

Double entry system has been defined differently by different authorities. Some of which are as follows: -

According to Carter, "The modern system of Accounting in use is known as Double Entry.

Double Entry is a system of Book-keeping by means of both personal and impersonal accounts."

M.J. Keller defines Double Entry System as follows: "The most common system of accounting data for an enterprise is the Double Entry System. As the name implies, the entry made for each transaction is composed of two parts, a 'Debit' and a 'Credit."

Each business transaction that results in transfer of money or money's worth involves a twofold aspect, (a) the yielding or giving of a benefit, and (b) the receiving of that benefit. In other words, every business transaction involves exchange of value for value, or inter-change of money or money's worth or every business transaction involves receiving something having value and giving something, which has value. According to Double Entry System, both these aspects of the transaction, the receiving aspect and the giving aspect, are recorded. Thus, if Building is bought from Mukesh, Building Account receives and Mukesh's Account gives. There must, therefore, be double entry to have a complete record of each transaction.

For a clear understanding of the principles of double entry system, it is necessary to first carefully bear in mind that certain transactions are common to almost every business. These common transactions are as follows:

1. The businessman enters into business dealings with a number of persons or firms.
2. He must have some assets or properties in which or with the help of which he carries on the business; and
3. He must incur certain expenses such as office rent, salaries, advertising, etc. for carrying on the business, and that he must have some sources from which the income of the

business is derived.

It follows, therefore, that in order to keep a complete record of all the business transactions, it will be necessary to keep the following accounts

(i) The account of each person or firm with whom the firm has to deal.

(ii) The account of each asset or property in the business; and

(iii) The account of each head of expense or source of income.

The accounts which come under first group are called Personal Accounts, those which come under second group are called Real Accounts, and those coming under the third group are called Nominal accounts.

Since words 'debit and credit', and 'Account' have been used in the above definitions and discussion, it will be better if we first understand the meaning of these words and then proceed to discuss the rules of double entry system.

The double entry system divides the page into two equal halves. The left-hand side of each page is called the debit side, while the right-hand side is called the credit side. There was no rational reason in the way in which the sides were chosen to represent different items, and the credit side could have easily been the left-hand side and the debit the right-hand side. The Venetian merchants who were the 'first known businessmen to use double entry just happened to select the left hand or debit side for the assets and opposite side to represent capital and liabilities, and so it has remained ever since.

An Account is a classified and chronological record in which the money values (sometimes also the quantities or the money values and quantities together) of all the benefits given or received by a particular party (which may be a human being or a personified object) are arranged in two separate columns on the right and left sides respectively of each sheet of paper or each page or folio of the book in which it is written. There will be a debit side as well as credit side to every account. This is indicated by writing "Dr" and "Cr" on the left-hand side and right-hand side margin respectively of the account. All entries in the Dr. side are preceded by the word 'To', meaning that the account of which the record is being prepared is a debtor to the account the name of which appears in the entry. On the other hand, all entries in the credit side are preceded by the word by', so that each entry may mean that the account of which the record is being prepared is credited by the account the name of which appears in the entry. The title of the account is written across the top of the account at the centre.

The account of the party that gives a benefit is called a "Creditor" and that of the party that receives it is called a "Debtor". As a general rule the value of each benefit received by an account is entered on the left-hand column of the account and the account is said to have been 'debited' with such value; on the other hand, the value of each benefit given by an account is entered on the right- hand column of the account and the account is said to have been 'credited' with such value. These are called debit and credit entries respectively.

Having understood the meaning of the words "Debit and Credit", and "Account", let us now proceed with the explanation of rules of double entry system.

Rules of Double Entry System: For debiting or crediting a particular account, we have first to see which class of account are affected by the transaction which is entered into by the businessman. After ascertaining that, the following rules of debit and credit will have to be followed:

(1) Personal Accounts: In the case of personal accounts, we debit the. person or the firm with the benefits received by him or by the firm and credit the person or the firm with the benefits imparted by the person or the firm. In short, we can say that-

Debit the Receiver (of benefits): and Credit the Giver (imparting the benefits)

(2) Real Accounts: Real accounts are debited with the incomings and are credited with the outgoings or,

Debit what, comes in the business; and Credit what goes out (of the business)

(3) Nominal Accounts: All amounts expended or lost are debited and all amounts gained are credited to nominal accounts

In other words:

Debit all expenses and losses, and Credit all incomes and gains.

It should be kept in mind that these rules never vary and will have to be rigidly followed under all conceivable conditions. It should also be noted that the above-mentioned phenomena like 'giver' and 'receiver', 'coming in' and 'going out' etc. are to be judged not from the proprietor's point of view but from the point of view of the business.

In addition to the above rules of double entry system, there are certain basic concepts and conventions of accounting which must be known before actual book-keeping and accounting work is started. These concepts are discussed here-in-after.

1.3 ACCOUNTING AS AN INFORMATION SYSTEM

Accounting is often referred to as the language of business. The primary aim of a language is to serve as a means of communication. Accounting is used to communicate financial and other information to people, organizations, Governments etc., about various aspects of business and no business entities. Accounting information is used when Mr. A applies for a loan at a bank or when A submits his income-tax returns. Business enterprises use accounting for their day-to-day activities and to report the result of these activities to their owners, creditors, employees and Governmental agencies. The accounting is, therefore, also an information system. In today's society, many persons and agencies outside the accounting information; (ii) Accountant may supervise the work of book-keeper's recording work but the bookkeeper has no role in accountant's work of interpretation; (iii) the work of bookkeeper is routine and clerical in nature and is increasingly being done by computers. But the work of accountant is technical in nature and requires higher level of knowledge, conceptual understanding and analytical skill; (iv) Book-keeping is done in accordance with basic concepts and conventions for all types of organisations. But the methods and procedures adopted by accountants in the analysis and interpretation of financial reports may not be same for all the firms.

1.3.1 Functions of Accounting:

Financial accounting performs the following major functions:

(i) **Maintaining systematic records:** Business transactions are properly recorded, classified under appropriate accounts and summarised into financial statements-income statement and the balance sheet.

(ii) **Communicating the financial results:** Accounting is used to communicate financial information in respect of net profits (or loss), assets, liabilities etc., to the interested parties.

(iii) **Meeting legal needs:** The provisions of various laws such as Companies Act, Income Tax and Sales Tax Acts require the submission of various statements, i.e., annual accounts, income tax returns, returns for sales tax purposes and so on.

(iv) **Protecting business assets:** Accounting maintains proper records of various assets and thus enables the management to exercise proper control over them with the help of following information regarding them: (a) How much is the balance of cash in hand and cash at bank?
(b) What is the position of inventories? (c) How much money is owed by the customers? (d) How much money is owing to the creditors? (e) What is the position of various fixed assets and how these are being used?

(v) **Accounting assists the management in the task of** planning, control and coordination of business activities.

(vi) **Stewardship:** In the case of limited companies, the management is entrusted with the resources of the enterprise. The managers are expected to act true trustees of the funds and the accounting helps them to achieve the same.

(vii) **Fixing responsibility:** Accounting helps in the computation of the profits of different departments of an enterprise. This would help **in fixing the responsibility of departmental heads**.

1.3.2 Advantages of Accounting

(i) **Assistance to management:** The accounting information helps the management to plan its future activities by preparing budgets in respect of sales, production, expenses, cash, etc. Accounting helps in coordination of various activities in different departments by providing financial details of each department. The managerial control is achieved by analyzing in money terms the departures from the planned activities and by taking corrective measures to improve the situation in future.

(ii) **Records rather than memory:** It is not possible at all to do any business by just remembering the business transactions which have grown in size and complexity. Transactions, therefore, must be recorded early in the books of accounts so that necessary information about them is available in time and free from bias.

(iii) **Intra-period comparisons:** Accounting information when recorded properly can be used to compare the results of one year with those of previous year(s).

(iv) **Aid in legal matters:** Systematically recorded accounting information can be produced as evidence in a court of law.

(v) **Help in taxation matters:** Income Tax and Sales Tax authorities could be convinced about the taxable income or actual turnover (**sales**), as the case may be, with the help of written records.

(vi) **Sale of a business:** In case, a sole trader or a partnership firm or even a company wants to sell its business, the accounting information can be utilized to determine proper purchase price.

1.3.3 Limitations of Accounting

(i) Accounting information is expressed in terms of money. Non-monetary events or transactions, however important they may be, are completely omitted.

(ii) Fixed assets are recorded in the accounting records at the original cost, that is, the actual amount spent on them plus, of course, an incidental charge. In this way the effect of inflation (or deflation) is not taken into consideration. The direct result of this practice is that balance sheet does not represent the true financial position of the business.

(iii) Accounting information is sometimes based on estimates; estimates are often inaccurate. For example, it is not possible to predict with any degree of accuracy the actual useful life of an asset for the purpose of depreciation expense.

(iv) Accounting information cannot be used as only test of managerial performance on the basis of more profits. Profit of a period of one year can readily be manipulated by omitting such cost of advertisement, research and development, depreciation and soon.

(v) Accounting information is not neutral or unbiased. Accountants calculate income as excess of revenues over expenses. But they consider only selected revenues and expenses. They do not, for example, include cost of such items as water or air pollution, employee's injuries etc.

(vi) Accounting like any other discipline has to follow certain principles which in certain cases are contradictory. For example, current assets (e.g., stock of goods) are valued on the basis of cost or market price whichever is less following the principle of conservatism. Accordingly, the current assets may be valued on cost basis in some year and at market price in another year. In this manner, the rule of consistency is not followed regularly.

1.3.4 The Users of Accounting Information

Financial accounting is primarily concerned with preparation of accounting information for the outsiders who do not have direct access to the accounting records. They obtain accounting information of business enterprises from their annual reports, data published by Government departments and information published in financial newspapers, e.g., the Economic Times, Financial Express etc., or business magazines e.g., Business India, Business World. The Economist, etc. In the following paragraphs, the users of accounting information have been grouped into a number of major headings and the requirements for each considered therein:

Creditors and short-term lenders: Creditors include suppliers of goods and services on credit. Short-term lenders such as commercial banks supply money for short periods to business organisations. Bankers and suppliers inspect the accounting information before making loans or granting credit. They want to know whether or not the enterprise will be able to meet its financial repayment obligations in time. Their specific interest lies in solvency, liquidity and profitability positions of the business enterprise. Accounting serves their purpose by disclosing true and fair view of current assets in the balance sheet and profitability position in the income statement so as to assure the creditors and lenders that their debts would be paid in time.

Investors: Under this category are included the existing shareholders and future shareholders. Basically, they will be interested in the dividends that are paid. They are also interested about future prosperity of their enterprise. But the income statement and the balance sheet of one year will not be helpful to guide the investors about the future prospects. So, the accounting information must provide the details of the profits and financial position of business so that the investors can find out the progress of the past few years and it may be assumed that this progress will be maintained in future as well. At present such information is generally given in the published accounts. The statement of the chairman in the annual reports also provides some indication about the future progress.

Long-term lenders: This category of users includes debenture holders and those providing long-term loans, say, industrial banks, financial institutions, etc. They are interested in knowing that they will get the interest due to them and that the same will be paid when it is due and payable. They will also see to it that their principal amount is also paid on due date. So, their main interest is in the profitability for interest payments and liquidity for the repayment of the loan amount. The availability of cash flow statements in addition to income statement and balance sheet has considerably helped users to evaluate the liquidity position of a business enterprise.

Management: The owners are not the only persons within the business enterprise who are interested in various aspects of the operations of a business. With are interested in various aspects of the operations of a business. With the separation of management and ownership (**particularly in a limited company**), the managers are responsible for carrying on the operations of the business enterprises. The type of accounting information needed by managers may vary with the size of the enterprise. The manager of a small business may need relatively little accounting information. As the business enterprise grows in size, the manager loses direct contact with daily operations. As a result, information about various aspects of the business enterprise must be supplied by accounting. Some of their needs for accounting information relate to : (i) setting objectives or targets for future periods and devising methods to attain those objectives (ii) observing and measuring the performance of the various departments of the business as also the enterprise as a whole; (iii) evaluating the performance in relation to the targets set up; highlighting the deviations from the planned targets; and (iv) taking such corrective action as may be necessary to overcome the shortfalls.

Employees (Labour unions): In this category are included both individual employees and groups of them represented by labour unions. Employees want more salary and other benefits such as overtime payments, bonus, housing, medical facilities and so on. The bargaining power of the unions is increased if workers' demands are based on facts and figures. In addition, some companies regularly issue certain reports containing financial information about the employers for a better understanding of the business by the employees. These reports highlight what the companies are doing for the welfare of their employees and what they intend to do in future.

Government and regulatory agencies: In recent years, the government has become one of the most important users of accounting information. The central, state and local governments have the responsibility of allocating the resources for different uses. Naturally they are interested in the activities of business enterprises such as sales, profits, dividend policies, investments, etc. Moreover, the Government activities are financed through the collection of tax. Thus, the accounting information about business activities is very helpful in the collection of income tax, excise duties, customs duties, sales tax, etc. Each tax requires a special tax return based on necessary accounting information of various business enterprises. Any distortion in the accounting information needed by the Government agencies would adversely affect the welfare policies of the various types of governments. Similarly, a number of regulatory agencies like Securities and Exchange Board of India (SEBI), the Insurance Regulatory Authority, the Reserve Bank of India etc. need accounting information for the efficient operation of capital markets.

Individuals and society: People are affected by the operations of a business enterprise in their localities. They want to know through the accounting information the trends in the prosperity of the enterprise and also the range of activities. This would enable them to assess the employment opportunities in their local areas. Society as a whole is concerned with the environment pollution. The accounting information would disclose how much money has been allocated to control such pollution. This has come to be known as social responsibility accounting.

1.3.5 Role of AI and Data Analytics in Accounting

We are living in the world of Artificial Intelligence. The organizations have realised that the AI can make their financial and accounting system much stronger and easier. The main reason behind the exponential growth of AI in accounting and finance is the data generation and computation.

This automation has the power to save 80-90% of the time usually taken by the workforce in data recording and analysing. This saved time can be put into many other relevant tasks and increase the productivity and output. The AI also helps the accounting team to forecast the needs related to various resources. Artificial intelligence helps the team to process the documents in the real time and generate the reports automatically. These AI generated reports are more reliable and can help in the strategic decision making. Following section talks about some of the key areas where AI can facilitate the accounting.

Invoice Processing: The generation and processing of invoice usually takes a lot of time when done manually. The AI based invoice management system can reduce the time taken and increase the volume.

Inbound Logistics: The AI can help the organization to contact their suppliers in no time and send the requisitions automatically. A well-established AI system can help in good inventory management.

Procurement: The AI system can help the organization to centralise its procurement activities by reducing the paperwork.

Auditability: the data analytics help organization to keep a track on every transaction and makes the audit process easy. The cognitive computing and predictive analytics facilitate the forecasting process.

Cash-flow management: The Artificial intelligence offer many tools which can help the enterprise to record the cash transactions conveniently. The AI based applications can also predict the cash requirements of future based upon the current expenses and inflation.

Chatbot- a new way of customer care: Today is the era of chatbots. The AI driven chatbots are able to solve the customers query in a speedy manner. The chatbots work on the basis of some predefined vocabulary and presents options accordingly. The chatbots have reduced the burden on the customer care staff drastically.

IN-TEXT QUESTIONS

1. Accounting is used to communicate ____________ information to people, organizations, Governments etc.
2. The accounting information helps the management to plan its future activities by preparing __________in respect of sales, production, expenses, cash, etc.
3. _____________ include suppliers of goods and services on credit.
4. The _____________ are responsible for carrying on the operations of the business enterprises.
5. Accounting has to follow certain principles which in certain cases are contradictory. True/False

1.4 BRANCHES OF ACCOUNTING

Accountants tend to specialise in various types of accounting work, and this has resulted in the development of different branches of accounting. Some of these divisions of accounting are given as:

(i) **Financial Accounting:** Accounting designed for outsiders (persons other than owners and managers) is known as financial accounting. It is concerned with the recording of business transactions and the periodic preparation of balance sheet and income statement from such records. In this manner, the financial accounting is useful for ascertaining profit or loss made during a given period and financial position at the end of the period.

(ii) **Management accounting:** It is concerned with the interpretation of accounting information to guide the management for future planning, decision-making, control, etc., Management accounting, therefore, serves the information needs of the insiders, e.g., owners, managers and employees.

(iii) **Cost accounting:** It has been developed to ascertain the costs incurred for carrying out various business activities and to help the management to exercise strict cost control.

(iv) **Tax accounting:** This branch of accounting has grown in response to the difficult tax laws such as relating to income tax. sales tax, excise duties, custom duties, etc. An accountant is required to be fully aware of various tax legislations.

(v) **Social accounting:** This branch of accounting is also known as social reporting or social responsibility accounting. It discloses the social benefits created and the costs incurred by the enterprise. Social benefits include such facilities as medical, housing, education, canteen, provident fund and so on while the social costs may include such matters as extra hours worked by employees without payment, environment pollution, unreasonable terminations, etc.

(vi) **Human resource accounting:** It is concerned with the human resources of an enterprise. Accounting methods are applied to identify human resources and its evaluation is done in money terms so that the society might judge the total work of the business enterprises including its nonhuman net assets. It is, therefore, an accounting for the people of the organisation. Unfortunately, no objectively verifiable measure has been developed for universal application.

(vii) **National accounting** means the accounting for the nation as a whole. It is generally not concerned with the accounting of individual business entities and is not based on generally accepted accounting principles. It has been developed by the economists and the statisticians.

1.5 BASIS OF ACCOUNTING

The business enterprises use accounting to calculate the profit from the business activities at the end of given period. There are two bases of calculating the profit, namely, the cash basis and the accrual basis.

(i) **Cash basis of accounting:** In this basis of accounting, the income is calculated as the excess of actual cash receipts in respect of sale of goods, services, properties, etc. over actual cash payments regarding purchase of goods, expenses on rent, electricity, salaries, etc. Credit transactions are not considered at all including adjustments for outstanding expenses and accrued income items. This method is useful for professional people like doctors, engineers, advocates, chartered accountants, brokers and small traders. It is simple to adopt because there are not adjustment entries. But this basis does not disclose the true profits because it does not consider the income and expense items which relate to the accounting period but not paid in cash. Moreover, this method is not applicable where the number of transactions is very large and expenditure on fixed assets is high. The income or profit is calculated with the help of receipts and payments account.

Accrual basis of accounting: Under this method the items of income (revenue) are recognised when they are earned and not when the money is actually received later on. Similarly, expense items are recognised when incurred and not when actual payments are made for them. It means revenue and expenses are taken into consideration for the purpose of income determination on the basis of the accounting period to which they relate. The **accrual basis** makes a distinction between actual receipts of cash and the right to receive cash for revenues and the actual payments of cash and legal obligations to pay expenses. It means that income accrued in the current year becomes the income of the current year whether the cash for that item of income is received in the current year or it was received in the previous year, or it will be received in the next year. The same is true of expense items. Expense item is recorded if it becomes payable in the current year whether it is paid in the current year, or it was paid in the previous year, or it will be paid in the next year. The advantages of this system are: (a) it is based on all business transactions of the year and, therefore, discloses the correct profit or loss; (b) the method is used in all types of business units; (c) it is more scientific and rational in application; (d) it is most suitable for the application of matching principle. The **disadvantages** are: (a) it is not simple one and requires the use of estimates and personal judgement; (b) it fails to disclose the actual cash flows.

Mixed or hybrid basis of accounting: Under this method revenues (items of income) are recognised on cash basis while the expenses are recorded on accrual basis. The purpose is to remain cautious, safe and hundred per cent certain for revenues items and make adequate provisions for expenses.

1.6 ACCOUNTING CONCEPTS

Accounting in the past was mainly used to (1) keep control over property and assets of the business concerned and (2) ascertain and report about the profit or loss and the financial position relating to the various periods. But not a day's accounting is used not only for the above-mentioned purposes but also for collecting, analysing and reporting of information to the management and others at the required points of time to facilities rational decision making.

Moreover, the accounts in the past were prepared mainly for the use of the proprietor. Today financial statements are required by the proprietors, creditors, potential investors, Government and many others. The proprietors study the financial statements to know about the profitability of their business. Creditors study them to ascertain the solvency of the business. Prospective investors are interested in them for the ascertainment of the correct earing potential of the business. Government makes use of these statements for finding out the net contribution that a business can make to the economic well being of the country.

To satisfy the diverse and complex needs of those who use accounting, one needs something more than the clerical procedures, journalising, posting, taking out trial balance and closing the books etc. The accountant should have 'guides to action' or 'principles' for completing his work of a wide dimensions. The usefulness of accounting will be maximised only if there exist some generally accepted concepts regarding the nature and measurement of liabilities, assets, revenues and expenses. There must also be some widely supported standards of disclosure and reporting. There will be widespread understanding of and reliance on accounting statements only if they are prepared in conformity with generally accepted accounting principles. If there is no common agreement on accounting matters, then complete chaotic conditions would prevail as in that case every businessman and/or every accountant could follow his own definition of revenue and expense.

Definition: The rules conventions of accounting are commonly referred to as 'principles'. A universal definition of the 'accounting principles' is difficult to give. However, 'accounting principles' can be defined in the following two ways:

1. Accounting Principle is a "General Truth" or a 'fundamental belief'. This definition implies a scientific bias and therefore, its application in the face of ever-changing socio-economics factors which affect the very basis of a business is doubtful.

Accounting principle may be defined as a 'rule of action or conduct'. This definition finds favour with the American Institute of Certified Public Accountants as it refers to changing character of rules of action or conduct due to the changes in business practices etc. According to AICPA, accounting principle is a general law or rule adopted or processed as a guide to action. The accounting principles do not prescribe one way of doing things. They recognize that there are a number of ways in which one thing can be done. The accountant has considerable latitude and choice within the generally accepted accounting principles in which to express his own idea as to the best way of recording and reporting is specified account. The practice of recording and reporting may thus differ from company to company.

It should be noted that it would be incorrect to suggest that accounting principles are a body of basic laws like those found in natural sciences like Physics and Chemistry. Accounting principles are man made and hence are more properly associated with such terms as concepts, conventions and standards. Accounting principles were not deducted from basic axioms, not is their validity verifiable by observation and experiment in a laboratory. Accounting principles are constantly evolving, being influenced by business practices, the needs of statement users, legislation and governmental regulations, the opinions and actions of shareholders, labour unions, creditors, and management, and the logical reasoning of accountants. The sum total of all such influences finds its expression first in accounting theory. Some theories are accepted while some others are rejected. *Theory becomes an accounting principle only when it is generally accepted.*

A distinction between Fundamental Accounting Assumptions and 'Accounting policies' has been made by the International Accounting Standards Committee (IASC). Fundamental Accounting assumptions or postulates according to the ISC underlie the preparation of financial statement. They need not be specifically stated on the face of such statements. Their acceptance and use are assumed in the preparation of financial statements Disclosure with full reasons, however, must be made in case they are not followed. Accounting policies on the other hand encompass the principles, basis, conventions, rules and procedures adopted by management in preparing and presenting financial statements. There are, as stated above, many different accountings and applying those which in the circumstances of the enterprise, are best suited to present properly its financial position and the results of its operations.

1.7 ESSENTIAL FEATURES OF ACCOUNTING PRINCIPLES

The general acceptance of an accounting principle or practice depends on its capacity to meet the criteria of relevance, objectivity and feasibility.

An accounting principle should be relevant, i.e., the use of it should result in information that is meaningful and useful to the financial statement users.

In other words, only those accounting rules which increase the utility of the business records to its readers will be accepted as an accounting principle by them.

It should be objective. The accounting information obtained should not be influenced by the personal bias or judgement of the statement makers. Objectivity can note reliability or trustworthiness. It means that there must be means of ascertaining the correctness of the information reported in a financial statement.

A principle is feasible to the extent that it can be implemented without undue cost or complexity. The accounting principles may be adopted to the needs of business quickly and easily. It means the accounting principles should be flexible, i.e., they should not be static. They should be capable of being changed with the changes in business methods and procedures.

The accounting principles generally combine all the above-mentioned features or criteria, but sometimes we may have to give up one criterion in favour of another or we may place greater importance on one and lesser importance on the other. For example, while valuing the fixed assets at cost for Balance Sheet purposes we give up the criterion of objectivity and usefulness in favour of feasibility. The fixed assets are valued at cost and not at market price even though the cost figure is not of much use of the reader because of changes in the value of rupee, a measuring rod. This is done because of the following two reasons.

1. The market price or replacement value of the assets is difficult to ascertain.
2. The market price or the replacement value of the fixed assets even if one is able to ascertain will be less objective in nature.

Thus, in developing new principles, the essential problem is to strike the right balance between objectivity and feasibility on the one hand and relevance on the other.

Definition of Accounting Conventions: Accounting conventions mean and signify customs or tradition relating to accounting. Thus, they differ from accounting concepts which are used to connote accounting postulates. In other words, we can say that accounting conventions relate to the practical side of accounting.

After understanding the meaning of accounting concepts and conventions let us now discuss each one of these concepts and conventions in some detail.

(1) Going Concern Concept: Kohler defines going concern as, "A Business enterprise in operation with the prospects of continuing operation in the future; its assets, liabilities, revenues, operating costs, personnel policies and prospectus; a concept basic to accounting, of importance in the valuation of intangible assets and the depreciation of tangible and intangible assets." (Kohler, E.L.: *A Dictionary for Accountants*, Prentice-Hall Inc. Engle Wood Cliffs, N.I., 1963).

Simply stated accounting assumes that the business will continue to operate for an indefinitely long period in the future. In other words, the accounting unit is considered to have a greater life expectancy than that of any asset which it now owns. This necessitates the making of a distinction between capital expenditure and revenue expenditure. Though every expenditure is a revenue expenditure in the long run, this distinction is important because accounts of a business supposed to run for a long period of time, are usually prepared for a short period say, a year.

If this assumption is not made, the generally accepted accounting principles that have been developed and that are applied in the process of accounting for the financial affairs of a business entity and which are, in many instances, appropriate only for a going concern will become redundant or useless. If the business is failing and its assets are subject to forced sale, the conventional accounting approach, although acceptable for a going concern, would often result in wrong or inadequate financial information.

Under this assumption a business is viewed as an Economic or financial system for adding value to the resources it uses. Its success is measured by comparing the value of its output with the cost of the resources used in producing that output. The difference in the value of its output and the costs of the resources used to produce that output is called profit. Resources purchased but not yet used in production are called assets. They are shown not at current value to an outside buyer, but at their cost. Their current resale value is not relevant, since is assumed that they will be used in the creation of future output values rather than being sold.

Thus, the accountant does not try to measure at all times what the business is currently worth to a potential buyer. He does not show in the balance sheets the value; the assets will fetch of the company goes into voluntary liquidation. He rather values the assets used for business purposes at cost. For a going concern that intends to continue using such assets for business purposes, forced sale or current market value is not particularly relevant. But if the business is winding up its affairs and must sell its assets to satisfy the claims of its creditors, the original cost of the assets is no indicator of realisable value.

The fact should be kept in mind while preparing the account of a concern if it is clear that the life expectancy of such business is very sort. It is only because of this that in the case of contracts, assets purchased are debited entirely to the contract account and not treated as an asset.

(2) *The Business Entity Concept:* For accounting purposes the business is treated as a complete unit or entity separate from those who own it or give credit to it. The owner or proprietor is considered o be separate and distinct from the business he owns or controls. Accounts are maintained for business entities as distinct from the persons who own them, operate them, or are otherwise associated with the business. For accounting purposes even, the proprietor will be treated as creditor to the extent of his capital. The proprietor's private affairs are thus not allowed to be mixed up with those of the business. It is only because of this concept that we are able to present a true picture of the firm. The entity concept is applicable to all forms of business organisations. For accounting purposes even, the sole trader or partner is considered to be an entity different from the business he owns although even in law there is no distinction between, the financial affairs of the business and those of the people who own it; a creditor of the business can use and if successful collect from the owner's personal resources as well as from the resources of the business.

The field of this concept has now been extended. It is now also applied for finding out the results of various departments of the same organisation separately with a view to fixing the responsibility for the results thereof.

"There follows from the distinction between the business entity and the outside world that an important purpose of financial accounting is to provide the basis for reporting on stewardship. The managers of a business are entrusted with funds supplied by owners, banks and others. Management is responsible for the wise use of these funds, and financial accounting reports are in part designed to show how well this responsibility or stewardship, has been discharged". (*Management Accounting Principles* by Robert N. Anthony page 22-23).

(3) *Money Measurement Concept:* Accounting records only those facts which could be expressed in terms of money. This concept ignores the records of events on which precise money values can not be put, even if they are very important. In other words, we cannot express qualitative events with the help of accounting unless they can be measured in terms of money with a fair degree of accuracy. This enables us to deal arithmetically (added, subtracted divided or multiplied) with things of diverse nature, e.g., cost of use of plant and machinery and use of skilled labour can be added up. This is so because money provides a common denominator by means of which heterogenous facts about a business can be expressed in terms of numbers that can be dealt with arithmetically.

This concept imposes severe limitations on the scope of accounting statements. The Accounts of Gupta & Company, for example, do not reveal that a competitor has introduced an improved service to the customers; they do not report that a strike is beginning or for that matter they do not record the fact that the production manager is not on speaking terms with the Sales Manager because all these events can not be expressed in terms of money. Thus, accounting does not give a complete picture of what is happening in the business or that of the conditions prevailing in the business.

It should, however, be noted that money is expressed in terms of its value at the time an event is recorded in the accounts. Change in the purchasing power of money due to inflation or deflation in future years are not taken note of. To sum up we. can say that while money is probably the only practical common denominator, the use of money implies homogeneity, a basic similarity between Re. 1 and another. This homogeneity does not, however, exist in periods of inflation or deflation.

(4) *Dual Aspect Concept:* Dual aspects is perhaps the most important of all the concepts. We require use of this recording each and every business transaction. To understand this concept fully we must know the meaning of the words (i) Assets and (ii) equities. Assets mean the resources owned by a business, e.g., Land, Building, Plant, Machinery, Stock of goods and so on. Equities on the other hand mean the claims of various parties against these assets. Equities can be divided into two broad categories (a) Owner's equity, (or capital) which is the claim of the owner or proprietor of the business and (b) creditors equity, i.e., the claim of creditors of the business. Thus, from the above discussion it follows that the amount of the assets of the business will always be equal to the amount of owners' equity and creditors' equity. This is so because all the assets of a business are claimed by someone, either by the owners or

by the creditors of the business, and also because the total of these claims can never exceed the amount of assets to be claimed. To put it in the form of an equation we can say that Assets=Equities (Owners' equities as well as Creditor's equities)

OR

Capital + Liabilities = Assets

In its most expanded form, it will be Capital + Revenue + Liabilities = Assets + Expenses. "Accounting systems are set up in such a way that a record is made of two aspects of each

event that affects these records and in essence these aspects are changes in assets and changes in equities.

Every event that is recorded in the accounts affects at least two items; there is no conceivable way of making only a single change in the accounts. Accounting is thereof properly called a "Double Entry System" (Robert N. Anthony-Management Accounting Principles, Page 26).

(5) *Realisation Concept:* Accounting is a historical record of transaction. It records what was happened. It does not anticipate events, though it usually records adverse effects of anticipated events that have already taken place. Profit it considered to have been earned on the date at which it is realised or on the date when goods or services are furnished to the customers for some valuable consideration or when the third Party becomes legally liable to make payment for goods and services rendered to them. For tangible goods profit is recognised as and when goods are shipped or delivered to the customers and not when either a sales order is received or when a contract is signed or/ and not even when goods are manufactured to meet the order.

This concept stops business firms from inflating their profits by recording sales and incomes that are likely to take place in future.

There are certain exceptions to this general rule-(a) The revenue is recognised as realised on an earlier date in case where it can be objectively measured earlier than the date of exchange between the seller and the buyer. For example, in case of mining revenue is recognised when the metal is mined, rather than when it is sold. This is so because the metal always has a specified value and hence no market exchange or sale is necessary to establish this value.

(b) In case of Hire purchase and instalment selling, revenue may be recognised only when the instalment payments are received and not when goods are delivered due to the doubt about the actual amount that will be received from the hirer.

(c) Not full revenue or profits, if the contract of sale stipulates after sale service agreement. Probable cost of adequate provision for repairs in such cases be made out of realised profits to arrive at the net revenue figure.

(d) In a business where mere production leads to the earning of profits as sales require no effort on the part of the manufacturer, profits are assumed to have been realised as and when goods are manufactured and not when they are actually sold.

(6) *Accrual Concept:* — According to accrual concept, income or profit arises only when there has been an increase in the owner's equity or increase in the owner's share of the assets of the firm but not if such increase results from money contributed by the owner himself.

"Any increase in owner's equity resulting from the operations of the business is called a revenue. Any decrease is called an expense. Income is therefore the. excess of revenue over expenses. (If expenses exceed revenue, the difference is called a loss).

It is extremely important to recognise that income is associated with change in owner's equity and that it has no necessary relation to change in cash. Income connotes. 'Well-offenses'. Roughly speaking the bigger the income, the better off are the owners. An increase in cash, however, does not necessarily mean that the owners are better off and that their equity is increased. The increase in cash may merely be offset by a decrease in some other asset or an increase in a liability with no effect on owner's equity at all". (Robert N. Anthony, Management Accounting principles, 8th Ptg., Page 45).

Thus, the profit is said to have arisen only when the total revenues or incomes exceed total expenses or losses. Settlement, in cash, of transactions already entered into is immaterial for calculating or taking into account the expenses, losses or gain etc. It is enough if they are incurred or earned during the period for which profit is being calculated.

(7) *Verifiable objective evidence concept:* -According to this concept all the entries recorded in the books of account should be supported by business documents known as vouchers. No entry be passed in the books unless it is supported by proper voucher which could also be verified later on as and when it becomes necessary to check the correctness of the accounts. The only limitation to this general rule is entries with regard to non-cash charges, e.g., Depreciation on fixed assets, provision for bad and doubtful debts and so on.

(8) *Cost Concept:* -According to the cost concept which is closely related to Going Concern Concept the assets or resources owned by a business are entered on the accounting records at cost or the price paid to acquire them. According to the same concept the cost of the asset is the basis for all subsequent accounting for the asset.

Thus, the accounting measurement of assets does not normally reflect the worth of assets except at the moment they are purchased because it is assumed that the purchaser is a prudent businessman and that he will, therefore, not pay more for an asset or service that it is worth at the time. This being so the historical cost is presumed to be equal to the fair value of the asset acquired. In other words, it means that the accountant observing this concept does not ordinarily record the changes in the real worth of an asset which might have occurred with passage in time or due to changes in the value of money, a measuring rod. For example, a building if purchased for Rs. 1,00,000 will be recorded in the books of accounts at Rs. 1,00,000. Subsequent changes in the worth or in the market value of this building would not ordinarily be recorded in the account's books. The change in the market price of this building, say Rs. 2,00,000 on the date of preparation of the balance sheet will not be considered.

It be noted that not all assets, but only fixed assets, are recorded according to this concept. There may be certain assets called current assets, in case of which there may well be a correspondence between accounting measurements and their real market values, cash, for example, is always shown not at its original cost but at its actual worth. Similarly, marketable securities and stock held for resale are generally shown at their near actual worth figure, i.e., at cost or market value which ever is lower. It is because of this fact that it is said that subsequent changes in the market value of assets would *ordinarily* not be reflected by changes in the accounts.

However, it should also be noted that cost concept does not mean that all assets remain in the accounting records at their historical or original cost so long as the company owns them. The cost of a fixed asset, such as a building, that has a long but nevertheless a limited life is systematically reduced over the life of the asset by the process called depreciation. It is because of the process of changing depreciation that the asset disappears from the balance sheet when its economic or useful life is over.

"Another important consequence of the concept is that if the company pays nothing for an item it acquires, this item will usually not appear in the accounting records as an asset. The knowledge, skill and expertise of an electronic company's research and development team does not appear in the company's balance sheet as an asset". (An insight into management accounting First Ed., by John Sizer; Page 42.) Following this the goodwill appears in the accounts of the company only when the company has purchased an intangible and valuable property right and paid for it. Even then it is shown at its purchase price even though the management may believe that its real value is considerably higher. No amount for "goodwill" or any other asset for that matter will be shown in the accounts if the company does not actually purchase such intangibles or assets.

It also follows from the cost concept that an event may affect the value of a business without having any effect on the accounting records. To take an extreme case, suppose that several key executives are killed in a plane accident. To the extent that "an organisation is but the lengthened shadow of a man, the real value of the company will change immediately, and this will be reflected in the market price of the company's stock, which reflects investor's appraisal of value. The accounting records, however, will not be affected by. this event.

The cost concept provides an excellent illustration of the problem of applying the three basic criteria... relevance, objectivity and feasibility. If the only criterion were relevance, then the cost concept would not be defensible. Clearly, investors and others are more interested in what the business is actually worth today rather than what the assets cost originally.

But who knows what a business is worth today? The fact is that any estimate of current value is just that-an estimate and informed people will disagree on what is the right estimate. Furthermore, accounting reports are prepared by the management of a business, and if they contained estimates of what the business is actually worth, these would be management's estimates. It is quite possible that such estimates be biased.

The cost concept, by contrast, provides a relatively objective foundation of accounting. It is not purely objectives, for judgements are necessary in applying it. It is much more objective, however

than the alternative of attempting to estimate current values. Essentially, the reader of an accounting report must recognise that it is based on cost concept, and he must arrive at his own estimate of current value, partly by analysing the information in the report and partly by using nonaccounting information.

Furthermore a "market value" or "current worth" concept would be difficult to apply, because it would require that the accountant attempt to keep track of the ups and downs of the market prices. The cost concept leads to a system that is much more feasible.

In summary, "adherence to the cost concept indicates a willingness on the part of those who developed accounting principles to sacrifice some degree of relevance in exchange for greater objectivity and greater feasibility." (Robert N. Anthony-Management Accounting Principles, Eighth Print., Page 25).

(9) *Accounting Period Concept:* —The net income being the difference between value assets at the time of commencement of business and at the time of liquidation of the business, is easier to calculate when the business comes to an end. But only a few business ventures have a small life. Generally, the business houses last for a very long period of time. Moreover, accountants assume an indefinite life of the business houses (Going concern concept). But the management and other parties would not like to wait for a very long period of time, until, the business has terminated, to obtain information on how much income has been earned or loss suffered by such businesses. It would be too late then to take any corrective steps at that time if the final accounts report that the business was incurring losses. Therefore, they need to know at frequent intervals as to how things are going. The accountant, therefore, measures the income

or loss not for the entire life of the business but only for a convenient segment of time. The time interval chosen is called the accounting period. Realisation concept and accrual concept are the main or basic guides for sorting out the transactions occurring during an accounting year with a view to measure the income of that period.

It should, however, be noted that more frequent reports, called the interim reports, be prepared and sent to management for their perusal and action, if necessary.

"Business are living, continuing organisms. The act of chopping the stream of business events into time periods is therefore somewhat arbitrary since business activities do not stop or change measurably as one accounting period ends and another begins. It is this fact which makes the problem of measuring income in an accounting period the most difficult problem of accounting"(Robert N. Anthony, Management Accounting Principles, Eighth Print., Page 44).

(10) *Matching Concept:* — The main motive of doing business now a days is to maximise profits. The proprietors want their accountants to ascertain the profit or loss made by their businesses. The accountants in turn are, therefore, busy most of their time in finding out techniques of measuring profits. For finding out the profits they have to match the revenues of a particular period with the expenses or cost which can be assigned to earning such revenues.

Thus, the problem is of matching revenues of the period with the cost of securing that revenue to ascertain the profit for a particular period. It should be noted here that the problem is that of matching the expenses. It means the first step is to ascertain what revenues are to be recognised in a given accounting period. The second step, of course, is to determine the expenses that are associated with these revenues. Some difficulties in measuring the revenue for the artificial accounting year are raised because business is, as said above, a continuous process.

(a) *Measurement of Revenue:* — Revenues are measured in accordance with the accrual concept. According to accrual concept the revenues accrue in the accounting year in which they are earned. It is immaterial whether equivalent cash received in that year or not.

Cash basis of determining income has, however, considerable appeal to many people. This is so because it is not only simple but also appears to be realistic. Moreover, it is verifiable and based upon convention of conservatism. It satisfies those businessmen who think that their profit is equal to the excess of current bank balance over the beginning bank balance. According to this basis income is equal to cash received during the year and expense is equal to cash paid out during the same period. Exceptions are, however, made of additional investments by the owners and creditors. These investments are regarded as non-income transactions.

The cash basis of determining income for the year is deficient in many respects. Therefore, the accountant generally rejects this basic and adopts accrual basis of determining income which rests on the concept of realisation. According to this basis a careful distinction must be made between revenues and cash receipts as revenues need not result in an equivalent amount of cash. It is possible that revenue may be earned this year even though payment is not received until next year. The balance sheet of this year in such a case will show the amount outstanding either as debtors or as accrued revenue. It may also be possible that the business receives cash in the current years which creates a liability to render a service in some future period. The examples of such cases may be subscription received in advance by a magazine publisher or insurance premium received in advance by an insurance company. Similarly, it may still happen that the firm may have received cash last year which become revenue in this year as the services promised then are rendered now. The balance sheet of last year in such a case will show cash received in advance as a liability under the head deferred revenue or pre-collected (received in advance) revenues.

Revenue is considered to have been earned on the date when goods or services are furnished to the customer in exchange for cash or some other valuable consideration, barring a few exceptions the revenues are not considered as being earned when an order is received or when goods are manufactured to meet the order or when a contract is signed. Accountants generally recognise revenues only when goods are dispatched to customers.

Measurement of Expenses: —Expenses are the costs incurred in connection with the earning of revenue. The term 'expenses' 'connotes' 'Sacrifices made', 'the cost of services or benefits received' or 'resources consumed' during in accounting period. The term 'Cost' is not synonymous with 'Expenses' Expenses means a decrease in owner's equity that arises from the operation of a business

during a specified accounting period, whereas cost means any monetary sacrifice whether or not the sacrifice affects the owner's equity during a given accounting period; (Robert N. Anthony, Management Accounting Principle, Eighth Print, Page 46).

The AAA (American Accounting Association) committee gives the following definition of expenses—" Expense is the expired cost directly or indirectly related to given fiscal period of the flow of goods or services into the market and of related operations Recognition of cost expiration is

based either on a complete or partial decline in the usefulness of assets or on the appearance of a liability without a corresponding increase in assets." It describes the recognition of expenses as, 'Expense is given recognition in the period in which there is (a) a direct identification or association with the revenue of that period, as in the case of merchandise delivered to customers; (b) an indirect association with the revenue of the period, as in the case of office salaries or rent; (c) a measurable expiration of assets costs even though not associated with the production of revenue for the current period, as in the case of losses from flood or fire."

It should also be noted that the words expenses and expenditure connote different meanings. An expenditure takes place when we purchase an asset or service. It may be made by cash or by incurring a liability or by the exchange of another asset. There may not necessarily be a correspondence between expenses and expenditure in a time segment of one year though over the entire life of a business most expenditures made by a concern become expense or in other words there are no expenses that are not represented by an expenditure.

According to the definition of the word expense given by the AAA Committee expense of the current year include the cost of the products sold in this year, though purchased or manufactured in a prior year. Similarly, other expenses like salaries of salesman who sold these goods and the cost of other services like telephone an electricity etc. consumed or used during the year whether paid or not in the current year shall also be included in the expenses of the current year. Thus, we can say that: —

(a) There, may be some expenditure which may become expenses also in the same year because the benefit of the same is consumed in the same year. Such expenses will be recognised as an expense of the current year.

(b) There may be other expenditures which were paid in previous year/years but become expense in the current year as the benefit thereof is consumed in the current year. Insurance protection is one such item, The premium is paid in advance, but the insurance protection is received later in the year. Till then the amount paid by way of premium is an asset. It becomes an expense in the accounting period when such protection is received.

(c) Some expenditure incurred now may become expenses next year as the goods bought now will be sold next year. These will be shown as an asset on the balance sheet of the current year and will be treated as an expense when these goods are sold.

(d) Some expenditure may not be paid for in the current year although goods and services were purchased and consumed during the current year. These will be treated as expenses of the current year. The amounts outstanding will be shown as a liability in the balance sheet of the current year.

In contrast to accrual basis, in cash basis an expense is said to have been incurred as and when cash is disbursed. Results of this approach are far from being satisfactory and so the accountant makes a distinction between an incurred cost, a disbursement, and the expiration of a cost. He pinpoints the events of expiration to determine the period to the charged.

IN-TEXT QUESTIONS

6. ________________ is concerned with the interpretation of accounting information to guide the management for future planning, decision-making, control, etc Management accounting
7. ______ basis of accounting, the income is calculated as the excess of actual cash receipts. Cash
8. In _________ basis of accounting, the items of income (revenue) are recognised when they are earned and not when the money is actually received. Accrual
9. Going concern concept assumes that the business will continue to operate for an indefinitely long period in the future. True/False
10. Under ____________ concept the business is treated as a complete unit or entity separate from those who own it or give credit to it.

1.8 ACCOUNTING CONVENTIONS

***(i) Convention of Consistency*:** Accounting is not composed of a set of rules which prescribe the 'one way that things can be done. There are many different ways in which items may be recorded in the accounts. For example, there are several methods of computing yearly depreciation. Each firm should, within these limits, select the methods which give the most equitable importance that the method selected be applied consistently year after year. Successive periodical financial statements would not be comparable, if the accountant continuously changed the method of accounting for certain expenses or assets though each method might be fully acceptable. For example, the profit figure can be changed significantly by changing the methods of depreciation, The user of the statement may be misled and think that the earnings had improved, whereas in reality the increase was solely due to change in the methods of depreciation, change in net income reported in successive statement should be to changes in business conditions or management effectiveness and not simply to changes in accounting methods.

However, it does not bind the firm to follow the same method until the firm closes down. A firm can change the method used, but such a change is not affected without the deepest consideration. It means that the accountant can change the method if he thinks that the results of operations and the financial position of the business would more fairly be reflected by such a change. When such a change occurs, then either in the profit and loss account itself or in one of the reports accompanying it, the effect of the change should be stated.

It should, however, be noted here that the word consistency used here has a narrow meaning. It does not refer to logical consistency at a given moment of time rather it refers to different categories of transactions should be consistent with each other. It only means that the transaction of the same category must be treated consistently from one accounting period to another. Thus, there will be no inconsistency involved if different categories of assets are valued on different basis, e.g., if stock is valued at cost or market value, whichever is lower and fixed assets are valued at cost.

Consistency offers the following advantages to the users of the statements: —

(1) *Intra-Firm comparisons are made possible*: — 'Financial statements are most meaningful as source of information about a particular business unit when statements made at several different times are compared with each other. Trends can be discerned, for example, only when the balance sheets of three or more years are placed side by side. To provide optimum comparability, transactions must be analysed and recorded in the same way from one period to another. Items included under one caption on one balance sheet or operating statement should be included under the same caption on another statement. The virtue of consistency is so great that even incorrect procedures consistently applied may produce useful results."

(2) Inter-Firm comparisons are made possible: Another use of financial statements is in the comparison of the one business with another business. Some consistency of treatment within an industry would therefore enhance the value of accounting reports. Consistency then, is one objective of generally accepted accounting principles.

(ii) Convention of Conservatism**:** It is the policy of "Playing safe". Financial statements are drawn upon rather a conservative basis. Window dressing in preparing the financial statements is not permitted. This convention is particularly applicable when matters of opinion or estimate are involved in cases of doubt the accountants choose to understate the owner's equity rather than overstate them. This could also be said, "Anticipate no profit and provide for all possible losses."

Businessmen are generally inclined to be optimistic. The bankers, creditors, investors and others who use financial statements may be misled as assets in many cases be overstated or liabilities understated in the absence of this convention.

To take an example, the provision for doubtful debts is a matter of estimates. Most accountants prefer leaning in the direction of over statement rather than under-statement of the allowance for bad and doubtful debts. The consequences of overstatement of assets and net income are more serious than those of understatement.

Balance sheet conservatism was once regarded as the most important of all the accounting principles. But this position of the convention of conservatism is questioned now. Accountants are now becoming increasingly aware that adherence to this principle may result in incorrect statement or sometimes in unconservative statement.

Charging expense accounts with expenditure which would more properly be charged to fixed asset accounts or to make excessive provision for depreciation may be conservative from the balance sheet standpoint, but it would result in misstatement of net income. Moreover, the net income for periods in which no depreciation will be charged to income statements will be over stands. The income statements for these years will be unconservative to that extent.

Thus, we can say that the conservatism can be regarded as a virtue if, as its consequence, income statements and balance sheets do fairly present the result of operations and the financial position stretching this convention to excessive lengths will imply creation of secret reserves which is in direct conflict with the doctrine of full disclosure."

"It was probably this convention that led to accountants being portrayed as being rather miserable by nature; they were used to favouring looking on the black side of things and ignoring the bright side. However, the convention has been considerable changes in the last few decades and there has been a shift along the scale away from the gloomy view and more towards the desire to paint a brighter picture when it is warranted." (Business Accounting by Frank Wood, First edition, Page 43)

***(iii) Convention of full disclosure*:** —"The accountant proposes to make disclosure of all material facts necessary to complete understanding by third parties or relevant to any decision which might be based on accounting statements." (Smith and Ashburne, Financial and Administrative Accounting, second edition page, 53). The accountant is supposed to prepare the accounts honestly and to disclose all material information. The Companies Act makes ample provision for the disclosure of material information in company accounts. It has prescribed standard form of balance sheet and a schedule of contents of revenue statement these forms are so designed that the disclosure of all relevant facts had become compulsory.

Disclosure prompts the accountant to report the realisable value of stock or marketable securities, for example, when that value is substantially different from cost. Disclosure calls for the details of each type of capital stock, such as the par of stated value per share, the preference attached to this issue, the number of shares authorised and the number outstanding and any other fact which would be an important consideration for the present or potential shareholders. If the business entity faces a possible liability or loss that is not definite in amount at the time of preparing statements, but reasonably certain of happening, the accountant is obliged to report the facts as accurately as he can.

It should, however, be noted that the convention of disclosure does not imply that any one's or everyone's desire with regard to disclosure shall be fulfilled. It only implies full disclosure of accounts which are of interest to the owners, creditors and present or prospective investors of business. Disclosure of minor details is neither possible nor desirable.

***(iv) Convention of Materiality*:** Materiality should be interpreted negatively. In its negative sense it means the information, the non-disclosure of which would vitiate the true and fair character of financial statement. The decision with regard to materiality of an information or amount depends upon the magnitude of the amount or the importance of the information for the statement's users. Thus, as to what is or is not material depends on the nature and size of the firm and on the accountants' Judgement.

American Accounting Association defines the term 'materiality' as "An item should be regarded as material if there is reason to believe that knowledge of it would influence the decision of informed investor."

According to this convention less important items are left out whereas mention by way of a footnote or otherwise is made of more important items. Thus, if a bottle of ink was bought it would be used up over a period of time, and this cost is used up every time some one dips his pen into ink. It is possible to record this as an expense every time it happens, but obviously the price of a bottle of ink is so little that it is not worthy recording it in this fashion. The bottle of ink is not a material item and therefore, would be charged as an expense in the period it was bought irrespective of the fact that it could last for more than one accounting period.

However, the effect of change in the profit or loss of a business due to change in the method of charging depreciation on fixed assets, provision for gratuity, basis of valuation of stock, etc. are considered to be material and hence the fact of the change and the extent of its effect on the profit or loss of the concern need to be disclosed.

Based on this principle, the most modern published accounts usually avoid mentioning the fraction of the rupee in the statements and reports. But in any case, actual accounting entries are always exact.

"The materiality concept is important in the process of determining the expenses and revenues for a given accounting period. Many of the expense items that are recorded for an accounting period are necessarily estimates, and in some cases, they are very close estimates, and in some cases, they are not so. There is a point beyond which it is not worth while to attempt to refine these estimates. Telephone expense is a familiar example. Telephone bills although rendered monthly often do not coincide with a calendar month. It would be possible to analyse each bill and classify all the calls according to the month in which they were made. This would be following the accrual concept precisely. Few companies bother to do this, however. They simply consider telephone bills as an expense of the month in which the bill is received on the grounds that a system that would ascertain the real expense would not be justified by the accuracy gained. Since in many businesses the amount of the bills is likely to be relatively stable from one month to another, no significant error may be involved in this practice. Similarly, very few businesses attempt to match the expenses of making telephone calls to the specific revenues that might have been produced by these Calls." (Robert N. Anthony-Managements Accounting Principles-Eighth Print Page 56)

IN-TEXT QUESTIONS

11. Convention of consistency implies that the methods of accounting should be same over a period of time to ensure the consistency. True/False
12. Convention of conservatism refers to the disclosure of the relevant information to the concerned stakeholders. True/False
13. Convention of Materiality states that less important items are left out whereas mention by way of a footnote or otherwise is made of more important items. True/False.

1.9 SUMMARY

The Chapter discusses about the basics of accounting. The accounting works on the double entry basis. The chapter focuses upon the main terms used in the financial accounting like credit and debit. It talks about the real, personal and nominal accounts and the rules of debit and credit followed in these three cases. The lesson talks about the main functions and the users of the accounting as well. Towards the end of the chapter, the accounting concepts and the conventions have been discussed.

1.10 GLOSSARY

- **Debit**: In accounts, the debit term is used whenever there is an increase in the asset of decrease in the liability.
- **Credit**: The term credit is used when there is a decrease in the asset or increase in the liability.
- **Personal Accounts**: In the case of personal accounts, we debit the. person or the firm with the benefits received by him or by the firm and credit the person or the firm with the benefits imparted by the person or the firm.
- **Real Accounts**: Real accounts are debited with the incomings and are credited with the outgoings
- **Nominal Accounts**: All amounts expended or lost are debited and all amounts gained are credited to nominal accounts.
- **Financial Accounting**: Accounting designed for outsiders (persons other than owners and managers) is known as financial accounting. It is concerned with the recording of

business transactions and the periodic preparation of balance sheet and income statement from such records.

1.11 ANSWER TO IN-TEXT QUESTIONS

1. Financial	8. Accrual
2. Budget	9. True
3. Creditors	10. Separate legal entity
4. Managers	11. True
5. True	12. False
6. Management Accounting	13. True
7. Cash	

1.12 SELF-ASSESSMENT QUESTIONS

1. What are the various branches of accounting?
2. The going concern concept and separate business entity concept are the two sides of the same coin. Explain.
3. What is the convention of consistency? What are its limitations?

1.13 REFERENCES

- *Pandey, K. (1999). Financial accounting. Lulu. com.*

1.14 SUGGESTED READINGS

- *Monga, J R. Financial Accounting: Concept and Applications. Mayur Paper Backs, New Delhi*
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LESSON 2

ACCOUNTING STANDARDS

STRUCTURE

2.1 LEARNING OBJECTIVES

- To understand the meaning generally accepted accounting principles
- To know the Accounting Standards applicable in India
- To explore the procedure followed during the preparation of Accounting Standards

2.2 INTRODUCTION

Accounting standards codify the generally accepted accounting principles. They lay down the norms of accounting policies and practices by way of codes or guidelines to direct as to how the items appearing in the financial statements should be dealt with in the books of account and shown in the financial statements and annual reports. They present the general principles to be put to application using professional judgement.

The main purpose of accounting standards is to provide information to the user as to the basis on which the accounts have been prepared. They make the financial statements of different business units or the financial statements of the same business unit comparable. In the absence of accounting standards, comparison of different financial statements may lead to misleading conclusions. Accounting standards bring about uniformity of assumptions, rules and policies adopted in financial reporting and thus they ensure consistency and comparability in the data published by the business enterprises. To be useful, an accounting standard must be capable of being well understood and it must be able to reduce significantly the degree of manipulation of the reported data.

2.3 UTILITY OF ACCOUNTING STANDARDS

The management of every business house is interested in reliable accounting data so that it may get the required information for making correct decisions and discharge its functions efficiently. Then, there are shareholders, investors, creditors, workers, Governments, researchers etc. who are also interested in reliable accounting data. Accounting standards play a very significant role; they make it possible that the people get the reliable and comparable accounting data. Thus, they help the investor to make more informed investment decisions. The government officials can use the accounting data for planning etc. with greater confidence. The researchers can make better analysis and draw more reliable conclusions. Even the job of Chartered Accountants is made easy.

They can guide their clients much better and refuse any demand by clients to accept data which are not in conformity with accounting standards.

Sometimes, there is a conflict of financial interests among the various groups that rely upon published financial statements. For example, potential shareholders and existing shareholders may have opposite interests in assessing the profitability and the net worth of a company. Accounting standards help in resolving such a conflict because financial statements which have been prepared on the basis of accounting standards will be acceptable to all the parties. It follows that accounting standards must be such as may command the greatest possible credibility among all those who use accounting data.

2.4 ACCOUNTING STANDARDS IN INDIA

Realizing that there was a need of accounting standards in India and keeping in view the international developments in the field of accounting, the Council of the Institute of Chartered Accountants of India constituted the Accounting Standards Board (ASB) in April 1977. The Accounting Standards Board is performing the function of formulating the accounting standards. While doing so, it takes into account the applicable laws, customs, usages and business environment. It gives adequate representation to all the interested parties; the Board consists of representatives of industries, Central Board of Direct Taxes and the Comptroller and Auditor General of India.

To start with, ASB finalized the procedure to be followed in the formulation of standards. The "Preface to the Standards of Accounting Standards" was issued in January 1979. The preface outlines scope and functions of ASB, the scope of accounting standards, the procedure to be followed by ASB in formulating the standards and the phased manner in which the compliance with the standards will be encouraged by the Institute.

IN-TEXT QUESTIONS

1. _________ codify the generally accepted accounting principles.
2. Accounting Standards make__________ of different business units comparable.
3. The ____________________ is performing the function of formulating the accounting standards.
4. Accounting standards help researchers to make better analysis. True/False
5. Accounting standards are different for every state of India. True/False

2.5 PROCEDURE OF PREPARING ACCOUNTING

The Accounting Standards Board determines the broad areas in which accounting standards are to be formulated and the priority which is to be given to each one of the selected areas. In the task of preparation of accounting standards, ASB is assisted by different study groups constituted to consider specific subjects. In the formation of study groups, care is taken that there is wide participation by members of the Institute of Chartered Accountants and other bodies. A dialogue is held with the representatives of the Government, the public sector undertakings, industries and other organizations to ascertain their views. Then, an exposure draft of the proposed accounting standard is prepared and issued for comments by the members of the Institute and the public at large. The draft is sent to various outside bodies like FICCI,

ASSOCHAM, SCOPE, C & AG, ICWAI, ICSI, CBDT etc. for their views. The draft includes the following points:

(i) A statement of concepts and fundamental accounting principles relating to the standard.

(ii) Definitions of the terms used in the standard.

(iii) The manner in which the accounting principles have been applied for formulating the standard.

(iv) The presentation and disclosure requirements in complying with the standard.

(v) Class of enterprises to which the standard will apply.

(vi) Date from which the standard will be effective.

After taking into the consideration the comments received from different quarters, the draft of the proposed standard is finalized by the Accounting Standards Board and submitted to the Council of the Institute of Chartered Accountants of India for the latter's approval. The Council considers the draft and if found necessary, modifies it in consultation with the Accounting Standards Board. Finally, the accounting standard is issued under the authority of the Council. Initially, the standard is made recommendatory and after some time it is made mandatory.

2.6 PROPAGATION OF ACCOUNTING STANDARDS

The following measures have been taken to propagate the accounting standards:

(i) Information regarding the current status of the various project relating to the accounting standards and drawing the attention of the members to the standards already issued is published in the journal of the Institute of Chartered Accountants of India.

(ii) Discussions on the accounting standards issued by the ICAI are arranged in the continuing education programs organized by the ICAI and its Regional Councils and Students' Associations.

(iii) There is regular communication with universities, colleges, business management institutes, public and private sector undertakings etc. with a view to keeping them informed about the issuance of different accounting standards from time to time and seeking their co-operation in the implementation of these accounting standards.

(iv) The institute uses the compliance with the accounting standards an important criterion in deciding about the awards which the Institute gives every year for the best presented accounts and the Institute has been drawing attention of the companies and corporations to this fact.

The following is the text of Preface to the Statements of Accounting Standards issued by the Institute of Chartered Accountants of India in January 1979:

2.7 PREFACE TO THE STATEMENTS OF ACCOUNTING

2.7.1 Formation of Accounting Standard Board

The Institute of Chartered Accountants of India, recognising the need to harmonise the diverse accounting policies and practices at present in use in India, constituted an Accounting Standards Board (ASB) on 21st April 1977.

2.7.2 Scope and Functions of Accounting Standard Board

- The main function of ASB is to formulate accounting standards so that such standards may be established by the Council of the Institute in India. While formulating the accounting standards, ASB will take into consideration the applicable laws, customs, usages and business environment.
- The Institute is one of the Members of the International Accounting Standards Committee (IASC) and has agreed to support the objectives of IASC. While formulating the Accounting Standards, ASB will give due consideration to International Accounting Standards, issued by IASC and try to integrate them, to the extent possible, in the light of the conditions and practices prevailing in India.
- The Accounting Standards will be issued under the authority of the Council. ASB has also been entrusted with the responsibility of propagating the Accounting Standards and of persuading the concerned parties to adopt them in the preparation and presentation of financial statement. ASB will issue guidance notes of the Accounting Standards and give clarifications on issues arising there from. ASB will also review the Accounting Standards at periodical intervals.

2.7.3 Audited Financial Statements

- For discharging the above functions, ASB will keep in view the purpose and limitations of published financial statements and the attest function of the auditors. ASB will enumerate and describe the basic concepts to which accounting principles should be oriented and state the accounting principles to which the practices and procedures should conform.
- ASB will clarify the phrases commonly used in such financial statements and suggest improvements in the terminology wherever necessary. ASB will examine the various

current alternative practices in vogue and identify such alternatives which should be preferred.

- The Institute will issue the Accounting Standards for use in the presentation of the general-purpose financial statements issued to the public by such commercial, industrial or business enterprises as may be specified by the Institute from time to time and subject to the attest function of its members. The term "General Purpose Financial Statements" includes balance sheet, statement of profit and loss and other statements and explanatory notes which form part thereof, issued for the use of shareholders/ members, creditors, employees and public at large References to financial statements in this Preface and in the Standards issued from time to time will be construed to refer to General Purpose Financial Statements.

- Responsibility for the preparation of financial statements and for adequate disclosure is that of the management of the enterprise. The Auditor's responsibility is to form his opinion and report on such financial statements.

2.7.4 Scope of Accounting Standards

- Efforts will be made to issue Accounting Standards which are in conformity with the provisions of the applicable laws, customs, usages and business environment of our country. However, if due to subsequent amendments in the law, a particular Accounting Standard is found to be not in conformity with such law, the provisions of the said law will prevail, and the financial statements should be prepared in conformity with such law.

- The Accounting Standards by their very nature cannot and do not override the local regulations which govern the preparation and presentation of financial statements in our country. However, the Institute will determine the extent of disclosure to be made in financial statements and the related Auditor's reports. Such disclosure may be by way of appropriate notes explaining the treatment of particular items. Such explanatory notes will be only in the nature of clarification and therefore, need not be treated as adverse comments on the related financial statements.

- The Accounting Standards are intended to apply only to items which are material. Any limitations with regard to the applicability of a specific Standard will be made clear by the Institute from time to time. That date from which a particular Standard will come into effect, as well as the class of enterprises to which it will apply, will also be specified by the Institute. However, no standard will have retroactive application, unless otherwise stated.

- The Institute will use its best endeavours to persuade the Government, appropriate authorities, industrial and business community to adopt these Standards in order to achieve uniformity in the presentation of financial statements.
- In carrying out the task of formulation of Accounting Standards, the intention is to concentrate on basic matters. The endeavour would be to confine Accounting Standards to essentials and not to make them so complex that they cannot be applied effectively and on a nation-wide basis. In the years to come, it is to be expected that Accounting Standards will undergo revision and a greater degree of sophistication may them be appropriate.

2.7.5 Procedure for Issuing Accounting Standards

- Broadly, the following procedure will be adopted for formulating Accounting Standards:
- ASB shall determine the broad areas in which Accounting Standards need to be formulated and the priority in regard to the selection thereof.
- In the preparation of Accounting Standards, ASB will be assisted by Study Groups constituted to consider specific subjects. In the formation of Study Groups, provision will be made for wide participation by the members of the Institute and others.
- ASB will also hold a dialogue with the representatives of the Government, public sector undertakings, industry and other organisations for ascertaining their views.
- On the basis of the work of the Study Groups and the dialogue with the organisations referred to in 5.3 above, an exposure draft of the Study Groups and the dialogue with the organisations referred to in 5.3 above, an exposure draft of the proposed standard will be prepared and issued for comments by members of the Institute and the public at large.
- The draft of the proposed standard will include the following basic points:
    - A Statement of concepts and fundamental accounting principles relating to the Standard.
    - Definitions of the terms used in the Standard.

  - The manner in which the accounting principles have been applied for formulating the Standard.
  - The presentation and disclosure requirements in complying with the Standard.
  - Class of enterprises to which the Standard will apply.
  - Date from which the Standard will be effective.

- After taking into consideration the comments received, the draft of the proposed Standard will be finalised by ASB and submitted to the Council of the Institute.
- The Council of the Institute will consider the final draft of the proposed Standard, and if found necessary, modify the same in consultation with ASB. The Accounting Standard on the relevant subject will then be issued under the authority of the Council.
- The Council of the Institute will consider the final draft of the proposed Standard, and if found necessary, modify the same in consultation with ASB. The Accounting Standard on the relevant subject will then be issued under the authority of the Council.

2.7.6 Compliance with the Accounting Standards

- While discharging their attest functions, it will be the duty of the members of the Institute to ensure that the Accounting Standards are implemented in the presentation of financial statements covered by their audit reports. In the event of any deviation from the Standards, it will be also their duty to make adequate disclosures in their reports so that the users of such statements may be aware of such deviations.
- In the initial years, the Standards will be recommendatory in character and the Institute Will give wide publicity among the users and educate members about the utility of Accounting Standards and the need for compliance with the above disclosure requirements. Once an awareness about these requirements is ensured, steps will be taken, in course of time, to enforce compliance with the accounting standards in the manner outlined in para 6.1 above.
- The adoption of Accounting Standards in our country and disclosure of the extent to which they have not been observed will, over the years, have an important effect, with consequential improvement in the quality of presentation of financial statements.

IN-TEXT QUESTIONS

6. After taking into the consideration the comments received from different quarters, the draft of the proposed standard is finalized by the Accounting Standards Board and submitted to the Council of the ________________of India for the latter's approval.
7. Accounting Standards board was constituted on ______________.
8. The main function of ASB is to formulate accounting standards so that such standards may be established by the Council of the Institute in India. True/False
9. Responsibility for the preparation of financial statements and for adequate disclosure is that of the shareholders of the enterprise. True/false
10. In the initial years, the accounting standards are only recommendatory in nature. True/False

Indian Accounting Standards

- The Institute of Chartered Accountants of India has so far issued twenty-nine accounting standards.
- They are as follows: —
- AS-1 - Disclosure of Accounting Policies.
- AS-2 (Revised) - Valuation of Inventories.
- AS-3 (Revised) - Cash Flow Statements
- As-4 (Revised - Contingencies and Events Occurring after
- the Balance Sheet Date.
- (v) AS-5 (Revised) - Net Profit or Loss for the Period, Prior
- Period Items and Changes in

Accounting Policies.

(vii) AS-7 - Accounting for Construction Contracts.

(ix) AS-9 - Revenue Recognition.

(x) AS-10 - Property Plant and Equipment

(xi) AS-11 (Revised) - Accounting for the Effects of Changes

		in Foreign Exchange Rates.
(xii)	AS-12	- Accounting for Governments Grants.
(xiii)	AS-13	- Accounting for Investments.
(xiv)	AS-14	- Accounting for Amalgamations.
(XV)	AS-15	- Accounting for Retirement Benefits in the Financial Statements of Employers.
(xvi)	AS-16	- Borrowing Costs
(xvii)	AS-17	- Segment Reporting
(xviii)	AS-18	- Related Party Disclosures
(xix)	AS-19	- Leases
(xx)	AS-20	- Earnings Per Share
(xxi)	AS-21	- Consolidated Financial Statements
(xxii)	AS-22	- Accounting for Taxes on Income
(xxiii)	AS-23	-Investments in Associates Accounting
(xxiv)	AS-24	-Discontinuing Operations
(xxv)	AS- 25	-Interim Financial Reporting
(xxvi)	AS- 26	-Intangible Assets Accounting
(xxvii)	AS- 27	-Reporting on interest in joint ventures
(xxviii)	AS- 28	-Assets Impairment
(xxix)	AS-29	-Contingent Assets and Liabilities

- The IASC and the ICAI, both, consider Going Concern, Accrual and Consistency as fundamental. In other words, it will be assumed, without the fact having to be stated, that the financial statements have been drawn up on accrual basis, without any change in the accounting policies and without there being any necessity or intention to liquidate or wind up the firm or a substantial part of it. The going concern assumption is very important; only on its basis can fixed assets be stated at cost less depreciation and their realizable value can be ignored. Also, some liabilities (such as gratuities, retrenchment compensation) arise only when the firm is liquidated. These can be ignored as long as the firm is a going concern. One can see that if the going concern assumption is not valid, the financial statements as ordinarily drawn up. will not be true at all.

- It is recognized that since the circumstances governing each firm differ, it should have the right of choosing the accounting policy that is appropriate to it. The IASC and the ICAI state that the choice should be made on the basis of prudence, materiality and substance over form. In other words, the real state of affairs (not merely sticking to, say, strict legal interpretation) and the information disclosed should be material from the point of view of appraisal of the profitability and the financial position of the firm; insignificant information should not be disclosed separately. Further, it is recommended that the accounting policy chosen should be disclosed.
- As I issued by the ICAI in November 1979 is given below. The standard has become mandatory with effect from 1.4.1991.

IN-TEXT QUESTIONS

11. Which of the following Accounting Standard deals with Cash flow statements.
    a. AS-1
    b. AS-2
    c. AS-3
    d. AS-4
12. Which of the following Accounting Standard deals with Revenue Recognition.
    a. AS-6
    b. AS-7
    c. AS-8
    d. AS-9
13. Which of the following Accounting Standard deals with Accounting for Amalgamations.
    a. AS-10
    b. AS-11
    c. AS-14
    d. AS-18

14. Which of the following Accounting Standard deals with Leases.
    a. AS-11
    b. AS-16
    c. AS-17
    d. AS-19
15. Which of the following Accounting Standard deals with Consolidated Financial Statements.
    a. AS-21
    b. AS-22
    c. AS-23
    d. AS-24

2.8 SUMMARY

The present chapter deals with the generally accepted accounting principles. They are codified by the Accounting Standards. The Accounting Standards prescribe the details that what is to be recorded and how it is to be classified and analysed. The lesson talks about the systematic way of bookkeeping and utility of Accounting Standards.

2.9 GLOSSARY

Accounting Standards: They codify the generally accepted accounting principles.

Accounting Standard Board: The boards responsible to formulate the Accounting Standards

2.10 ANSWERS TO IN-TEXT QUESTIONS

1. Accounting Standards	8. True
2. Financial Statements	9. False
3. Accounting Standards Board	10. True
4. True	11. (c)

5. False 6. Institute of Chartered Accountants of India 7. 21st April 1977	12. (d) 13. (c) 14. (d) 15. (a)

2.11 SELF-ASSESSMENT QUESTIONS

1. What are Accounting Standards.
2. What is Accounting Standard Board?
3. What is the role of ICAI in the formulation of Accounting Standards.
4. What is the procedure of setting the Accounting Standards.
5. Explain the relevant Provisions regarding the AS-21.

2.12 SUGGESTED READINGS

- *Monga, J. R., & Bahadur, R. (2022) Financial Accounting: Concepts and Applications. Scholar Tech Press, New Delhi.*
- *Tulsian, P. C. (2016). Financial Accounting. S Chand Ltd., New Delhi.*
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LESSON 3

ACCOUNTING PROCESS

STRUCTURE

3.1 LEARNING OBJECTIVES

- To Understand the meaning and utility of Accounting Process
- To Understand the details contained in the Subsidiary Book
- To Explain the with illustration about Purchase Book, Sales Book

- To Explain with illustration about Purchase Return, Sales Return
- To Explain the illustration about Cash Boom, Discount Columns
- To Understand about Triple Column Cash Book
- To Understand the Trial Balance

3.2 INTRODUCTION

Bookkeeping began with the entry of all transactions into one book which recorded the details of transactions. This book was called a book of prime entry or Journal. The transactions were copied from Waste Books or Memorandum Book into the Journal in a chronological order. This work of entering every transaction into the Journal first and then posting to ledger, however, was soon found to be tedious and cumbersome as well as lacking facilities for ready and easy reference. With the result the Journal was sub-divided into various subsidiary journals to record accounting transactions of similar nature date-wise.

3.3 MEANING OF ACCOUNTING PROCESS

The Accounting process starts with the classification of data. First of all, the cash transactions were separated and used to be dealt with in another book. Then the transactions relating to credit purchases and credit sales were separated and started to be recorded separately. Thus, the use of journal in its original form became obsolete, and the book itself was superseded by the books of prime-entry or subsidiary books.

Subsidiary books can also be termed as 'Books of original entry' because transactions are entered there in the first instance in a chronological order or in the order, they take place. Subsidiary books can be defined as 'Books of original entry wherein we record transactions of one particular type or nature in order to obviate unnecessary clerical labour'

These subsidiary books or journals can be classified as under:

(a) Sales Book

(b) Purchases Book

(c) Purchases Returns Book or Returns outwards Book

(d) Sales Returns Book or Return Inward Book

(e) Cash Book

(f) Bills Receivable Book

(g) Bills Payable Book

If the needs of business so require, a few more of these subsidiary books such as Consignment Book, Advertisement Book, Sale or return book, etc., may also be kept.

The use of subsidiary books for writing the transactions in the first instance has certain obvious advantages over the system of recording the transactions directly into the ledger of T form. These are:

1. ***Check over errors:*** The chances of errors increase unless the transaction is debited and credited simultaneously in two different accounts in the ledger.

2. ***Subsidiary books record is supported by vouchers:*** Whereas the records in subsidiary books are always supported by vouchers such as Invoice, Credit Note, Debit Note, Cheques.

   Pay-in-slips, Statement of creditors, etc., the ledger accounts are not supported by any such vouchers.

3. ***Legal point of view:*** The records in subsidiary books are better evidence in a legal suit as compared directly into the records.

4. ***Chronological order:*** The transactions are not recorded in a chronological order if they are recorded directly into the ledger.

5. ***Common nature transactions:*** The transactions of common nature can be recorded at one place if we record transactions in the subsidiary books.

6. ***Facilities posting:*** Keeping of subsidiary books facilities posting the transactions into the ledger because all the transactions of common nature are recorded at one place.

7. ***Promotes division of labour:*** Subsidiary books-keeping promotes division of labour as the work of recording the transactions can be divided amongst various accounts clerks.

8. ***Chances of errors and frauds are minimized:*** With the introduction of division of labour the work of one account clerk will automatically be checked by author accounts clerk. This will minimize the chances of errors and frauds at the recording and posting stage itself.

9. ***Quick management decisions:*** The management can take decisions quickly as the accounting work is completed in time (due to division of labour) and also because they can have the benefit of trend and distributional pattern in planning and decision making as the transactions of common nature are recorded at one place.

10. ***Saving of clerical labour:*** By recording transactions of common nature through separate subsidiary books, a considerable saving of clerical labour in posting is affected. Only the periodical totals of subsidiary books will be posted into the ledger instead of recording each separate transaction.

11. ***Future reference facilitated:*** The future reference to any particular item is considerably facilitated because of grouping together of the transactions of common nature.

3.4 DETAILS CONTAINED IN SUBSIDIARY BOOKS

The day books or subsidiary books are mainly concerned with showing details of invoices and other documents relating to transactions. Thus, they will show details of:

Prices per article and the appropriate quantity.

Trade discount representing a reduction in the price of goods.

Extra charges made for packing material and/or carriage charged on the goods.

After studying the advantages of having separate subsidiary books for transactions of common nature, let us now study about each of them in some details.

Journal: Journal is the most important to all the subsidiary books. It lays down the foundation of the entire book-keeping work of a business concern. Originally, all the business transactions used to be recorded in journal. The word 'Journal' is derived from one French Word 'Jour' which means 'day'. The transactions which took place during a day used to be recorded in the Journal in order of date from waste book or a Memorandum book.

Thus "A journal is a chronological record of accounting transactions showing the names of accounts that are debited or credited, the number of debits and any useful supplementary information about the transaction". (Robert N. Anthony; Management Accounting Principles, English Print page 70).

It be noted here that due to the difficulties, discussed later in this lesson, involved in writing each and every entry in journal, the use of journal now a days is restricted to recording of the following only-

a. Opening Entries,
b. Closing Entries,
c. Writing Off of bad debts
d. Writing off of depreciation
e. The correction of errors
f. Adjustment entries
g. Compound entries
h. Transfer entries and other entries of special nature.

The common transactions are generally recorded in other special purpose subsidiary books.

In other words, Journal can be used for recording such entries as cannot conveniently be made or recorded in any other subsidiary book or which are not sufficiently large in number to require a special subsidiary book being maintained for them.

Form: While passing a Journal entry the debit entry is listed first. The debit amount appears in the first of the two amount columns. The amount to be credited appears below the debit entry. The amount of this entry appears in the second of the two amount columns. Ledger Folio (L.F.) column is provided to facilitate a ready reference of the page in the ledger on which that particular column is provided to facilitate a ready reference of the page in the ledger on which that particular account appears. This reference is inserted at the time of recording the entry in the ledger. The presence of this reference indicates that the entry has been posted in the ledger. Every entry requires a brief explanation at the foot of each entry. This brief explanation is technically known as "narration".

IN-TEXT QUESTIONS

1. Subsidiary books can also be termed as ___________________.
2. While passing a Journal entry the _______________entry is listed first.
3. Purchase book is used to record only cash purchases of goods. True/False
4. The chances of errors increase unless the transaction is debited and credited simultaneously in two different accounts in the ledger. True/False
5. Keeping of subsidiary books facilities posting the transactions into the ledger because all the transactions of common nature are recorded at one place. True/False

3.5 PURCHASE BOOK

Purchase book: Purchase book is "used to record only credit purchases of goods, i.e., to record credit purchases of those commodities only in which the firm deals. Thus, the purchases of nylon sarees on credit by a firm dealing in sweets will not be recorded in purchase book. Purchase book is also called the 'Bought Book', 'Bought Day Book', 'Purchases Day Book', or 'Invoice Book'.

The rulings vary from the ordinary two columns for details a total respectively to the several columns in use in those businesses where owing to the complexity of the transactions, analysis becomes imperative if the system of book-keeping is to furnish really satisfactory information.

The transactions recorded in the purchase book are daily posted into the ledger to the credit of the different parties from whom the goods have been purchased on credit. At intervals of generally a month the total value of all the purchases is cast. This total amount is posted to the debit of purchases account in the ledger. This completes the double entry at the end of each interval.

The treatment of trade discount necessitates special attention. Trade discount is an allowance from the catalogue price of goods. It should be deducted from the invoices which will be entered net in the Purchase Book. Cash discount allowed, if any, will be based upon the true figure, i.e., after deducting trade discount.

Illustration I. From the following particulars prepare the Purchase Book of Mis Adesh Kumar, a dealer in Electrical goods.

Sept. 1,1993 : Bought from *Mis* Om Prakash & Company. 10 Usha Diplomat fans @Rs. 200/- per fan. 600 Phillips Lamps @2.50 per Lamp.

Packing charges Rs. 100/-:

Sep. 10 : Purchased

from *Mis* Kiran & Company. 3 Kassels Fans-48" @Rs. 250/- per fan.

30 Bundles ofPVC wire@Rs. 100/- per bundle. Trade discount allowed@ 10%.

Purchased from *Mis* Anand:and brothers. 10 Immersion Heaters@Rs.30/- each..

4 table lamps (Ashok) @Rs.25/- each.

Solution

Purchase Book of M/s Adesh Kumar

Date	Particulars	LF	Details Rs.	Amount Rs.
1993	***M/s Om Prakasli and Company***			
Sept. 1	10 Usha Diplomat Fans			
	@ Rs. 200/- per fan		2,000.00	
	600 Phillips Lamps			
	@ Rs. 2.50 per lamp		1,500.00	
	Packing Charges		100.00	3,600.00
	M/s Kiran and Company			
Sept. 10	3KesselsFans–48"			
	@ Rs. 250/- per fan		750.00	
	30 Bundles of PVC wire			
	@Rs. 100/- per Bundle		3.000.00	
			3,750.00	
	Less Trade Discount 10%		375.00	3,375.00
	M/s Anand and Company			
Sept. 30	10 Immersion Heaters			
	@ Rs.30/-each		300.00	
	4 Table Lamps (Ashok)			
	@ Rs. 25/- each		100.00	400.00
				7,375.00

3.6 SALES BOOK

Sales Book: Sales Book is used to recording only the credit sales of goods in which the firm ordinary deals. Cash sales of goods and sales of assets of the firm are not recorded in the Sales Book. It is known by various names, e.g., 'Day Book' 'Sold Day Book' and 'Sales Day Book'

The rulings may be the ordinarily two columns or it may be the columnar form if it is desired to know the goods wise details of sales.

The Sales Book is also treated in a similar way in respect of the credit sales, the individual transactions are debited to the different parties to whom goods have been sold and the total at the end of each interval is posted to the credit of the Sales Account in the ledger. Thus, the double entry is completed in the ledger.

Illustration 2. Enter the following transactions in the books of Mis Naurang Lal Chuttan Lal of Sikandarabad.

1993		
Sept. 3	:	Sold to M/s Satya Prakash & Co. 10 kg. of Tea @ Rs. 22.50 per kg. 15 kg. of Cocoa @ Rs. 15 per kg. Trade Discount @ 10%.
Sep. 13	:	Sold to M/s Gyan Prakash & Bros. 18 kg.Tea@ Rs.25/-per.kg. 35 kg. Coffee @ Rs. 40/- per kg.
Sept. 26	:	Sold to M/s Shiv Prakash 10 Boxes of Biscuits each of 10 kg. @ Rs. 10/- per kg. 60 Boxes of Sweets each of 15 kg, @ Rs. 5/- per kg.

Solution

Sales Book of M/s Naurang Lal Chhuttan Lal, Slkandrabad

Date	Particulars	LF	Details Rs.	Amount Rs.
1993				
Sept. 3	***M/s Satya Prakash and Co.***			
	10 kg. of Tea @ 22.50 per kg.		225.00	
	15 kg. of Cocoa @ Rs. 15/- per kg.		225.00	
			450.00	
	Less Trade Discount 10%		45.00	405.00
Sept. 13	***M/s Gyan Prakash & Bros.***			
	18 kg. Tea @ Rs. 25/- per kg.		450.00	
	35 kg. Coffee @ Rs. 40/- per kg.		1,400.00	1,850.00
Sept. 25	***M/s Shiv Prakash***			
	10 Boxes of Biscuits of 10 kg.			
	each @ Rs. 10/-per kg.			1,000.00
	60 Boxes of Sweets each			
	of 15 kg. @Rs. 5/- per kg.		4,500.00	5,500.00
				7,755.00

Note: The trade discount of the selling price should be deducted on the invoice on the net sale carried out and posted into the ledger only.

3.7 PURCHASE RETURN BOOK

Purchases Returns Book: Sometimes goods purchased may be returned by us to the suppliers due to their being of the wrong kind, or not up to the sample, or because they are damaged. These returns are recorded in the "Purchases Returns Book" or "Returns outward Book". Allowance claimed for short weight, overcharge, breakage, etc., are usually also dealt with in the same book.

The person from whom allowances are claimed or to whom goods are returned is debited and the "Purchase Returns and Allowance Amount" credited at the end of each month with the monthly total of Purchase Returns Book. Some accountants make a distinction between returns and allowances. The total of allowances then will be posted to the credit of Allowances Account which shall be closed to trading account through the Purchases Account.

The ruling of this book is similar to that of Purchase Book and Sales Book.

The treatment of trade discounts will be similar to that in the case of Purchase Book and Sales Book. The amount to be entered will be the net figure, i.e., after deduction of trade discount.

Illustration 3. Enter the following in the books of M/s Banwari Lal Kaka & Sons. Delhi.

1993

Sept. 4	:	Returned to M/s Rekha & Co. 5 New Style of General English @ 3/- per copy. New Style Arithmetic @ Rs. 3.50 pr copy Trade 2 Discount @ 10%
Sept 14	:	Returned to M/s Sunita & Co. New Style co-ordinate Geometry @ Rs. 5/- per 3 copy. 7 New Style Memory-@ Rs. 2/- per copy.
Sept 24	:	Returned to M/s Usha & Co. 15 New Style Geometry @ Rs.7/- per copy. 19 New Style Book-keeping @ Rs. 5/- per copy, Packing Charges Rs. 10/-

Solution

Puchases Returns Book of M/s Banwari Lal Kaka and Sons

Date	Particulars	LF	Details Rs.	Amount Rs.
1993	***M/s Rekha & Co..***			
Sept. 4	5 New Style of General Eng. @ 3/- per copy		15.00	
	2 New Style Arthmetic @ Rs. 3.50/- per copy		7.00	
			22.00	
	Less : Discount 10%		2.20	19.80
Sept. 14	***M/s Sunita & Company.***			
	3 New Style Co-ordinate @ Rs. 5/-per copy		15.00	
	7 New Style Memory @ Rs. 2/- per copy		14.00	29.00
Sept 24	***M/s Usha and Co.***			
	15 New Style Geometry @ Rs. 7/- per copy		105.00	
	19 New Style Book-Keeping @ 5/- per copy		95.00	
			200.00	
	Packing Charges		10.00	210.00
				258.80

3.8 SALES RETURN BOOK

Sales Returns Book: Sales Returns Book is used for the purpose of recording returns of all goods sold. The goods may be returned by the customer due to their not being of the correct description, of being inferior quality or being damaged in transit. This book is also called Returns Inwards Book is debited to the Returns Inward Account. The double entry is thus completed.

Allowances claimed in respect of short delivery, overcharge or breakage in transit, etc., are usually included in the Sales Returns Book. Some accountants prefer to keep a separate "Allowances Account" in addition-to a Sales Returns Account. Allowances Account is closed to Trading Account through the Sales Account.

Treatment of trade discount will be similar to that in the case of sales, i.e., the amount to be entered will be net figure after deduction of trade discount.

Illustration 4.

Prepare Sales Returns book of Mis Sharda & Co. and enter the following transactions therein:

1993

Sept. 5 : M/s Naresh Kumar & Co. returned.
2 kg. Sugar @ Rs. 4/- per kg.
1 kg. Tea @ Rs. 26/- per kg.

Sept. 15 : M/s Rajesh Kumar & Co. returned.
1 Box of Biscuits @ Rs. 50 per Box.
Trade discount 10%

Sep. 25 : M/s Mukesh Kumar and Co. returned.
10 kg. Cocoa @ 6/- per kg.

Sept. 29 M/s Rama & Co. returned.
2 kg. Coffee @ Rs. 30/- per kg.
5 kg. Sweets @ Rs. 12/- per kg.

Solution: **Sales Returns Book of M/s Sharda & Co.**

Date	Particulars	LF.	Details Rs.	Amount Rs.
1993				
Sept. 5	***M/s Naresh Kumar & Co.***			
	2 kg. Sugar @ Rs 4/- per kg.		8.00	
	1 kg. Tea @ 26/- per kg.		26.00	34.00
Sept. 15	***M/s Rajesh Kumar & Co.***			
	1 Box Biscuits @ Rs. 50/- per box		50.00	
	Less : Trade discount @ 10%		5.00	45.00
Sept. 25	***M/s Mukesh & Co.***			
	10 Kg. Cocoa @ 6/- per kg.		60.00	60.00
Sept. 29	***M/s Rama & Co.***			
	2 kg. Coffee @ Rs. 30/- per kg.		60.00	
	5 kg. Sweets @ Rs. 12/- per kg.		60.00	120.00
				259.00

These above-mentioned books are kept in a columnar form. Separate columns are ruled for: -

(1) the date of each transaction, (2) the name of the other party to the contract with a short description of goods dealt with (3) the number of pages in the ledger where the account of the party appears (4) the amount of each transaction. As stated earlier, separate columns for each class or group of commodities can be added to Day Books and separate ledger accounts for the purchase and sale of each group commodity can be prepared if the commodities dealt if could be subdivided.

3.9 BILLS RECEIVABLE

Usually, the business firms record entries for bills receivables in the journal but where they receive a large number of bills during a year, a Bills Receivable Book is used for dealing with bills drawn or received. It may be incorporated in the double entry system, if desired. In that case it will be nothing but a journal in modified form. It cannot dispense with the journal entries if not incorporated in the double entry system.

Necessary particulars regarding the names of the drawer and acceptor, the date of the bill, the amount and due date of the bill etc., are recorded in the Bills Receivable Book as and when a bill is received by the firm. Bills Receivable Book may be used as a Memorandum Book only or a part of the double entry system. If it is used as a part of the double entry system, then the account of the person, not necessarily the acceptor from whom the of the amount of all the bills received during month is posted to the debit of Bills Receivable Account. The entries for Bills Receivable will flow through the usual channel, i.e.: the Journal if the Bills Receivable Book is kept as a Memorandum Book only.

The remarks column in the Bills Receivable Book is employed for recording of necessary observations pertaining to discounting, dishonouring and renewal of the bills, etc.

Bills Payable Book: Like Bills Receivable Book, Bills Payable Book also is kept by the Business concern only where the dealings in bills payables are very frequent; otherwise records of bills payable are kept through the Journal. It is kept recording full details of all the bills accepted by the firm. It thus affords a convenient medium for posting Bills Payable transactions.

Bills Payable Book is ruled and employed in the same manner as the Bills Receivable Book is ruled and employed.

The personal account of the person for whom the bill is accepted is credited individually and the Bills Payable Account is credited with the monthly total amount of the Bills Payable Book.

Bills Receivable Book

No. of Bill	Date when received	From whom received	Drawer	Acceptor	Endorser	Where payable	Term	Due Date including days of grace	Ledger folio	Amount	Date of disposal	To Whom sent	Remarks

3.10 CASH BOOK

Cash Book: Cash transaction, in any business is by far the largest in number. The number of such transactions is so large that a special book, called the 'Cash Book' is set apart for recording cash transactions. If every cash transaction were recorded in the journal first and enormous amount of clerical labour would be entailed in debiting or crediting cash account every time cash is received or paid. This labour could be avoided by keeping a separate Cash Book to record all cash transactions. This makes the cash book the most important of all the other subsidiary Books of Account.

It is sometimes asked: Is cash book a subsidiary Book of Account or a part of ledger?

Cash Book is generally treated as a book of Original Entry because all the entries pertaining to cash transactions are recorded direct into it. No other subsidiary book is kept for recording such transactions. But really speaking it is nothing else but a part of the Ledger, bound separately. This is so because

(a) it is written in the form of a ledger account and (b) no separate cash account, in addition to a Cash Book, is maintained in the ledger. Thus, it is nothing more or less than the Cash and Bank account taken out of the ledger and bound separately for the sake of greater convenience. This becomes clear when we remember that the balances of Cash Book are entered in the Trial Balance and Balance Sheet like all other ledger balances. However, it be noted that though Cash Book is a part of ledger, the use of a subsidiary book in this connection is often done away with and the double entry is completed by direct transfer from Cash Book to the other Ledgers.

Types: -The Cash Book may be of various types; the most common types being the following:

1. Simple of single column Cash Book.
2. Single Bank column Cash Book.
3. Cash Book with double, either Cash and Discount or Bank and Discount columns.
4. Three Column Book-Cash, Bank and Discount column Cash Book.
5. Petty Cash Book.
6. Multi-columnar Cash Book.
7. Subsidiary Cash Book.

In addition to the above types, cash book is sometimes also divided into (a) Receipt Journal and

(b) Payments Journal

Simple Cash Book: Simple Cash Book makes record of Cash transactions only. It is just like Cash Account. It will have the same rulings as a Ledger Account, there being columns for date, particulars, folio and the amount on the either side of the account. All the cash receipts are recorded on the debit side {left hand side) and all the cash payments are recorded on the Credit side (right hand side). Both the sides debit and credit, have four columns. The first column is used for recording the date, the second column (particulars column) is used for recording the source of receipt of payment. The third column stands for the reference of page number of the Ledger where the account concerned appears. The last column is for the amount of the receipt or payment concerned.

Illustration 5. Prepare simple cash book of Mr. Shiv Singh from the following transactions:

				Rs.
June	1	Started business with cash	...	10000
	4	Paid for purchases	...	4000
	7	Received from Cash sales	...	3200
	8	Paid to Shri Raj Kumar	...	700
	9	Received from Shri K.Kumar	...	900
	16	Paid for stationery	...	137
	25	paid for office furniture	...	595
	29	Received from Cash Sales	...	1200
	30	paid for salaries to staff	...	600
		paid for office rent	...	350

Solution

M/s Shiv Singh

Dr. **Cash Book** **Cr.**

Date	Particulars	L.F.	Amount Rs.	Date	Particulars	L.F.	Amount Rs.
1993				1993			
June1	To Capital		10,000	June 4	By purchases		4,000
7	To Sales		3,200	8	By Raj Kumar		700
9	To K.Kumar		900	16	By Stationery		137
29	To Sales		1,200	25	By Off. furniture		595
			30		By Office rent		350
			30		By Salaries		600
			30		Balance c/d		8,918
			15,300				15,300
July 1	To Balance b/d		8,918				

3.11 CASH BOOK WITH CASH AND DISCOUNT COLUMNS

Cash Book with Cash and Discount Columns: Cash Book with Cash and Discount columns is one in which and additional amount column of 'Cash Discount' on each side is provided.

Cash Discount is a deduction from the amount paid or received. Such cash discount can either be 'discount allowed' or ' discount received'. It will be 'discount received' if the trader pays his account promptly or within the period of credit. It will be 'discount allowed' if he receives the payment from his own customers promptly. Since discount is received or allowed at the time of receipt or payment of Cash, it is necessary to record this fact at the same place and time where and when cash transaction is recorded. This is why the Cash Book usually contains two additional amount columns, one on each side. Discount columns on the debit side records Cash discount allowed by a businessman whereas the discount column on the credit side records discount received by him.

Cash discount should, however, be distinguished from trade discount. Cash discount is allowed or received for prompt settlement of account or for settlement of account within the period of credit. The trade discount on the other hand, is an allowance made by a wholesaler to a retailer on the catalogue or invoice price. The object of the trade discount may be either to encourage large scale buying by the retailer or to enable the retailer to sell the goods at the price mentioned in the catalogue or Price List issued by the wholesaler. The trade discount is deducted from the invoice itself and the entry in the books is made with the net amount, i.e., after deducting the trade discount.

Certain important points in connection with the cash discount be noted:

1. The Discount columns are not to be balanced. This is so because the total of the debit side discount columns represents total discount allowed whereas the total of the credit side discount column represents the total discount received.
2. Discount columns do not serve the purpose of Discount Account because they are only the memorandum columns. A discount account will be opened in the ledger and the total of these columns will be posted therein.
3. The rules for recording discounts allowed and received in the personal accounts are:
    1. Debit the creditor's account with the amount of discount received while debiting his account with the amount of cash paid, and
    2. Credit the debtor's account with the amount of discount allowed together with cash received from him.
4. The total of the discount column appearing in the debit side of the Cash Book will be posted on the debit side of the Discount Allowed Account and the total of the discount

column appearing on the credit side of the Cash Book will be posted on the credit side of the Discount Received Account in the ledger.

This is at first sight appears to be incorrect. How can a debit total be transferred to the debit of an account? Here one must look at the entries for discounts in the personal account. Discount allowed have been entered in the credit of the individual personal accounts. The entry of the total in the expense account of discount allowed must, therefore, be on the debit side to preserve double entry balancing. The converse applies to discounts received.

The sides on which the two types of discounts are entered in the discount accounts in the ledger can be easily reconciled if discounts allowed are seen as an expense of attracting money. As an expense they will be found as a debit in the discount allowed account. Similarly, discounts received may be seen as income received for prompt payment of account, and as income will, therefore, appear on the credit side in the discounts received account.

5. Discount account being a nominal account, the following rule should be applied while recording discounts.

Debit all losses and expenses (Discount allowed) Credit all gains and incomes (Discount Received)

Illustration 6. You are requested to prepare double column (Cash and Discount Columns) Cash Book of Mis Suresh Kumar and Company.

1993			Rs.
July	1	Opening balance of cash in hand	9000
	5	Received from Nirmal	780s
		Allowed him discount	20
	9	Paid to Nasir	560
		He allowed us discount	40
	13	Sold goods for cash	700
	17	Purchased goods for cash	520
	21	Paid for Electricity	78
	25	Paid for Advertisement	22
	29	Received from Umeshwar	947
		Allowed him discount	53
	31	Paid Rent	250
		Paid Salaries	450

Solution

M/s Suresh Kumar & Co.

Cash Book (Cash & Discount columns)

Date	Particulars	L. F.	Discount Rs.	Amount Rs.	Date	Particulars	L. F.	Discount Rs.	Amount Rs.
1993					1993				
July 1	To Balance b/d			9,000	July 9	By Nasir		40.00	560
5	To Nirmal		20.00	780	17	By Purchase			520
13	To Sales			700	21	By Electricity			78
29	To Umeshwar		53.00	947	25	By Advt.			22
					31	By Rent			250
						By Salareis			450
						By Balance			9,547
			73.00	11.427				40.00	11.427
Aug. 1	To Balance b/d			9,547					

3.12 TRIPLE COLUMN CASH BOOK

Triple column Cash Book: In this type of Cash Book, three amount columns are provided on either side. Three columns are for (a) Discounts (b) Cash (c) Bank. Triple column cash Book is generally used by big business houses which have numerous bank transactions. No bank account need be opened because the bank columns themselves represent debit and credit sides of the Bank Account. The businessmen are thus able to save their time in posting.

The method of recording in this type of Cash Book is similar to the one adopted in case of the columnar Cash Book. But contra entries involving Cash and Bank deserve special attention. When cash is deposited into the bank or cash is withdrawn from the bank, the transactions is to be recorded in the cash column on one side and the bank column on the other side. If cash is withdrawn from the bank, the amount will be debited in the cash column and will be credited in the bank column. Similarly, when we deposit the cash in the bank, an entry will be made on the credit side of the cash book in the bank column; and the corresponding entry will be made on the credit side of the cash book in the ledger column. Such entries are known as contra entries. A small letter (c) is written in ledger folio column to indicate that this is a contra entry. No further posting of contra entries is required in the ledger as both the aspects, Debit and Credit, are recorded in the Cash Book itself.

3.13 PETTY CASH BOOK

Petty Cash Book: Many firms often have numerous small items of expenditure to meet, and to ease the burden of work and entries in the Cash Book they keep what is known as a Petty Cash Book, based on a system in which one person is made responsible for these small disbursements against documents referred to as Petty Cash Vouchers. If these numerous expenses involving small amounts are recorded in the main Cash Book, it will become unmanageable. By recording these transactions into the Petty Cash Book, we save the Cashier from making numerous entries for all the petty payments in the main Cash Book which remains handy and does not become cumbersome.

Petty Cash Book can be conveniently maintained in a columnar form because the items to be posted in it fall easily into some well-defined classes. One column is left unnamed or is named as 'Miscellaneous Expenses' for the recording of such expenses which are small but not so frequent to justify a separate column for each of them.

Example 9

Receipts Side

Receipts Side

Date	Particulars	Sales	B/R	Debtors	Rent	Loan	Dividend	Interest	Miscellaneous Receipts

Payment Side

Date	Particulars	Purchases	B/P	Creditors	Rent	Wages	Interest	Salary	Miscellaneous Payments

The Petty cash book has two sides-Receipts Side and Payments Side. Payments Side occupies for greater space than the Receipts Side because it has to have many amount columns as stated above.

The Petty Cash Book is just like the Cash Book. The amount received by the Petty Cashier is entered on the debit side and payments are entered on the credit side. The difference between the totals of the two sides represents the unspent balance of petty cash, with the Petty Cashier. The expenditure is analysed under appropriate headings, and the analysis is copied into the main Cash Book from where it is posted to the ledger. Sometimes a Petty Cash Account is opened in the Ledger, and the monthly summary journalised and posted to the debit of the accounts concerned. Corresponding Credit is given to the Petty Cash Account.

The best method of keeping the Petty Cash Book is Imprest system of Petty Cash. The head cashier, under this system, advances a

		Rs.
1	Purchased Postage Stamps	10.00
9	Taxi fare given to Shri Sudharashan Kumar	12.00
16	Tea and lunch to auditors	37.00
24	Telegram to Shri Anil Kumar	3.00
27	Paid for stationery	2.00
28	Paid to Mr. Krishan Kumar for Cyclostyling	9.00
	Prepare Petty Cash Book	

certain sum of money to the Petty Cashier in the beginning. The Petty Cashier goes on making payments out of this advance throughout the month. At the end of the month the head cashier

Checks the Petty Cash Book puts his initials; and gives a cheque for the exact amount spent, so that imprest amount is always in hand at the beginning of each month.

Illustration 8. Mr. Chander Mohan receives Rs. 100 from his head Cashier to keep petty Cash Book on Imprest system. He makes the following payments.

Solution:

Subsidiary Cash Book: The main Cash Book, just like Journal, also can be sub-divided into for example, Petty Cash Book, Receipts from debtors Cash Book, Payments to Creditors Cash Book and so on. Such divided cash books are called Subsidiary Cash Books. The total of such Subsidiary Cash Book is taken to the main Cash Book.

Multi-Columnar Cash Book: When the triple columnar Cash Book does not satisfy the business requirements, the Cash Book on each side is divided into as many columns as there are frequent heads of receipts and payments. The recurring items of receipts and payments are recorded in the suitable columns. This saves the labour of sorting out similar items at the end of the period. The total of the various columns is posted to the concerned accounts in the Ledger. It is very much in use now-a-days.

Double Column with Bank and Discount Column: This type of Cash Book is maintained in a business house where all the transactions are through Bank. The recording of transactions is done in the same manner as is done in the case of double column Cash Book.

Single Bank Column Cash Book: This type of cash book represents only the Bank Account. The businessman makes use of this type of cash book when he does not handle any cash but settles every transaction through cheque. Such Cash Book can, unlike other Cash Books, have credit balance also. It might happen so because of overdraft facilities granted by bank.

Solution (Example 8)

Petty Cash Book

Amount Received Rs.	Date	Particulars	Vouc her No.	Total Rs.	Postage and Tele-gram Rs.	Carriage and Cartage Rs.	Con-vey-ance Rs.	Station-ery Rs.	Cyclo-styling Rs.	Sund ries Rs.	Remarks
100.0	1993										
	Sept 1	To Bank									
	1	By Postage and stamp	1	10.00	10.00						
	9	By Taxi Fare	2	12.00			12.00				
	16	By Tea and Lunch to Auditors	3	37.00						37.00	
	24	By Telegram	4	3.00	3.00						
	27	By Stationary	5	2.00				2.00			
	28	By Cyclostling	6	9.00							
				73.00	13.00		12.00	2.00	9.00	37.00	
	30	By Balance c/d		27.00							
100.00				100.00							
27.0	Oct.	To Balance b/d									
73.0		To Bank									

3.14 TRIAL BALANCE

Ledger: One of the objects of accounting is to ascertain, with the least amount of trouble and cost, what the dealer owes to his creditors, what is owed to him by his customers, what are his expenses and incomes and so on. It is also clear that this information can not readily be obtained by recording the transactions into the journal alone. Suppose one wants to find out the amount owed to or owed by Mr. X to him then he will have to search through all the journal entries relating to Mr. X because he must have purchased goods several times from him and must have paid him money at different times. If this process is followed in order to ascertain one's position with every person or firm one deals with, the object of accounting will be only partly realized. Moreover, it will mean unnecessary wastage of time, energy and money. Some simpler means of bringing together the entries referring to each person or firm must, therefore, be found. This is done by collecting and condensing all the entries in another book, called the Ledger. All the entries relating to each person which so far stand dispersed through the journal are collected and condensed at one particular place called the account.

The Ledger according to the Batliboi is the chief book of accounts, and it is in this book that all the business transactions would ultimately find their place under their respective accounts in a duly classified form.

According to Pickles the ledger is the most important book of the account is the "destination of the entries made in the subsidiary books. It is essentially a collection of the three types of account Real, Personal and Nominal.

From the above discussion it becomes fully evident that the Ledger is not a book of prime entry because no entry is made direct into this book. It is first passed through the subsidiary books. This, however, is a book of primary importance. It contains the accounts relating to all the transactions that take the place in a business concern. Generally, one page of the ledger is devoted to one account, though there is no such hard and fast rule. This is done so to avoid mistakes and clumsiness of the entire writing.

If the number of accounts be very large, then it may not be possible for all the accounts to be contained in one ledger. In such a case ledger may be divided into several sections of volumes. As pointed out in your pervious lesson Cash Book is only a sub-division of ledger containing cash transactions.

One way of dividing the ledger is to divide it into Personal and Impersonal of General Ledger. The personal-Ledger can further be sub-divided into Sold Ledger and Bought Ledger. Similarly, the Impersonal Ledger can also be sub-divided into Real (containing the Accounts of assets and properties of the firm} and Nominal Ledger (containing all other accounts except the Personal Accounts and Real Accounts). Sometimes a private Ledger is maintained to keep capital Account and Drawing Account. No such Ledger, however, is kept in the case of a company.

It should be noted that the methods of sub-dividing the ledger as mentioned above, however, is not only method. The methods of division, if any division is all required, will always depend upon the circumstances of each particular case.

Every ledger has an index in the very beginning. It is usually an alphabetically index. One page of the index is allotted to one alphabet and the names commencing with that alphabet arc written in the page allotted to that alphabet. The page number on which the account appears in the ledger is written against each account in the index.

Rulings of Ledger-Many different rulings are met with in business. The most common have columns for date, particulars of transactions, folio and amount. Additional amount columns could be added if the business needs so require.

An alternative form or ruling, which is adopted by banks and some business organizations is that entire page of the Ledger is divided into six columns.

These 6 columns are

1. Date

2. Particulars
3. Folio
4. Dr. Amount
5. Cr. Amount
6. Balance's

The advantage of this alternative ruling is that the balance of an account can automatically be found out after transaction. There is no need to wait ti II the end of the period for ascertaining the balance's

Alternative—1

.... Account

Date	Particulars	Folio	Amount Rs. P.	Date	Particulars	Folio	Amount Rs. P

Alternative—2 .... **Account**

Date	Particulars	Folio	Dr. Amount Rs. P	Cr. Amount Rs. P.	Balance Rs. P.

IN-TEXT QUESTIONS

6. The word ....which means 'day'. The transactions which took place during a day used to be recorded in the Journal in order of date from waste book or a Memorandum book.
7. ________________is "used to record only credit purchases of goods, i.e., to record credit purchases of those commodities only in which the firm deals.
8. Sometimes goods purchased may be returned by us to the suppliers due to their being of the wrong kind, or not up to the sample, or because they are damaged. These returns are recorded in ....
9. Sales Returns Book is used for the purpose of recording returns of all goods sold. True/False
10. Usually, the business firms do not record entries for bills receivables in the journal' 'but where they receive a large number of bills during a year, a Bills Receivable Book is used for dealing' 'with bills drawn or received. True/False

3.15 SUMMARY

The current chapter deals with the process of bookkeeping. It talks about the cash transactions and procedure followed while recording them. The process of accounting is a tedious task and therefore needs to be recorded in separate books. The chapter discusses about the various books used during the recording and classifying the accounting transaction.

3.16 GLOSSARY

Journal: Journal is the most important to all the subsidiary books. It lays down the foundation of the entire book-keeping work of a business concern. Originally, all the business transactions used to be recorded in journal. The word 'Journal' is derived from one French Word 'Jour' which means 'day'. The transactions which took place during a day used to be recorded in the Journal in order of date from waste book or a Memorandum book.

Form: While passing a Journal entry the debit entry is listed first. The debit amount appears in the first of the two amount columns. The amount to be credited appears below the debit entry. The amount of this entry appears in the second of the two amount columns. Ledger Folio (L.F.)

column is provided to facilitate a ready reference of the page in the ledger on which that particular column is provided to facilitate a ready reference of the page in the ledger on which that particular account appears.

Purchase book: Purchase book is "used to record only credit purchases of goods, i.e., to record credit purchases of those commodities only in which the firm deals. Thus, the purchases of nylon sarees on credit by a firm dealing in sweets will not be recorded in purchase book. Purchase book is also called the 'Bought Book', 'Bought Day Book', 'Purchases Day Book', or 'Invoice Book'.

Sales Book: Sales Book is used to recording only the credit sales of goods in which the firm ordinary deals. Cash sales of goods and sales of assets of the firm are not recorded in the Sales Book. It is known by various names, e.g., 'Day Book' 'Sold Day Book' and 'Sales Day Book.

Purchases Returns Book: Sometimes goods purchased may be returned by us to the suppliers due to their being of the wrong kind, or not up to the sample, or because they are damaged. These returns are recorded in the "Purchases Returns Book" or "Returns outward Book". Allowance claimed for short weight, overcharge, breakage, etc., are usually also dealt with in the same book.

Sales Returns Book: Sales Returns Book is used for the purpose of recording returns of all goods

sold. The goods may be returned by the customer due to their not being of the correct description, of being inferior quality or being damaged in transit. This book is also called Returns Inwards Book is debited to the Returns Inward Account. The double entry is thus completed.

Bills Receivable Book: Usually the business firms record entries for bills receivables in the journal' 'but where they receive a large number of bills during a year, a Bills Receivable Book is used for dealing' 'with bills drawn or received.

Cash Book: Cash transaction, in any business are by far the largest in number. The number of such transactions is so large that a special book, called the 'Cash Book' is set apart for recording cash transactions.

3.17 ANSWERS TO IN-TEXT QUESTIONS

1. Books of Original Entry. 2. Debit 3. False. 4. True. 5. True	6. Journal 7. Purchase Book 8. Purchase return book 9. True 10. False

3.18 SELF-ASSESSMENT QUESTIONS

1. What do you mean by Cash Book?
2. Write short notes on Multi Column Cash book.
3. Explain Purchase Book with suitable example?
4. Discuss details contained in Sales book.
5. Explain the use of Journal.
6. Write short note on Subsidiary Cash Book
7. What do you mean by "Sales Book”? Explain by giving examples?
8. Explain Purchase Return Book, Sales Return Book with examples?
9. What is Double Column with Bank and Discount Column? Explain the use.
10. Explain the methods of preparing Trial Balance.

3.19 SUGGESTED READINGS

- *Monga, J R. Financial Accounting: Concept and Applications. Mayur Paper Backs, New Delhi*
- *Goyal, Bhushan Kumar and H.N. Tiwari, Financial Accounting, Taxmann*

UNIT II

LESSON 4
INVENTORY

Ms. Sumita Jain

STRUCTURE

4.1 LEARNING OBJECTIVES

- To know the meaning of Inventory
- To understand the procedure of Inventory management
- To apprise the significance of Inventory valuation
- To understand the Inventory valuation methods

4.2 INTRODUCTION

The inventory includes goods purchased and held for resale, for example, goods purchased by a retailer and held for resale, computer software held for resale, or land and other property held for resale. Inventory also consists of finished goods or works in progress produced by the enterprise and includes materials, maintenance supplies, consumables, and loose equipment intended for use in the production process. Inventory does not include machinery parts that can only be used in relation to an item of fixed asset and whose use is expected to be irregular; such machinery parts are accounted for in accordance with Accounting Standard (AS) 10, Property Plant and Equipment.

4.3 BUSINESS INCOME

What is Business Income: It is a kind of earned income which is treated as the ordinary income for the tax purposes. It is an outcome generated from the business operations of any organization. To simplify, it can be termed as the net profit of the organization as per its financial statements.

The term business income is mainly used for the calculation of the income tax as per the taxation rules. As per Internal Revenue service (IRS) "may include income received from the sale of products or services," such as "fees received by a person from the regular practice of a profession...[and] rents received by a person in the real estate business."

The Business income is the result of the profits and gains occurred during an accounting period which are affected by the business losses and expenses. The tax calculated on the business income is different for different businesses such as sole proprietorship, partnership and limited liability partnership.

Sole Proprietorship: This type of business is not considered as a separate business entity and therefore the tax is calculated as an individual.

Partnership: This kind of business is unincorporated where two or more partners work together sharing profits and losses. The partnership can not be made taxable and therefore each partner is liable for paying the tax individually.

Limited Liability Company: It is a hybrid combination of partnership and the corporation. Here an individual is liable for paying the income tax as the business income.

Corporation: It is termed as a separate legal entity where the individual owning the business is considered separated from the business and they are taxed as C-Corps. The company is taxed for its income.

4.4 AS-10 PROPERTY, PLANT AND EQUIPMENT

The accounting standard- 10 deals with the property, plant and machinery. The main motive behind the AS-10 is the treatment of Property and Plant & machinery. It allows the users to have an information regarding the assets of the organization. It talks about the investments done by the entity in the plants and machinery etc. It also deals with the amount recognition and the depreciable amount on the asset.

Following are some important definitions used in the AS-10.

Bearer plant: "(a) is used in the production or supply of agricultural produce;"

"(b) is expected to bear produce for more than one period:"

"(c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales."

Carrying amount: "Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses."

Cost: "Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other Indian Accounting Standards, e.g., Ind AS 102, Share-based Payment.

Depreciable amount: "It is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation: "It is the systematic allocation of the depreciable amount of an asset over its useful life.

Entity-specific value: "It is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.

Fair value: "It is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See Ind AS 113, Fair Value Measurement.)"

Impairment loss: "An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount".

Recognition of Cost:

The cost of an item of property is recognised when:

(a) the property is associated with the benefits in the future.

(b) the cost can be computed reliably.

Initial Cost: Sometimes the organizations have to purchase the property which is not of economic benefit but acquired for the safety and environmental reasons. These kinds of assets help in the future economic benefit of other assets. Such costs are known as initial costs.

Subsequent costs: sometimes the plant and machinery require a continuous repair after small intervals. This cost is called the subsequent cost.

Measurement of Cost: The cost of an asset is the recognised value of the asset as on the date.

Measurement after recognition: The organization shall have two options for the measurement after the recognition. The first option is the cost model and the second one is the revaluation model.

Cost model: once the property has been recognised as the asset, the plant and equipment are carried at its cost minus its depreciation, or any other loss/damage happened to the asset.

Revaluation Model: Where the computation of fair value of the asset is possible and reliable, the revaluation model can be fit. The revaluation shall be made on the regular intervals in order to ensure the fair and just value at the end of the accounting period.

4.5 MEANING OF INVENTORY

The term "inventory" or "merchandise" or "stock-in-trade" means a complete list of goods that a business has for sale at a given time. In accounting, inventory also includes goods that are in different stages of production, i.e., work-in-progress.

As per Accounting Standard (AS) 2 issued by the Institute of Chartered Accountants of India (ICAI), the inventory assets are:

(A) held for sale in the normal course of business (finished goods).

(B) in the process of production for such sales (raw materials and work-in-progress); or

(C) as materials or supplies consumed in the production process or in the rendering of services (stores, parts, raw materials, consumables).

(d) inventory does not include machinery.

Types of Inventories

In case of Manufacturing concerns

Raw material
Work-in-progress
Finished goods

in case of Trading concerns

Finished goods

The types of inventories are related to the nature of the business. The inventories of a trading concern are primarily from products purchased for resale in their actual form. It may also contain a list of supplies such as wrapping paper, cartons and stationery. The inventories of a manufacturing concern include several types of inventories: raw materials, factory supplies, work processes and finished products.

At the end of the year each trading entity is required to find the closing balance of inventory which includes raw material inventory, work-in-process, finished goods and miscellaneous items. The value of the closing stock is shown on the *credit side* of the trading account and the *asset side* of the balance sheet. Therefore, it is necessary to know the value of the inventory before preparing the final accounts of the business unit

IN-TEXT QUESTIONS

1. ____________inventory includes goods that are in different stages of production.
2. Inventory should be valued at a lower level of cost or net realizable value True / False
3. Which of the following is not a component of inventory
   a. Raw material
   b. Work- in- progress
   c. Finished Goods
   d. None of the above
4. The value of the closing stock is shown on the __________of the trading account
5. The closing stock is shown on the ___________ of the balance sheet.

4.6 SIGNIFICANCE OF INVENTORY MANAGEMENT

Inventory is generally the most important component of current assets held by a trading or manufacturing enterprise. This can be 75% or more of the total current assets. It is widely recognized that the major asset affecting efficiency of operations is inventory. Both, excess of inventory and shortfall of it affect the production activity and profitability of the enterprise whether it is manufacturing or trading business. The process of inventory valuation helps to determine the price at which we will record the inventory in the final accounting statement of the company. Hence, accurate inventory valuation is necessary to properly represent the company's finances.

Let's take a look at how important inventory valuation is to a company.

1] **Determination of Income**

The valuation of inventory is necessary to determine the true income earned by a business entity during a particular period. To determine gross profit, cost of goods sold is compared with revenue for the accounting period. The cost of goods sold is calculated as follows:

Cost of Goods Expense = Inventory Opening + Purchase + Direct Expense - Closing Inventory

Inventory valuations will have a major impact on income determination. If valuations are overstated or understated, it can be explained as:

a. When the closing stock is overstated, the net income for the accounting period will be overstated.

b. When the opening stock is overstated, the net income for the accounting period will be understated.

c. When the closing stock is understated, the net income for the accounting period will be understated.

d. When the opening stock is understated, the net income for the accounting period will be overstated.

Inventory valuation (closing inventory) has a direct impact on a firm's income determination. Inaccurate or incorrect valuation of inventory can reduce or increase the profitability of the firm.

2] **To Determine the Financial Situation**

Inventory is not only part of the trading account, but also a part of the balance sheet. Inventories are classified as current assets and it is very important to have accurate and correct inventory valuations.

If the calculated value of the inventory is incorrect, it will represent an incorrect financial position at the balance sheet date.

3] **Liquidity Analysis**

Inventory is a current asset because the firm is not expected to keep it for long. There is a lot of turnovers when it comes into stock. Inventory is an important part of a company's working capital. It is important to value it accurately so that the current ratio and liquid ratio can be calculated correctly. These ratios are important for checking the liquidity of a company.

4] **Statutory Compliance**

Schedule III to the Companies Act, 2013 requires goods of each category to be disclosed in the financial statements i.e., raw materials, progress in work and finished goods under a broad head. As per the requirements of Accounting Standard, financial statements should disclose:

(A) The accounting policies adopted in measuring inventories, including the cost formula used,

(B) The total carrying number of inventories and their classification appropriate to the enterprise.

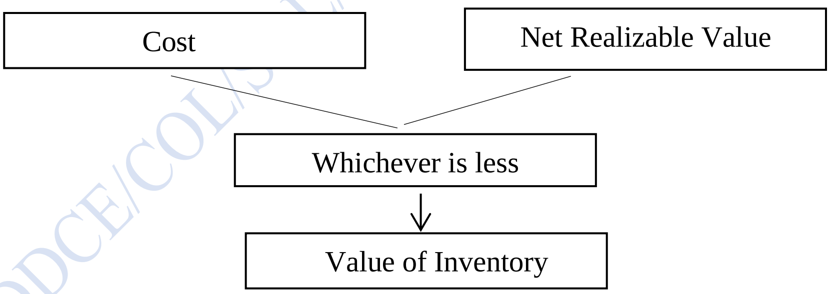
Basic Principle of Inventory Valuation

According to AS-2, there is a fundamental principle for inventory valuation i.e., inventory should be valued at a lower level of cost or net realizable value. This principle comes from a conservative system of accounting. Inventory pricing is important when a lot is purchased at different prices at different times. In the event of no change in the price level, determining the historical cost of the inventory will not be a major problem.

Let us understand the terms cost and net realizable value.

- Cost: The amount of expenditure incurred on the acquisition of goods.
- Net realizable value: In the ordinary course of business, the estimated selling price is less the estimated cost of completion and the estimated cost required to make the sale. An appraisal is made of net realizable value on an item-by-item basis. However, in some circumstances, it may be approximate to group similar or related objects.

Basis Of Inventory Valuation



4.7 INVENTORY RECORD SYSTEM

There are two major methods of determining the physical quantity and monetary value of inventories sold and in hand. One system is known as the "***Periodic Inventory System***" and the other is known as the "***Perpetual Inventory System***". Periodic systems are the least expensive to use. But the useful information obtained from the perpetual system takes the cost consideration. These systems are distinguished on the basis of actual records kept ascertaining the cost of goods sold and the valuation of the closing inventory.

1) Periodic Inventory System / Physical Inventory System

The periodic inventory system is a method of locating inventory by taking the actual physical count (or measurement or weight) of all inventory items on a particular date at which the inventory is required. Usually, at the end of the financial year, there is a physical count of the stock, after which the record is adjusted and updated accordingly. It is because of the actual physical calculation that the system is also called a physical inventory system.

The cost of goods sold is shown below:

Cost of goods sold = Opening inventory (known) + Purchase (known) - Closing inventory (physically counted)

This system has various drawbacks as the cost of goods sold may include items lost or stolen during the year. However, with the help of sales revenue, an estimate can be made about lost inventory, but this figure is not accurate.

Benefits of Periodic Inventory System

(i) As long as the business is small, it is easy to use.

(ii) It is less expensive than continuous inventory system as it does not involve any software cost, training cost.

Limitations of Periodic Inventory System

(i) The periodic inventory method is based on the assumption that not all goods are accounted for or sold or used by physical inventory calculations. In this way, losses from theft, waste, evaporation, etc. are improperly included in the cost of goods sold.

(ii) Physical calculations at the end of the accounting period will adversely affect normal business operations for several days.

(iii) If income statements are required more than once a year, it will be very expensive if the inventory figures are obtained only by physical calculation.

(iv) Inventory control is not possible under this system.

2) Perpetual Inventory System

The perpetual inventory system is a system of recording inventory balances after each receipt and issue. A separate account is kept for each type of inventory in a card or sheet to record the purchase and sale of each inventory throughout the year. To ensure the accuracy of sequential list records, the physical inventory must be checked and compared with the record balance. Under this system, the cost of goods released is determined directly and the inventory of goods is taken as a residual figure with the help of an inventory ledger in which the flow of goods is recorded on a continuous basis. If there is a deficiency due to loss or theft, it can be easily located, and corrective action can also be taken immediately. The basic feature of this system is the maintenance of inventory ledger, keeping records of goods on an ongoing basis.

Benefits of Perpetual Inventory System

(i) Normal business operations are not disrupted and there is no need to close the business operations for stock taking.

(ii) In some cases, the quantity of inventory items may be such that it is impossible to do a full count in one day.

(iii) There is no 'out of stock' situation suddenly. Situation which may lead to customer dis-satisfaction can be avoided under this system.

(iv) Losses are easy to control under the perpetual system because the inventory record consistently indicates the goods that must be on hand.

(v) If there is any irregularity or change in the procedures by the shopkeepers, then this can lead to a thorough investigation and investigation.

Limitations of Perpetual Inventory System

(i) It is an expensive system because it involves the setup cost. Most systems require the purchase of new equipment and inventory software. The system includes point of sale scanners that read the bar code of each item. Perpetual inventory systems also add to the labour cost because all inventories must be entered into the system.

(ii) Permanent inventory systems can be misleading when reviewing inventory levels. Employees may make a mistake in entering or scanning the wrong number of items.

(iii) Increased monitoring due to employee errors or customer theft requires additional financial investment. Safety monitors are usually required to be installed and some companies employ security personnel for a check.

Conclusion

The Periodic Inventory System is less expensive than the Perpetual Inventory System but gives more accurate information because continuous recording of inventory and its verification is performed. In addition to this, the financial statements are also prepared quickly as the inventory records are maintained properly in the Perpetual Inventory System, which is not possible in case of Periodic Inventory System. The Perpetual Inventory System is best suited for big enterprises while small businesses can go for Periodic Inventory System

Distinction between Periodic Inventory System and Perpetual Inventory System

Basis for Comparison	Periodic Inventory System	Perpetual Inventory System
Meaning	This system is based on physical count of various items of inventories.	This system is based on continuous record keeping of various items of inventories.

Provides Information About	Under this system, inventory is directly determined, and cost of sales is taken as a residual figure.	Under this system, cost of sales is directly determined, and inventory is taken as a residual figure.
Cost	This system is comparatively simple and less expensive.	This system is costlier as detailed records and high cost of maintaining them are must.
Stewardship of Inventory	This system provides a periodic stewardship of the inventory, and little is known about the exact composition and amount of inventory items between actual counts in the beginning and at the end.	This system provides a continuous stewardship of the inventory. Inventory records are continuously updated so that financial statements can be prepared at shorter intervals.
Impact on Business Operations	This system requires closure of business for counting of inventory.	Inventory can be determined without affecting the operations of the business.
Inventory Control	Under this system, inventory control is not possible.	This system provides a basis for inventory control so that physical stocks can be compared with book records and discrepancies, if any investigated.

4.8 INVENTORIES TAKING

Usually, all work is suspended for one or two days during the financial year and physical inventory is taken for everything in the warehouse or store. Often, inventory taking cannot be done on the day of closing. This is done a few days later or sometimes a few days before. In such a case, the actual value of the stock should be so adjusted as to be related to the end of the year. To do this, it will be necessary to take into account the goods that have come in (purchase and sale returns) and those that have gone out (sales and purchase returns) during the interval between the closing of the year and the date of the actual inventory taking.

Stock Taking Calculation

Calculation of closing stock if physical stock taking is done during the first week of the next financial year

Stocks as on say 07/04/2019	xxx
Less Purchase (less return) from 01/04/2019 to 07/04/2019	xxx
Add Sales (less return) from 01/04/2019 to 07/04/2019	xxx
Stock as on 31/03/2019	xxx

4.9 METHODS OF INVENTORY VALUATION

The most important goal of accounting for inventory is to accurately estimate costs and sales. Inventory valuation allows a company to provide a monetary value for goods that are in their inventory. This information allows a company to properly evaluate expenses and revenue on its financial statements so that they can make sound business decisions. The various techniques for valuation of inventory include:

(i) Specific Identification Method

(ii) FIFO (First in First Out) Method

(iii) LIFO (Last in First Out) Method

(iv) Weighted Average Method

1. Specific Identification Method

To apply this method, it is necessary to identify each item of goods sold and closing inventory. Thus, the special identification method only applies where you can easily differentiate different purchases. Consequently, the cost of goods sold includes goods sold at specific costs during the accounting period. And the closing inventory includes the cost of particular items in hand or items that are left. For example, companies selling automobiles, furniture, jewellery etc. can use this valuation method successfully. This is because these companies manufacture or handle goods that are expensive but easily identifiable.

Limitations of Specific Identification Method

(i) Inadequate Method:

It is neither possible nor feasible to identify each item of inventory, therefore, the practice of specific identification of costs may be difficult or impossible to implement or considered inadequate in most situations.

(ii) Probability of Net Income Manipulations:

It is easy for the business owner to manipulate net income under this method. For example, a wholesaler purchased the same quality paper during the year at three different prices. Now, the wholesaler can manipulate net income at the time of selling the paper. He can choose either the lowest or the highest price and attribute it to a particular lot of paper to be sold exclusively to the customer.

(iii) Arbitrary allocation of certain costs:

This method is associated with the arbitrary allocation of some costs for list items. For example, discounts, shipping fees, and storage costs are difficult to allocate directly to a given inventory. Therefore, in such cases the business owners are bound to allocate such costs arbitrarily. This affects the accuracy of the specific identification method.

2. First In, first out Method (FIFO)
In the FIFO method of inventory valuation, the goods which are purchased at the earliest are released first for sale from the inventory account. This method is based on the assumption that costs must be charged to the revenue in the order in which they are incurred, i.e., first units received are the first ones to be sold or the units sold in the order in which they were acquired. The closing inventory is therefore considered to be consist of recently purchased goods.

It should be kept in mind that this assumption of cost flow or goods flow should not be correct as a physical fact. It is only concerned with the method of accounting and not the actual physical movement of goods.

Benefits of First In, first out (FIFO) Method

(i) Easy To Relate and Understand:

FIFO helps to maintain inventory records in a natural way i.e., recording is done in the same order when units are purchased or produced, so it is very easy to understand and relate.

(ii) Based on The Matching Principle of Accounting:

FIFO best fits the situation where entity holds inventory that has fast turnover and converts quickly thus revenue and costs are from related periods. It also conforms to the principle of accounting.

(iii) Provides a Better Reflection of Market Prices:

Since closing inventory value is based on recent purchases, there is a much better reflection of the market prices of a similar product prevailing at the period and date. Since the oldest available units are accounted for under cost of goods sold, the potential risk of a reduced net realizable value and the resulting loss is automatically ruled out, as the entity is not pulling the old units into inventory records.

(iv) Reliable Analysis:

Since the value of the closing stock is significant in the current asset total and related accounting ratios, the very relevant ending inventory value will give rise to reliable analysis.

(v) Reduces Losses and Degradation:

The assumption that previously purchased goods are sold first reduces losses and degradation according to good and efficient management practices.

(vi) Widely accepted method:

Widely accepted by regulatory authorities and standards including IFRSs and GAAPs.

Limitations of First In, first out (FIFO) Method

(i) Difficulty In Managing Inventory: It can be clumsy, complex, and difficult to manage the inventory and associated prices of each group if the entity makes multiple orders for goods that have fluctuating prices. Thus, it is prone to even more errors as well.

(ii) Need for Inflation Adjustment:

As the cost of goods sold is based on the earliest inventory, those prices are no longer relevant to the analysis conducted after the end of the period. Therefore, additional work may be required to adjust inflation and other factors affecting the inventory price to obtain the appropriate figure.

(iii) When the entire inventory is purchased at the beginning of the year, this is not an appropriate method:

The effect of inappropriate cost of sales figure is amplified if entity buys inventory in the beginning of the period for the whole period especially if prices fluctuate significantly. Thus, forcing management to change procurement process and spread the purchases over the period to minimize the impact which may cause higher total ordering cost.

(iv) Difficulty In Complying with The Matching Principle:

The Matching principle requires the revenue and costs to be matched and reported in the same period. Compliance can be difficult if the nature of the product is such that it has slow turnover and requires time to convert, and price may change during this delay and thus revenue and costs must be from different periods.

(v) Causes Overstatement of Profit:

Due to inflation, the value of inventory may increase even if the physical count has decreased. This cause overstatement of profit or "bloating" with no real value to back up and renders profit comparison over the period and other analysis based on profit unreliable.

3. Last In, First Out Method (LIFO)

In the LIFO method of inventory valuation, the items which were purchased in the last are the first that are issued for sale from the inventory account. Therefore, the stock-in-hand (closing inventory) is valued at the earlier price. It is based on the assumption that despite the actual physical flow of goods, the goods sold are those that were acquired in the last and goods that remain unsold (closing inventory) are those that have been previously acquired.

The LIFO method of inventory valuation is based on an irrational assumption that inventories that last entered in the stores are the first to be issued or consumed. However, the flow of goods which is commonly observed in business entities is contrary to this notion. Therefore, the LIFO method is no longer adopted for valuating inventories. Generally, in practice FIFO and Weighted Average Method are popular among business entities.

Benefits of Last In, first out (LIFO) Method

(i) LIFO Matches Current Revenue with The Most Recent Costs:

The LIFO method provides a better measurement of current revenue by matching the most recent costs against current revenue. The Non-LIFO methods (such as the FIFO method) matches old costs against current revenue. When old costs are matched against current revenues in an inflationary environment, the inventory profit (also known as 'paper profit' or 'transitory profit') is created. Inventory profit occurs when the replacement cost of the inventory exceeds the inventory cost listed against the revenue. This inventory profit understates cost of goods sold (COGS) and overstates profit.

The LIFO method helps to reduce the inventory profits by matching the most recent costs against revenue. This results in reduction of understatement of cost of goods sold (COGS) and overstatement of profit. Therefore, the quality and reliability of earnings under LIFO improves.

(ii) Tax Benefits and Improvements in Cash Flow:

The main reason for the popularity of last-in, first-out (LIFO) method of inventory valuation is its tax benefits. When LIFO method is used in periods of inflation, the current purchases at higher prices matched against revenue that reduces the overstatement of profits and therefore lower income tax bills. A reduction in income tax improves the company's cash flow.

(iii) LIFO Minimizes Write-Downs to Market:

The net income of a company using LIFO is less likely to be affected by future price declines. Typically, companies using the LIFO method do not have much inventory at current high prices, because under this method, the most recent inventory purchased at higher prices is sold first. Therefore, the possibility of write-downs to market in future due to decline in inventory prices are minimized or even eliminated under LIFO.

(iv) Physical Flow of Inventory:

In some situations, the physical flow of the inventory corresponds to the LIFO cost flow. For example, in the case of a coal pile, the most recent coal added to the coal pile is always at the top of the coal pile. Therefore, the last coal is always the first coal out.

This advantage is not the reason for the popularity of the LIFO method because in situations where the physical flow of the inventory matches the LIFO cost flow, they are very rare. The benefits of 1, 2 and 3 described above are the main arguments for widespread employment of this method.

Limitations of Last In, First Out (LIFO) Method

(i) Low Income in Times of Inflation:

The LIFO method reduces reported income during periods of inflation. Therefore, many companies fear that an accounting change for LIFO will negatively impact investors and reduce the company's stock price as many investors may not be able to understand the impact of LIFO method and inflation reports.

(ii) Understatement of Inventory: Under the LIFO method, the balance sheet inventory data is generally understated as it is based on the earliest costs. Due to understatement of inventory, the working capital situation may look worse than the real situation.

(iii) LIFO Liquidation Problem:

The LIFO liquidation can increase the reported income for a given period resulting in higher tax payments for the period. To avoid this problem, a company can buy large quantities of goods, so that they can match against revenue. Therefore, adopting LIFO can develop poor purchasing habits among companies.

(iv) Manipulation of Income:

A company using the last-first, first-out (LIFO) method can easily manipulate its reported earnings by making changes to its buying patterns at the end of the year.

4. Weighted Average Cost Method (WAC)
The Weighted Average Cost (WAC) method of inventory valuation uses a weighted average to determine the amount that goes into cost of goods sold (COGS) and inventory. The weighted average cost method divides the cost of goods available for sale by the number of units available for sale. The WAC method is permitted under both GAAP and IFRS accounting.

Weighted Average Cost (WAC) Method Formula

The formula for the weighted average cost method is as follows:

$$\text{WAC per unit} = \frac{\text{Cost of goods available}}{\text{Units available for sale}}$$

Where:

- Costs of goods available for sale is calculated as beginning inventory value + purchases.
- Units available for sale are the number of units a company can sell, or the total number of units in inventory.

Benefits of Weighted Average Cost (WAC) Method

(i) The biggest advantage of using the weighted average cost method over other cost formulas such as FIFO or LIFO is that it simplifies calculations and record keeping and can be easily processed even if the entity has a high frequency of inventory ordering. As bookkeepers don't have to keep track of each and every batch purchased and its associated price, the number of records and the possibility of human error are minimized.

(ii) The weighted average cost method is a much better method than FIFO or LIFO when it comes to goods that cannot be separated or, for example, it is impossible to distinguish one batch of goods from another, such as oil, earth, Wheat, iron ore etc. When they are extracted the batches loose their individual identity and are thus used in random. The weighted average cost method considers inventory inflows in the same way such that each batch lost its identity when the average cost was calculated. Therefore, it is very favorable and relevant in such industries.

(iii) The weighted average cost method is a widely accepted method for inventory valuation and is also allowed under many accounting standards and guidelines. IFRS allow the use of a weighted average cost method.

(iv) The weighted average costing method automatically adjusts to the effects of random price hikes and dips particularly near the end and start of the period. Suppose the entity has only units left from the batch that was purchased last month when prices suddenly increased manifolds, but is expected to return to normal again, in such a case if the FIFO method is used If done, it will become disproportionate due to the rising value of the stock. But weighted average cost method will make it much better as it will spread the effect of hike and thus normalize sudden fluctuations.

(v) The cost of sales calculation will be more consistent and less affected by changes in prices under weighted average cost method as compared to FIFO and LIFO. In case of rising prices, unlike FIFO method which gives understated cost of goods sold, or LIFO method which will give cost of goods sold of the whole period as per prices prevailing at the end of period, Weighted Average Cost method will be in the middle of both. Therefore, comparison of period-to-period is much more meaningful and requires less adjustment as opposed to FIFO or LIFO which may require price adjustment for analysis purposes.

Limitations of Weighted Average (WAC) Method

(i) The cost of ending inventory determined under the weighted average cost method may differ significantly from the prevailing prices for similar products at such a date. Thus, it becomes difficult to reduce costs and make appropriate decisions about the NRV rule. Since the closing stock figure is significant in profit and current asset totals, these figures may be unreliable for decision-making purposes and may require reinstatement for valuation purposes.

(ii) If the entity is using a cost-over-pricing strategy to price its products, each time a new purchase is made at a different rate than the former, it will also change the price. Such frequency of price changes can upset customers and make it difficult for management to cite their potential customers and related pricing and cost decisions.

(iii) Under the weighted average cost method each batch loses its identity, thus it can be difficult to price items correctly where the age of the unit plays an important role. In such situations, the weighted average cost method will help much less than FIFO or LIFO which keeps track of individual batches of units produced or purchased.

(iv) The average cost calculation often displays the cost per unit in long decimals which are rounded off for record purposes. Differences of such approximation may become collectively material, especially by the end of the period, especially if it involves large amounts of transactions. And may distort gross profit and current asset figures.

(v) Although the weighted average cost method helps in normalizing the fluctuation, but it can also be affected when a large amount of inventory is purchased at the start or end of the period especially when prices differ from the rest of the period.

IN-TEXT QUESTIONS

6. In __________ method, the items which were purchased in the last are the first that are issued for sale from the inventory account.
7. Under_________ method, Costs of goods available for sale is calculated as beginning inventory value + purchases.
8. In the _________ method of inventory valuation, the goods which are purchased at the earliest are released first for sale from the inventory account.
9. The ____________________ is less expensive than the Perpetual Inventory System.
10. The _______________ system is a system of recording inventory balances after each receipt and issue.

4.10 SUMMARY

In this chapter of Inventory, we have studied the meaning of inventory, types of inventory record system, inventory valuation, significance of inventory valuation and methods of inventory valuation. Benefits and Limitations of FIFO, LIFO and Weighted Average Method has also been discussed in detail in this chapter.

4.11 GLOSSARY

Inventory: A complete list of goods that a business has for sale at a given time.

Work-in-progress: Goods that are in different stages of production.

Periodic inventory system: It is a method of locating inventory by taking the actual physical count (or measurement or weight) of all inventory items on a particular date at which the inventory is required.

Perpetual inventory system: It is a system of recording inventory balances after each receipt and issue.

4.12 ANSWERS TO IN-TEXT QUESTIONS

1. Work-in-progress	6. LIFO
2. True	7. WAC
3. None of the above	8. FIFO
4. Credit side	9. Periodic Inventory System.
5. Asset side	10. Perpetual Inventory System.

4.13 SELF-ASSESSMENT QUESTIONS

1. FIFO is a method of valuing:
   a) Inventories
   b) Fixed assets
   c) Company
2. In which of the following inventory cost flow assumption, the cost of the most recent purchase is matched first against sales revenue?
   a) FIFO Method
   b) LIFO Method
   c) Weighted Average Cost Method
3. In which of the inventory cost flow assumption, the cost of the most recent purchase is likely to remain in inventory?
   a) FIFO Method
   b) LIFO Method
   c) Weighted Average Cost Method

4. The inventory system that does not update the inventory account automatically at the time of each purchase or sale.
   a) Periodic
   b) Perpetual
5. Out of which of the following is not an inventory?
   a) Raw material
   b) Finished products
   c) Machines
   d) Consumable tools
6. Which one of the following inventory costing methods is supposed to issue the most recently purchased goods?
   a) FIFO Method
   b) LIFO Method
   c) Weighted Average Cost Method
   d) Moving Average Method
7. All of the following are the methods of inventory costing except?
   a) FIFO Method
   b) LIFO Method
   c) Weighted Average Cost Method
   d) Stock Take
8. Which accounting concept is most reflected in the following accounting policy "Inventories are stated at the lower of average purchase cost and Net Realizable Value"?
   a) Prudence
   b) Consistency
   c) Matching
   d) Money Measurement
9. The specific identification method of inventory valuation is based on which of the following information?
   a) actual cost of each item of merchandise
   b) average cost of each item of merchandise
   c) earliest cost of each item of merchandise
   d) latest cost of each item of merchandise

10. The weighted average cost of an inventory item is calculated by dividing which of the following?
    a) sum of the unit cost on the purchase invoices by the number of units purchased
    b) cost of goods available for sale by the number of units on the ending inventory
    c) cost of goods available for sale by the number of units available during the period
    d) cost of goods sold by the number of units available during the period

[Answers: 1 (a), 2 (b), 3 (a), 4 (a), 5(c), 6 (b), 7 (d), 8 (a), 9 (a), 10 (c)]

4.14 SUGGESTED READINGS

- *Monga, J R. Financial Accounting: Concept and Applications. Mayur Paper Backs, New Delhi*
- *Goyal, Bhushan Kumar and H.N. Tiwari, Financial Accounting, Taxmann*

LESSON 5

INVENTORY MANAGEMENT

Sumita Jain

STRUCTURE

5.1 LEARNING OBJECTIVES

To know the methods of inventory records

- To understand the procedure of inventory records
- To understand FIFO, LIFO, Weighted Average Method
- To know the significance and drawbacks of different methods

5.2 INTRODUCTION

In the previous lesson, we have studied the three cost flows assumptions:

1. First In, First Out (FIFO)
2. Last In, First Out (LIFO)
3. Weighted Average

Each of the three cost flow assumptions listed above can be used in two systems (or methods) of inventory: Periodic and Perpetual. Let's discuss in detail.

5.3 FIFO METHOD

FIFO Method can be done in two ways

1. **Periodic FIFO Method**
2. **Perpetual FIFO Method**

1. Periodic FIFO Method

"Periodic" means that the inventory account is not regularly updated during the accounting period. Instead, the cost of goods purchased from suppliers is debited to an account called Purchases. The Inventory account is adjusted to equal the cost of the merchandise that has not been sold at the end of the accounting year. The cost of goods sold will be stated on the income statement, calculated by taking the cost of goods purchased and subtracting the increase in inventory (or adding the decrease in inventory).

"**FIFO**" is an abbreviation for **F**irst **I**n, **F**irst **O**ut. Under the FIFO cost flow assumption, the first (oldest) costs are the first ones to depart from inventory and become the cost of goods sold on the income statement. The final (or most recent) cost will be reported on the balance sheet as inventory.

2. Perpetual FIFO Method

The Inventory account changes constantly (or perpetually) under the perpetual system. When a retailer buys goods, the retailer debits its Inventory account for the cost; when the retailer sells the good to its customers its Inventory account is credited and its Cost of Goods Sold account is debited for the cost of the goods sold. Instead of remaining inactive as it does with the periodic method, the Inventory account balance is continuously updated.

Under the perpetual system, two transactions are recorded when the goods are sold: (1) the sales amount is debited to Accounts Receivable or Cash and is credited to Sales, and (2) the cost of the goods sold is debited to Cost of Goods Sold and is credited to Inventory. (Note: The second entry is not made under the periodic system). With perpetual FIFO, the first (or oldest) costs are the first transferred from the Inventory account and debited to the Cost of Goods Sold account.

The final result under perpetual FIFO is the same as under periodic FIFO. In other words, the first costs are the same whether you move the cost out of inventory with each sale (perpetual) or whether you wait until the year ends (periodic).

IN-TEXT QUESTIONS

1. _________ means that the inventory account is not regularly updated during the accounting period
2. __________ is an abbreviation for **F**irst **I**n, **F**irst **O**ut.
3. The_________ account changes constantly (or perpetually) under the perpetual system.
4. when the retailer sells the good to its customers its Inventory account is ______and Cost of Goods Sold account is ________for the cost of the goods sold.

5.4 PRACTICAL PROBLEMS

Problem *–From the following transactions calculate the cost of closing inventory and cost of goods sold by applying FIFO method under perpetual and periodic inventory systems respectively:*

Date	Transactions	Units	Price Per Unit (₹)
1 July 2019	Opening balance brought forward	2000	10
15 July 2019	Purchases	1000	15
31 July 2019	Purchases	800	11
1 August 2019	Sales	2400	-
15 August 2019	Sales	1000	-
16 August 2019	Purchases	800	15
30 August 2019	Sales	1000	-

Solution:

FIFO Method: (Perpetual Inventory System)

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Unit Price (₹)**	**Amount (₹)**
01- July	-	-	-	-	-	-	2,000	10	20,000
15- July	1,000	15	15,000	-	-	- -	2,000 1,000	10 15	20,000 15,000
31-July	800	11	8,800	-	-	-	2,000 1,000 800	10 15 11	20,000 15,000 8,800
01- August	-	-	-	2,000 400	10 15	20,000 6,000	600 800	15 11	9,000 8,800
15- August	-	-	-	600 400	15 11	9,000 4,400	400	11	4,400
16- August	800	15	12,000	-	-	-	400 800	11 15	4,400 12,000
30- August	-	-	-	400 600	11 15	4,400 9,000	200	15	3,000

(i) Closing Inventory = 200 Units x ₹15 = **₹3,000**

(ii) Cost of Goods Sold = ₹26,000+₹13,400+₹13,400=**₹52,800**

FIFO Method: (Periodic Inventory System)

The Closing Inventory is 200 units, and it would be assumed to be part of the most recent purchases because goods of old costs are assumed to be sold first under FIFO method.

(i) Closing Inventory = 200 Units x ₹15 = **₹3,000**

(ii) Cost of Goods Sold = Cost of units in beginning inventory + Cost of units purchased during the period – Cost of units in ending inventory = ₹20,000 +(₹15,000+₹8,800+₹12,000)-₹3,000=**₹52,800**

5.5 LIFO METHOD

LIFO Method can be done in two ways

1. **Periodic LIFO Method**
2. **Perpetual LIFO Method**

1. Periodic LIFO Method

"Periodic" means that the inventory account has not been updated during the accounting period. Instead, the cost of goods purchased from suppliers is debited to an account called Purchases. The Inventory account is adjusted to equal the cost of the goods that is unsold at the end of the accounting year. The other costs of goods will be stated on the income statement as the cost of goods sold.

"**LIFO**" is an abbreviation for **L**ast **I**n, **F**irst **O**ut. Under the LIFO cost flow assumption, the last (or most recent) costs are the first ones to leave inventory and become the cost of goods sold on the income statement. The first (or oldest) costs will be reported as inventory on the balance sheet.

2. Perpetual LIFO Method

The Inventory account is constantly (or perpetually) changes under the perpetual system. When a retailer purchases goods, the retailer debits its Inventory account for the cost of the goods. When the retailer sells the goods to its customers, the retailer credits its Inventory account for the cost of the goods that were sold and debits its Cost of Goods Sold account for their cost. Instead of remaining inactive as it does with the periodic method, the Inventory account balance is continuously updated.

Under the perpetual system, two transactions are recorded at the time when the goods are sold: (1) the sales amount is debited to Accounts Receivable or Cash and is credited to Sales, and (2) the cost of the goods sold is debited to Cost of Goods Sold and is credited to Inventory. (Note: The second entry is not made under the periodic system).

With perpetual LIFO, the final costs available at the time of the sale are the first to be removed from the Inventory account and debited to the Cost of Goods Sold account. As this is the perpetual system, we cannot wait until the end of the year to determine the final cost- an entry must be recorded at the time of the sale to reduce the Inventory account and to increase the Cost of Goods Sold account.

If costs continue to increase throughout the year, then perpetual LIFO will yield a lower cost of goods sold and higher net income than periodic LIFO. Generally, this means that periodic LIFO will result in less income taxes than perpetual LIFO.

(Note: If you want to reduce the amount paid in income tax during the period of inflation, you should discuss LIFO with your tax adviser).

IN-TEXT QUESTIONS

5. __________ is an abbreviation for **L**ast **I**n, **F**irst **O**ut
6. Under the LIFO cost flow assumption, the last (or most recent) costs are the _________ to leave inventory.
7. The Inventory account is constantly (or perpetually) changes under the _______ system.
8. With perpetual LIFO, the final costs available at the time of the sale are _____to be removed from the Inventory account
9. when the retailer sells the good to its customers its Inventory account is ______and Cost of Goods Sold account is ________for the cost of the goods sold.

Problem *– From the following transactions calculate the cost of closing inventory and cost of goods sold by applying LIFO method under perpetual and periodic inventory systems respectively:*

Date	Transactions	Units	Price Per Unit (₹)
1 July 2019	Opening balance brought forward	2000	10
15 July 2019	Purchases	1000	15
31 July 2019	Purchases	800	11
1 August 2019	Sales	2400	-
15 August 2019	Sales	1000	-
16 August 2019	Purchases	800	15
30 August 2019	Sales	1000	-

Solution:

LIFO Method: (Perpetual Inventory System)

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)
01- July	-	-	-	-	-	-	2,000	10	20,000
15- July	1,000	15	15,000	-	-	- -	2,000 1,000	10 15	20,000 15,000
31-July	800	11	8,800	-	-	-	2,000 1,000 800	10 15 11	20,000 15,000 8,800
01-August	-	-	-	800 1,000 600	11 15 10	8,800 15,000 6,000	1,400	10	14,000
15-August	-	-	-	1,000	10	10,000	400	10	4,000
16-August	800	15	12,000	-	-	-	400 800	10 15	4,000 12,000
30-August	-	-	-	800 200	15 10	12,000 2,000	200	10	2,000

(i) Closing Inventory = 200 Units x ₹10 = **₹2,000**

(ii) Cost of Goods Sold = ₹29,800+₹10,000+₹14,000=**₹53,800**

LIFO Method: (Periodic Inventory System)

The Closing Inventory is 200 units, and it would be assumed to be part of the earliest purchases because goods of old costs are assumed to be sold later under LIFO method.

(i) Closing Inventory = 200 Units x ₹10 = **₹2,000**

(ii) Cost of Goods Sold = Cost of units in beginning inventory + Cost of units purchased during the period – Cost of units in ending inventory = ₹20,000 +(₹15,000+₹8,800+₹12,000)-₹2,000 = **₹53,800**

5.6 WEIGHTED AVERAGE METHOD

Weighted Average Method can be done in two ways first one is

1) **Periodic Weighted Average Method**
2) **Perpetual Weighted Average Method**

1) Periodic Weighted Average Method

Under "periodic" the inventory account is not updated, and purchases of goods are recorded in an account called Purchases. Under this cost flow assumption an average cost is calculated using the total goods available for sale (cost from the opening inventory plus the costs of all subsequent purchases made during the entire year). In other words, the periodic average cost is calculated after the end of the year- after all the purchases of the year have occurred. This average cost is then applied to the units sold during the year as well as to the units in inventory at the end of the year.

$$\text{Weighted Average Unit Cost} = \frac{\text{Total Cost of Units Available for Sale (Quantity X Cost Per Unit)}}{\text{Total Number of Units}}$$

2. Perpetual Weighted Average Method

The Inventory account is constantly (or perpetually) changes under the perpetual inventory system. When a retailer purchases the goods, the costs are debited to its Inventory account; when the retailer sells the goods to its customers the Inventory account is credited and the Cost of Goods Sold account is debited for the cost of the goods sold. Instead of staying inactive as it does with the periodic method, the Inventory account balance under the perpetual average is changed whenever a purchase or sale occurs.

Under the perpetual system, two sets of entries are made whenever goods are sold: (1) the sales amount is debited to Accounts Receivable or Cash and is credited to Sales, and (2) the cost of the merchandise sold is debited to Cost of Goods Sold and is credited to Inventory. (Note: The second entry is not made under the periodic system.)

Under the perpetual system, "average" means the average cost of the goods in inventory as of the date of the sale. This average cost is multiplied by the number of units sold and is removed from the Inventory account and debited to the Cost of Goods Sold account. We use the average as of the time of the sale because this is a perpetual method. (Note: Under the periodic system we wait until the year is over before calculating the average cost.)

The weighted average cost per unit is calculated by multiplying the prices for units in the opening inventory and in each purchase by the number of units in the beginning inventory and in each purchase and are then averaged i.e., divided by the total number of units.

IN-TEXT QUESTIONS

10. In the periodic average cost is calculated at the ______ of the year.
11. When a retailer purchases the goods, the costs are ______to its Inventory account.
12. When the retailer sells the goods to its customers the Inventory account is ________under the periodic system.)
13. Under the perpetual system, ________ means the average cost of the goods in inventory as of the date of the sale
14. Under the perpetual system, ____ sets of entries are made whenever goods are sold

5.7 PRACTICAL PROBLEMS

Problem *– From the following transactions calculate the cost of closing inventory and cost of goods sold by applying Weighted Average method under perpetual and periodic inventory systems respectively:*

Date	**Transactions**	**Units**	**Price Per Unit (₹)**
1 July 2019	Opening balance brought forward	2000	10
15 July 2019	Purchases	1000	15
31 July 2019	Purchases	800	11
1 August 2019	Sales	2400	-
15 August 2019	Sales	1000	-
16 August 2019	Purchases	800	15
30 August 2019	Sales	1000	-

Solution:

Weighted Average Method: (Periodic Inventory System)

Under periodic inventory system, weighted average cost is calculated on all the goods available for sale.

Date	Units	Unit Cost ₹	Total Cost ₹
01-Jul	2,000	10	20,000
15-Jul	1,000	15	15,000
16-Jul	800	11	8,800
31-Aug	800	15	12,000
	4600		55,800

Weighted Average Cost Per Unit = ₹55,800/ 4600 = **₹12.13**

(i) Ending Inventory = 200 X ₹12.13 = **₹24,26.09**

(ii) Cost of Goods Sold= Opening Stock (Units) + Purchases (Units) – Closing Stock (Units) = 4400units. Cost of Goods Sold = 4400 units X ₹12.13 = **₹53,372.**

Weighted Average Method: (Perpetual Inventory System)

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)	Units	Weight Cost (₹)	Amount (₹)
01- July	-	-	-	-	-	-	2,000	10.00	20,000
15 - July	1,000	15	15,000	-	-	-	3,000	11.67	35,000
31 - July	800	11	8,800	-	-	-	3,800	11.53	43,800
1- August	-	-	-	2,400	11.53	27,663	1,400	11.53	16,137
15 - August	-	-	-	1,000	11.53	11,526	400	11.53	4,611
16 - August	800	15	12,000	-	-	-	1,200	13.84	16,611
30 - August	-	-	-	1,000	13.84	13,842	200	13.84	2,768

(i) Ending Inventory = 200 X ₹13.84 = **₹2,768**

(ii) Cost of Goods Sold= ₹27,663+₹11,526+ ₹13,842 =**₹53,031**

Problem – Under perpetual inventory system, prepare Store Ledger Card (FIFO, LIFO and Average) and Comparative Cost Sheet from the following date.

Jan 01 Balance b/d	40 units	@ 22 each
Jan 03Purchases	20 units	@ 12 each
Jan 09 Sales	30 units	@ 22 each
Jan 21 Purchases	30 units	@ 32 each
Jan 25 Sales	40 units	@ 30 each
Jan 29 Purchases	10 units	@ 12 each

Solution:

Store ledger (FIFO METHOD)

Date	**Receipts (Purchases)**			**Issue (Sales)**			**Balance (Stock-in-hand)**		
	Units	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Unit Price (₹)**	**Amount (₹)**
1st January							40	22	880
3rd January	20	12	240				40 20	22 12	880 240
9th January				30	22	660	10 20	22 12	220 240
21st January	30	32	960				10 20 30	22 12 32	220 240 960
25th January				10 20 10	22 12 32	220 240 320	20	32	640
29th January	10	12	120				20 10	32 12	640 120

Store ledger (LIFO METHOD)

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)
1st January							40	22	880
3rd January	20	12	240				40 20	22 12	880 240
9th January				20 10	12 22	240 220	30	22	660
21st January	30	32	960				30 30	22 32	660 960
25th January				30 10	32 22	960 220	20	22	440
29th January	10	12	120				20 10	22 12	440 120

Store ledger (WEIGHTED AVERAGE METHOD)

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)	Units	Weight Cost (₹)	Amount (₹)
1st January							40	22.00	880.00
3rd January	20	12	240				60	18.67	1120.00
9th January				30	18.67	560	30	18.67	560.00
21st January	30	32	960				60	25.33	1520.00
25th January				40	25.33	1,013	20	25.33	506.67
29th January	10	12	120				30	20.89	626.67

Comparative Cost Sheet

Methods	Sales (₹)	COGS (₹)	Gross Profit (Sales - COGS) (₹)	Closing Stock (Units)	Purchases (₹)
FIFO	1860	1440	420	30	1320
LIFO	1860	1640	220	30	1320
Average	1860	1573	287	30	1320

Problem – Compute the gross profit earned during December and the value of stock held on 31st December; using each of the following alternatives bases of valuation: FIFO, LIFO and Weighted Average Cost using Perpetual Inventory System.

A tailor shop has the following transactions during September:

December 1 bought2,400 blouses at₹30 each

December 10bought800blouses at ₹34 each

December 12 sold 800 blouses at₹40 each

December 14 bought1,200 blouses at₹40 each

December 16 sold1,600 blouses at ₹50 each

December 20 bought 1,200 blouses at ₹50 each

December 25 sold 1,400 blouses at ₹60 each

Solution:

Sales = 800 X ₹40 + 1,600 X ₹50 + 1,400 X ₹60 **= ₹1,96,000**

FIFO (Perpetual Inventory System)

Cost of Goods Sold=800 X ₹30 + 1,600 X ₹30 + 800 X ₹34 + 600 X ₹40 = **₹1,23,200**

(i) Gross Profit = Sales – Cost of Goods Sold = ₹1,96,000 - ₹1,23,200 **= ₹72,800**

(ii)Closing Inventory = 600 X ₹40 + 1,200 X ₹50 = **₹84,000**

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)
December - 1	2,400	30	72,000				2,400	30	72,000
December-10	800	34	27,200				2,400 800	30 34	72,000 27,200

December-12				800	30	24,000	1,600 800	30 34	48,000 27,200
December - 14	1,200	40	48,000				1,600 800 1,200	30 34 40	48,000 27,200 48,000
December - 16				1,600	30	48,000	800 1,200	34 40	27,200 48,000
December - 20	1,200	50	60,000				800 1,200 1,200	34 40 50	27,200 48,000 60,000
December - 25				800 600	34 40	27,200 24,000	600 1,200	40 50	24,000 60,000

LIFO (Perpetual Inventory System)

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)
December -1	2,400	30	72,000				2,400	30	72,000
December - 10	800	34	27,200				2,400 800	30 34	72,000 27,200
December - 12				800	34	27,200	2,400	30	72,000
	1,200	40	48,000				2,400	30	72,000

December - 14							1,200	40	48,000
December - 16				1,200 400	40 30	48,000 12,000	2,000	30	60,000
December - 20	1,200	50	60,000				2,000 1,200	30 50	60,000 60,000
December - 25				1,200 200	50 30	60,000 6,000	1,800	30	54,000

<u>Cost of Goods Sold</u>=800 X ₹34 + 1,200 X ₹40 + 400 X ₹30 + 1,200 X ₹50 + 200X ₹30 = **₹1,53,200**

(i) <u>Gross Profit</u> = Sales – Cost of Goods Sold = ₹1,96,000 - ₹1,53,200 **= ₹42,800**

(ii) <u>Closing Inventory</u> = 1,800 X ₹30 = **₹54,000**

Weighted Average (Perpetual Inventory System)

Date	**Receipts (Purchases)**			**Issue (Sales)**			**Balance (Stock-in-hand)**		
	Units	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Weight Cost (₹)**	**Amount (₹)**
December - 1	2,400	30	72,000				2,400	30	72,000
December - 10	800	34	27,200				3,200	31	99,200
December - 12				800	31	24,800	2,400	31	74,400
December - 14	1,200	40	48,000				3,600	34	1,22,400
December - 16				1,600	34	54,400	2,000	34	68,000
December - 20	1,200	50	60,000				3,200	40	1,28,000

December - 25				1,400	40	56,000	1,800	40	72,000

<u>Cost of Goods Sold</u>=800 X ₹31 + 1,600 X ₹34 + 1,400 X ₹40 = **₹1,35,200**

(i) <u>Gross Profit</u> = Sales – Cost of Goods Sold = ₹1,96,000 - ₹1,53,200 **= ₹60,800**

(ii) <u>Closing Inventory</u> = 1,800 X ₹40 = **₹72,000**

Problem–For the below mentioned data, calculate the value of closing stock of raw materials on 31st March 2019 according to

(i) Last -In-First-Out Method

(ii) Weighted Average Basis, using perpetual inventory system.

A company started its business on 1st April 2019. It purchased and used raw material during the year 2019 as stated below:

April 10, 1600, Kgs @ ₹60 per Kg.

May 15 2,400 Kgs @ ₹55 per Kg.

June 10 Issued 2,000 Kgs.

June 15 Issued 1,000 Kgs.

July 25 1,800 Kgs @₹65 per Kg.

August 12 Issued 1,200 Kgs.

Solution:

Last -In-First-out Method (Perpetual Inventory System)

Date	**Receipts (Purchases)**			**Issue (Sales)**			**Balance (Stock-in-hand)**		
	Units	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Unit Price (₹)**	**Amount (₹)**
April 10	1,600	60	96,000				1,600	60	96,000
May 15	2,400	55	1,32,000				1,600 2,400	60 55	96,000 1,32,000
June 10				2,000	55	1,10,000	1,600 400	60 55	96,000 22,000
June 15				400 600	55 60	22,000 36,000	1,000	60	60,000
	1,800	65	1,17,000				1,000	60	60,000

July 25							1,800	65	1,17,000
August 12				1,200	65	78,000	1,000 600	60 65	60,000 39,000

Value of Closing Stock =1000 X ₹60 + 600 x ₹65 =**₹99,000**

Weighted Average Basis (Perpetual Inventory System)

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount	Units (₹)	Weight Cost	Amount (₹)
April 10	1,600	60	96,000				1,600	60.00	96,000
May 15	2,400	55	1,32,000				4,000	57.00	2,28,000
June 10				2,000	57.00	1,14,000	2,000	57.00	1,14,000
June 15				1,000	57.00	57,000	1,000	57.00	57,000
July 25	1,800	65	1,17,000				2,800	62.14	1,74,000
August 12				1,200	62.14	74,571	1,600	62.14	99,429

Value of Closing Stock =1600 X ₹62.142857 =**₹99,429**

Problem –The following are the inventory details of Sri Mils for the month of October 2019. Prepare Stores Ledger Account and calculate value of closing stock as per FIFO and LIFO method under perpetual system of inventory valuation. (B. Com (P) Delhi -2015)

Date	Transactions	Units	Price per Unit (₹)
1-October	Opening Stock	1100	30
7-October	Purchases	700	32
15-October	Issued for Consumption	600	-
16-October	Purchases	500	35
20-October	Issued for Consumption	1300	-
29-October	Purchases	750	37
31-October	Issued for Consumption	475	-

Solution:

FIFO METHOD (Perpetual Inventory System)

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)
1-October							1,100	30	33,000
7-October	700	32	22,400			-	1,100 700	30 32	33,000 22,400
15-October				600	30	18,000	500 700	30 32	15,000 22,400
16-October	500	35	17,500			-	500 700 500	30 32 35	15,000 22,400 17,500
20-October				500 700 100	30 32 35	15,000 22,400 3,500	400	35	14,000
29-October	750	37	27,750				400 750	35 37	14,000 27,750
31-October				400 75	35 37	14,000 2,775	675	37	24,975

<u>Value of Closing Inventory</u>= 675 x ₹37 = **₹24,975**

LIFO METHOD (Perpetual Inventory System)

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)
1-October							1,100	30	33,000
7-October	700	32	22,400			-	1,100 700	30 32	33,000 22,400
15-October				600	32	19,200	1,100 100	30 32	33,000 3,200
	500	35	17,500			-	1,100	30	33,000

16-October							100 500	32 35	3,200 17,500
20-October				500 100 700	35 32 30	17,500 3,200 21,000	400	30	12,000
29-October	750	37	27,750				400 750	30 37	12,000 27,750
31-October				475	37	17,575	400 275	30 37	12,000 10,175

Value of Closing Inventory= 400 x ₹30+ 275 x ₹37 = **₹22,175**

Problem –From the following data, prepare the stores ledger account as per the Perpetual Inventory System and calculate the value of closing inventory on March 31,2019 using:

(i) Last-In-First Out Method; and
(ii) Weighted Average Cost Method

(B. Com (P) Delhi -2016)

March 1 Opening Stock 400 Units @ ₹7.50 each

Purchase

March 5, 600 Units @ ₹8.00 each

March 15, 500 Units @ ₹9.00 each

March 21, 400 Units @ ₹8.50 each

Issues

March 5, 300 Units

March 10, 500 Units

March 21, 400 Units

Solution:

LIFO METHOD (Perpetual Inventory System)

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)
March 1							400	7.50	3,000
March 3				300	7.50	2,250	100	7.50	750
March 5	600	8.00	4,800			-	100 600	7.50 8.00	750 4,800
March 10				500	8.00	4,000	100 100	7.50 8.00	750 800
March 15	500	9.00	4,500				100 100 500	7.50 8.00 9.00	750 800 4,500
March 17				400	9.00	3,600	100 100 100	7.50 8.00 9.00	750 800 900
March 21	400	8.50					100 100 100 400	7.50 8.00 9.00 8.50	750 800 900 3,400

<ins>Value of Closing Stock</ins> = ₹750+₹800+₹900+₹3,400 =**₹5,850**

WEIGHTED AVERAGE COST METHOD (Perpetual Inventory System)

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)	Units	Weight Cost (₹)	Amount (₹)

March 1							400	7.50	3,000
March 3				300	7.50	2,250	100	7.50	750
March 5	600	8.00	4,800			-	700	7.93	5,550
March 10				500	7.93	3,964	200	7.93	1,586
March 15	500	9.00	4,500				700	8.69	6,086
March 17				400	8.69	3,478	300	8.69	2,608
March 21	400	8.50	3,400				700	8.58	6,008

Value of Closing Stock = **₹6,008**

Problem –Receipts and issue of certain units of goods in ABC Ltd. for the month of September 2017 are given below:

Date	**Particulars**
1st September 2017	Opening balance 350 units @ ₹30 each
4th September 2017	Purchase 115 units @ ₹35 each
6th September 2017	Issue 250 units
9th September 2017	Issue 125 units
15th September 2017	Purchase 575 units @ ₹20 each
19th September 2017	Issue 400 units
26th September 2017	Purchase 180 units @ ₹50 each
29th September 2017	Issue 65 units

You are required to find out the value of closing stock and cost of goods sold (COGS) for the month of September 2017, by using perpetual system of recording of inventory and following methods of valuation of inventory.

a. FIFO method
b. Weighted Average Price method ***(B. Com(P)-Delhi 2017)***

Solution:

FIFO Method (Perpetual Inventory System)

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)
1st September							350	30.00	10,500
4th September	115	35	4,025				350 115	30.00 35.00	10,500 4,025
6th September				250	30.00	7,500	100 115	30.00 35.00	3,000 4,025
9th September				100 25	30.00 35.00	3,000 875	90	35.00	3,150
15th September	575	20.00	11,500				90 575	35.00 20.00	3,150 11,500
19th September				90 310	35.00 20.00	3,150 6,200	265	20.00	5,300
28th September	180	50.00	9,000				265 180	20.00 50.00	5,300 9,000
29th September				65	20	1,300	200 180	20.00 50.00	4,000 9,000

Value of Closing Stock= **₹13,000**

Cost of Goods Sold = ₹7,500+ ₹3,875+ ₹9,350+₹1,300 = **₹22,025**

Weighted Average Price Method (Perpetual Inventory System)

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)
1st September							350	30.0000	10,500
4th September	115	35	4,025				465	31.2366	14,525
6th September				250	31.24	7,809	215	31.2366	6,716
9th September				125	31.24	3,905	90	31.2366	2,811
15th September	575	20.00	11,500				665	21.5207	14,311
19th September				400	21.52	8,608	265	21.5207	5,703
26th September	180	50.00	9,000				445	33.0404	14,703
29th September				65	33	2,148	380	33.0404	12,555

Value of Closing Stock= **₹12,555**

Cost of Goods Sold = ₹7,809+ ₹3,905+ ₹8,608+ ₹2,148 = **₹22,470**

Problem –Akshita limited started its business on 1st January 2015. It purchased and used raw material during the month of January in 2015 as follows:

1 January: Opening Stock 500 kgs @ ₹60 per kg

5 January: Purchased 800 kgs @ ₹62 per kg

10 January: Issued 600 kgs

12 January: Purchased 1,200 kgs @ ₹57 per kg

18 January: Issued 1000 kgs

21 January: Issued 500 kgs

25 January: Purchased 900 kgs @ ₹65 per kg

28 January: Issued 800 kgs

Calculate the value of closing stock according to LIFO, FIFO and Weighted Average basis, using perpetual inventory system. (B.COM (P) Delhi – 2018)

Solution:

Store Ledger - LIFO Method (Perpetual Inventory System)

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)	Units	Unit Price (₹)	Amount (₹)
1st January							500	60	30,000
5th January	800	62	49,600				500 800	60 62	30,000 49,600
10th January				600	62	37,200	500 200	60 62	30,000 12,400
12th January	1,200	57	68,400				500 200 1,200	60 62 57	30,000 12,400 68,400
18th January				1,000	57	57,000	500 200 200	60 62 57	30,000 12,400 11,400
21st January				200 200 100	57 62 60	11,400 12,400 6,000	400	60	24,000
25th January	900	65	58,500				400 900	60 65	24,000 58,500
28th January				800	65	52,000	400 100	60 65	24,000 6,500

<u>Value of Closing Stock</u> = 400 X ₹60 + 100X ₹65 = **₹30,500**

Store Ledger - FIFO METHOD (Perpetual Inventory System)

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Unit Price (₹)**	**Amount (₹)**
1st January							500	60	30,000
5th January	800	62	49,600				500 800	60 62	30,000 49,600
10th January				500 100	60 62	30,000 6,200	700	62	43,400
12th January	1,200	57	68,400				700 1,200	62 57	43,400 68,400
18th January				700 300	62 57	43,400 17,100	900	57	51,300
21st January				500	57	28,500	400	57	22,800
25th January	900	65	58,500				400 900	57 65	22,800 58,500
28th January				400 400	57 65	22,800 26,000	500	65	32,500

Value of Closing Stock = 500 Units @₹65 per unit = **₹32,500**

Store Ledger - WEIGHTED AVERAGE (Perpetual Inventory System)

Date	Receipts (Purchases)			Issue (Sales)			Balance (Stock-in-hand)		
	Units	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Weight Cost (₹)**	**Amount (₹)**
1st January							500	60.00	30,000
5th January	800	62	49,600				1,300	61.231	79,600
10th January				600	61.231	36,738	700	61.231	42,862
12th January	1,200	57	68,400				1,900	58.559	1,11,262
18th January				1,000	58.559	58,559	900	58.559	52,703
21st January				500	58.559	29,279	400	58.559	23,423
25th January	900	65	58,500				1,300	63.018	81,923
28th January				800	63.018	50,414	500	63.018	31,509

Value of Closing Stock = 500 Units @₹63.018 per unit = **₹31,509**

Problem – Compute using perpetual inventory system:

(i) ***the gross profit earned during December and***

(ii) ***the value of stock held on 31st December; using each of the following alternative bases of valuation: FIFO, LIFO and Weighted Average Cost***

A tailor shop has the following transactions during December:

December 1 bought 1,000 suits at ₹20 each

December 10 bought 200 suits at ₹25 each

December 12 sold 200 suits at ₹30 each

December 14 bought 400 suits at ₹40 each

December 16 sold 600 suits at ₹30 each

December 20 bought 800 suits at ₹40 each

December 25 sold 1000 suits at ₹50 each

Solution:

Sales = 200 X₹30 +600 X ₹30 + 600 X ₹50 =**₹74,000**

FIFO Method (Perpetual Inventory System)

Date	**Receipts (Purchases)**			**Issue (Sales)**			**Balance (Stock-in-hand)**		
	Units	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Unit Price (₹)**	**Amount (₹)**
1st December	1,000	20	20,000				1,000	20	20,000
10th December	200	25	5,000				1,000 200	20 25	20,000 5,000
12th December				200	20	4,000	800 200	20 25	16,000 5,000
14th December	400	40	16,000				800 200 400	20 25 40	16,000 5,000 16,000
				600	20	12,000	200 200	20 25	4,000 5,000

16th December							400	40	16,000
20th December	800	40	32,000				200 200 400 800	20 25 40 40	4,000 5,000 16,000 32,000
25th December				200 200 400 200	20 25 40 40	4,000 5,000 16,000 8,000	600	40	24,000

<u>Closing Stock</u>= 600 units X ₹40 = **₹24,000**

<u>Cost of Goods Sold</u>=₹4,000 + ₹12,000 + ₹33,000 =**₹49,000**

<u>Gross Profit</u> = Sales – Cost of Goods Sold= ₹74,000 - ₹49,000 = **₹25,000**

LIFO Method (Perpetual Inventory System)

Date	**Receipts (Purchases)**			**Issue (Sales)**			**Balance (Stock-in-hand)**		
	Units	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Unit Price (₹)**	**Amount (₹)**
1st December	1,000	20	20,000				1,000	20	20,000
10th December	200	25	5,000				1,000 200	20 25	20,000 5,000
12th December				200	25	5,000	1,000	20	20,000

14th December	400	40	16,000				1,000 400	20 40	20,000 16,000
16th December				400 200	40 20	16,000 4,000	800	20	16,000
20th December	800	40	32,000				800 800	20 40	16,000 32,000
25th December				800 200	40 20	32,000 4,000	600	20	12,000

<u>Closing Stock</u>= 600 units X ₹20 = **₹12,000**

<u>Cost of Goods Sold</u>=₹5,000 + ₹20,000 + ₹36,000 =**₹61,000**

<u>Gross Profit</u> = Sales – Cost of Goods Sold= ₹74,000 - ₹61,000 = **₹13,000**

WEIGHTED AVERAGE Method (Perpetual Inventory System)

Date	**Receipts (Purchases)**			**Issue (Sales)**			**Balance (Stock-in-hand)**		
	Units	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Unit Price (₹)**	**Amount (₹)**	**Units**	**Unit Price (₹)**	**Amount (₹)**
1st December	1,000	20	20,000				1,000	20.00	20,000
10th December	200	25	5,000				1,200	20.83	25,000
12th December				200	20.83	4,167	1,000	20.83	20,833
14th December	400	40	16,000				1,400	26.31	36,833

16th December				600	26.31	15,786	800	26.31	21,048
20th December	800	40	32,000				1,600	33.15	53,048
25th December				1,000	33.15	33,155	600	33.15	19,893

Closing Stock= 600 units X ₹33.15 = **₹19,893**

Cost of Goods Sold=₹4,167 + ₹15,786 + ₹33,155 =**₹53,107**

Gross Profit = Sales – Cost of Goods Sold= ₹74,000 - ₹53,107 = **₹20,893**

5.8 SUMMARY

In this chapter of Inventory valuation, we have studied the methods of inventory valuation i.e. First -In-First-Out, Last -In-First-Out and Weighted Average Cost. Various solved questions have also been discussed in detail in this chapter.

5.9 GLOSSARY

Inventory: A complete list of goods that a business has for sale at a given time.

"FIFO": It is an abbreviation for First In, First Out. Under the FIFO cost flow assumption, the first (oldest) costs are the first ones to depart from inventory

"**LIFO**": It is an abbreviation for **L**ast **I**n, **F**irst **O**ut. Under the LIFO cost flow assumption, the last (or most recent) costs are the first ones to leave inventory.

Cost of goods sold: It is usually the largest expense on the income statement of a company selling products or goods.

5.10 ANSWERS TO IN-TEXT QUESTIONS

1. Periodic 2. FIFO 3.Inventory 4. Cr., Dr 5. LIFO 6. First one 7. Perpetual 8. First	9. Cr., Dr. 10. End 11. Debited 12. Credited 13.Average 14. Two

5.11 SELF-ASSESSMENT QUESTIONS

1. Which of the following method of inventory is the most appropriate for a business that deals in a precious metal such as gold?
   a) Periodic Inventory System
   b) Perpetual Inventory System
2. What is the sum of Opening Inventory and Net Purchases?
   a) Ending Invent Closing Stock
   b) Cost of goods manufactured
   c) Cost of goods available for sale
3. What is Cost of goods available for sale less Closing Inventory?
   a) Opening Inventory
   b) Work In process
   c) Cost of goods sold
4. The weighted average cost method under a perpetual inventory system is called.
   a) Moving average cost method
   b) Residual method
   c) Arithmetic cost method
5. Weighted average method for inventory valuation is permissible under which of the following?
   a) IFRS only
   b) US GAAP only
   c) Both IFRS and US GAAP
6. Weighted average method is same as which of the following?
   a) FIFO method
   b) LIFO method
   c) None of the above
7. The cost of goods available for sale can be calculated by which of the following?
   a) Opening stock + Purchases – Closing Stock
   b) Opening stock + Purchases

`c) Closing stock + Purchases

8. The final result under periodic FIFO is same as under the perpetual FIFO?

   a) No

   b) Yes

[Answers: 1 (b), 2 (c), 3 (c), 4 (a), 5(c), 6 (c), 7 (a), 8 (b)]

5.12 SUGGESTED READINGS

- *Monga, J R. Financial Accounting: Concept and Applications. Mayur Paper Backs, New Delhi*
- *Goyal, Bhushan Kumar and H.N. Tiwari, Financial Accounting, Taxmann*

UNIT III

LESSON 6

ACCOUNTS FROM INCOMPLETE RECORDS: SINGLE ENTRY SYSTEM

STRUCTURE

6.1 LEARNING OBJECTIVES

- To Understand the meaning and Definition of Single-entry System of bookkeeping
- To convert single entry into double entry
- To Understand the Preparation of Trading and Profit and Loss *Ale* from Single Entry Records.

6.2 INTRODUCTION

Single entry system of bookkeeping is something which only affects one account. A transaction can only increase or decrease the value of account unlike the credit and debit in the double entry system.

In the single-entry system, a cashbook is maintained to record all the receipts and payments made in cash.

Here the personal accounts of creditors and debtors are also being managed. The current chapter talks in detail about the financial statements maintained under the single-entry system.

6.3 MEANING AND DEFINITION OF SINGLE-ENTRY SYSTEM OF BOOKKEEPING

Single entry system of book-keeping is not a system at all. It means recording transactions not according to well defined rules but according to mere convenience. Under the Double Entry System, a transaction must be recorded with both the aspects. If there is debit, there must be a credit and *vice-versa*. It is not under the single-entry system. Debit and credit may be completed in transactions, while no record at all may be there in respect of a number of transactions. Most transactions are recorded only once without completed double entry. It is all a matter of convenience. Accounts are not maintained. While there is no hard and fast rule; usually only the cash account, bank (sometimes the passbook is treated as sufficient for this purpose) and personal account (that is, account of customers and creditors) are kept. Generally, there will be no accounts to show purchases, sales, assets, incomes and losses and expenses.

Disadvantages: This Single-Entry system has the following disadvantages:

1. Since there is no trail balance, there is no proof of accuracy.
2. Profit or losses cannot be ascertained properly because of lack of information about purchases, sales, expenses, etc.
3. Since accounts relating to assets (furniture, office equipment, etc.) are not maintained, there is no control over such assets. This may result in wastages and misappropriation.
4. The Balance Sheet (called Statement of Affairs here) can be prepared only with difficulty and that loo without sufficient accuracy.
5. Useful comparison for the guidance of management cannot be made because relevant information will generally be missing.

Joint stock companies cannot keep books on the Single-Entry System under law, but sole proprietorships and partnerships may, if they so wish, adopt this system. But unless the firm is very small, it is not desirable to do so.

How to ascertain profit? Ascertainment of-profit or loss under this system is really simple. "Suppose I start a business on 1st January 2002 with Rs. 20,000. On 31st December 2002 I find that may capital is Rs.25,000 (for finding out capital see below). This surely means that I have made a profit ofRs.5,000, the capital could not have grown otherwise. But suppose I brought an additional Rs.4,000 as capital during the year. This explains the increases in capital to this extent. This brings down the profit to Rs. 1,000. One thing more I must have drawn some money for private use. Suppose the figure is Rs.500 per month or Rs.6,000 for the year. Had this money not been drawn, the capital would have been Rs.31,000 and the profit earned would have been Rs.7,000. The formula to find out profit, therefore, is:

		Rs.
Capital at the end of the year		25,000
Add: Drawings during the year		6,000
		31,000
Less: Flesh Capital introduced	4,000	
Capital in the beginning of the year	20,000	24,000
Profit during the year		7,000

IN-TEXT QUESTIONS

1. Since there is no_______________, there is no proof of accuracy.
2. ____________cannot be ascertained properly because of lack of information about purchases, sales, expenses, etc.
3. Since accounts relating to assets (furniture, office equipment, etc.) are not maintained, there is no control over such assets. This may result in__________.
4. Bookkeeping began with the entry of all transactions into one book which recorded the details of transactions. True/False
5. Journal is the most important to all the subsidiary books. True/False.

6.4 HOW TO ASCERTAIN CAPITAL

Capital is really assets minus liabilities. Under the Single-Entry System also, capital is ascertained in this manner. Statement of Affairs (not at all different from balance sheet) is prepared and assets and liabilities put on the proper sides. The difference between assets and liabilities is capital. Personal account and cash account are usually maintained and hence the amount of sundry debtors, cash balance, bank balance and sundry creditors will be readily available. The amount of other assets can be ascertained only by physical inspection.

Statement of Profit for the year ending on......

			Rs.
Capital at the end			
	Add :	Drawings during the year	
	Less :	Additional Capital introduced during the year	
(A)		Adjusted Capital at the end of the year ...	
(B)		Less : Capital at the beginning ...	
		Profit or loss...	

Illustration-1

A keep his books by single entry system. From the following information find out the profit earned by him during 2002

	Rs.	Rs.
Bank Balance	740 (Cr.)	400 (Dr.)
Cash in hand	....	10
Debtors	5,300	8,800
Creditors	1,500	1,950
Stock	1,700	1,900
Plant	2,000	2,000
Furniture	140	140

On 30th, June, A brought in Rs. 600 as additional capital and without Rs. 300 for private use. A provision for doubtful debts 5% is necessary. plant and Furniture are subject to depreciation 5% interest on capital is to be changed at 5%.

Solution.

Statement of Affairs as at 1st January, 2002

Liabilities	Rs.	Assts	Rs.
Bank overdraft	740	Sundry Debtors	5300
Sundry Creditors	1.500	Stock	1700
Capital (Balancing figure)	6.900	Plant	2000
		Furniture	140
Total	9,140	Total	9,140

Statement of Affairs as at 31st December, 2002

Liabilities	Rs.	Assts		Rs.
Sundry Creditors	1,950	Cash in Hand		10
Capital (Balancing Firure)	10,753	Cash at Bank		400
		Sundry Debtor	8,800	

		Less Provision for doubtful debts 440		8,360
		stock		1,900
		Plant	2,000	
		Less Depreciation	100	1,900
			......	
		Furniture	140	
		Less Depreciation	7	133
Total	12,703	Total		12,703

		Rs.
Profit : Capital as al Dec . 3 1 , 2002		10,753
Add: Drawings		300
		11,053
Less: Fresh Capital	600	
Capital on 1- 2002	6.900	
Interest	360*	7,860
Profit earned		3,193

IN-TEXT QUESTIONS

6. The Balance Sheet _____________ can be prepared only with difficulty and that loo without sufficient accuracy.
7. Useful comparison for the guidance of management cannot be made because___________
8. Purchase book is "used to record only credit purchases of goods, i.e., to record credit purchases of those commodities only in which the firm deals. True/False
9. Sales Returns Book is used for the purpose of recording returns of all goods sold. True/False
10. Usually, the business firms do not record entries for bills receivables in the journal' 'but where they receive a large number of bills during a year, a Bills Receivable Book is used for dealing' 'with bills drawn or received. True/False.

6.5 CONVERSION INTO DOUBLE ENTRY

Conversion into Double Entry. If the books are maintained on Single Entry basis, they can be converted into double entry basis but with good deal of effort. Assuming that accounts of cash, bank, customers and suppliers have been maintained, the following steps will be necessary:

1. Take the statement of affairs at the end of previous year. Open all accounts (except those already opened) with proper balances.
2. Go through the cash book (or cash and bank accounts). Excepting transaction, with customers and suppliers (this transaction must have been posted already) others should be posted to proper accounts.
3. Analyse all personal accounts (a) Analysis of accounts of customers will reveal the following: -

	Entry Now
Credit Sales	Credit Sales Ale
Bills Dishonoured	Credit *BIR* Ale
Charges debited to them	Credit Charges Ale
Cash recieved	Debit Cash Ale
Discount allowed to	Debit Discount Ale
them Sales Returns	Debit Sales Return Ale
Bad Debts written off	Debit Bad Debts Ale
Bills Receivable received	Debit Bills Rceivable Ale

** Interest on Rs. 6.900for one year and on Rs. 600for 6 months.*

(b) Analysis of accounts of suppliers will reveal the following: Entry now

Credit Purchases Debit Purchases A/c

Bills Payable Dishonored	Debit Bills Receivable A/c
Cash Paid	Credit Cash A/c
Purchase Returns	Credit Returns Outwards A/c
Discount Received	Credit Discount A/c
Bills Payable issued	Credit Bills Payable A/c

6.6 HOW TO GO THROUGH THE WASTE BOOK AND SEE IF ANY TRANSACTION STILL

1. Go through the waste book and see if any transaction still remains to be recorded. For instance, interest may be due on loan. The entry to be passed is:

4. Go through the waste book and see if any transaction still remains to be recorded.
For instance, interest may be due on loan. The entry to be passed is:

Interest A/c To Loan Creditor	...	....	Dr.

3.6 Preparation of Trading and Profit and Loss A/c From Single Entry Records.

If Single Entry books have been converted into Double Entry books, a trial balance can then be taken out. From the trial balance, final accounts can be easily prepared. However, a short cut is also possible. This short cut will be available only of the summary of cash transaction is prepared.

Students will remember that for preparing the Trading Account the following information is necessary:

Opening Stock	(available form previous statement of affairs.)
Purchases	(always ascertained by making an inventory.)
Wages, etc.	
Sales	
Closing Stock	

Purchase and sales are ascertained on common sense basis. If I owe Rs. 50/- to the grocer on 1st April, pay him Rs.90 during the month and still owe him Rs. 40 at the end of the month. I must have purchased from him goods for Rs. 80, i.e., Rs. (90+40) -50. Similarly, the grocer can calculate the sale to me.

In business firms credit purchases and credit sales are found by preparing accounts of total Creditors and total Debtors. Consider the Following:

Dr. Total Creditors A/c Cr.

	Rs.		Rs.
ToCash (as per CashBook)	43,000	By Balance c/d (given as per previous Statement of affairs)	9,000
To Discounts (as per analysis)	800		
To Returns	1,100	By Credit Purchases (balancing figure)	44,000
To Balance c/d (as per schedule of Creditors)	8,500		
	53,400		53,400

Items on the debit side total Rs. 53400 of this Rs. 9000 is the opening balance. Therefore, the balancing figure or Rs. 44400 must be the credit purchases. Cash purchases must have been recorded on the credit side of the Cash Book and will be taken form there. Thus, total purchases can be found out.

Can you find out the credit sales from the following?

	Rs.
Total Debtors on Ist Jan. 2002	15,600
Cash Received during 2002 form Drs.	68,200
Discount allowed to them	1,800
Bad Debts written off	600
Returns Inwards	2,500
Bills Reveivable received form them	11,000
Bills Dishonoured	1,500
Total Debtors on Ist Dec., 2002	14,300

Make the total debtors A/c. The debit side will be short: The balancing figure will be credit sales. Thus–

Dr. Total Debtors Account Cr.

			Rs.		Rs.
To Balance b/d	15,600	By Cash	68,200
To B/R (Dishonoured)	1,500	By Discount	1,800
To Credit Sales		By Bad Debts	600
(Balancing figure)	81,300	By Return Inwards	2,500
		By B/R	11,000
		By Balance c/d	14,300
	98,400		98,400
To Balance b/d	14,300		

Cash sales will be on the debit side of the Cash Book. Credit Sales plus Cash Sales give you total sales. Examination of the credit side of the Cash Book will also reveal wages, carnage inwards, etc., which will be debited to the Trading Account.

Thus, all information to prepare Trading Account becomes available and gross profit will be ascertained. This is put on the credit side of the Profit and Loss Account. Credit side of the Cash Book reveals expenses. These expenses after proper adjustments (for expenses prepaid or outstanding) will be debited to the Profit and Loss Ale. Debit side of the Cash Book will reveal income (such as sale of old newspapers.) These will be put on the credit side of the Profit and Loss Ale. The profit and Loss Ale should also be debited with any depreciation which has to be written off. Thus, net profit or net loss can be ascertained. Thus, will be transferred to the Capital Account.

6.7 BALANCE SHEET

Balance sheet at the end of the year. The balance for cash, debtors, slock and creditors will be given as at the end of the year. These will put down in the Balance Sheet. Capital will be as per previous Statement of Affairs adjusted for net profit or net loss and drawings (see credit side of Cash Book).

Illustration: 2

The following information is given:

	1st January, 2002	31st December, 2002
	Rs.	Rs.
Total Debtors	19,300	20,500
Total Creditors	9,800	8,100
Stock	11,600	12,300
Plant and Machinery	30,000	—
Furniture	1,500	—

Summary of Cash Book

	Rs.		Rs.
To Balance b/d	5,000	By S. Creditors	31,000
To Receive From Debtors	78,000	By Wages	15,000
To Cash Sales	15,000	By Salaries	12,000
To Sales of Old Machinery	4,000	By Machinery	10,000
To Sales of Old Packing Boxes	600	By Investments	6,000
		By Drawings	6,000
		By General Exps.	17,000
		By Balance c/d	5,600
	1,02,600		1,02,600

Bad Debts written off during the year were Rs. 1500. Discount allowed were Rs. 2000 and received were Rs. 600. Depreciation on Machinery is to be 10% on the value of machinery on 31st December 2001. Furniture is to be depreciated at 5%. Interest @6% is to be allowed on capital.

Prepare Trading Account, Profit and Loss Account for 2002 and Balance Sheet as at December 31,2002

Solution:

We must first find

(1) Capital in the beginning,

(2) Credit Sales and

(3) Credit Purchases.

Statement of Affairs as at 1st January,2002

Liabilities	Rs.	Assets	Rs.
Sundary Creditors	9,800	S.Debtors	19,300
Capital (Balancing Figure)	57,600	Stock	11,600
		Plant and Machinery	30,000
		Furniture	1,500
		Cash	5,000
	67,400		67,400

(2) Credit Sales:

Total Debtors Account

Dr.	Rs.		Cr. Rs.
To Balance b/d	19300	By Cash	78000
To Credit Sales		By Bad Debts A/c	1500
(Balancing Figure)		By Discounts	2000
		By Balance c/d	20500
	1,02,000		1,02,000
To Balance b/d	20500		

(3) Credit Purchases:

Total Creditors Account

Dr.	Rs.		Cr. Rs.
To Cash	31,000	By Balance b/d	9,800
To Discounts recd.	600	By Credit Purchases	
To Balance c/d	8,100	(Balancing figure)	29,900
	39,700		39,700
		By Balance b/d	8,100

Trading and Profit and Loss Account
for the year ending Dec. 31,2002

Dr.	Rs.			Cr. Rs.
To Opening Stock	11,6000	By Sales:		
To Purchases	29,900	Credit	82,700	
To Wages	15,000	Cash	15,000	97,700
To Gross Profit c/d	53,500	By Closing Stock		12,300
	1,10,000			1,10,000
To Salaries	12,000	By Gross Profit b/d		53,500
To General Expenses	17,000	By Sale of Old Packing boxes		
600				
To Discount allowed	2,000	By Discount Recd		600
To Bad Debts	1,500			
To Depreciation				
Machinery–				
10%on Rs. 36,000	3,600			
Furniture–				
5%on Rs. 1,500	75			
To Interest on Capital–				
6% on Rs. 57,600	3,456			
To Net profit–				
Transferred to Capital A/c	15,069			
Total	54,700		Total	54,700

Balance Sheet of
as at December 31, 2002

Liabilities		Rs.	Assets		Rs.
Sudry Creditors		8100	Cash		5,600
Capital			Sundry Debtors		20,500
Balance on I-2002	57,600		Stock		12,300
			Investments		6,000
Add Interest	3,456		Furniture	1,500	
Profit	15,069		Less Depreciation	75	1,425
			Plant and Machinery		
	76,125		Balance on 1-2002	30,000	
Less Drawing	6,000		Additions	10,000	
				40,000	
		70125	Less Sales	4,000	
				36,000	
			Less Sales	4,000	
				36,000	
			Less Depreciation		
			@10%	3,600	
					32,400
Total		78,225	Total		78,225

Illustration: 3

A and B share profits and losses in the raito of 3:2. Prepare Trading Ale: Profit and Loss Ale and Balance Sheet from the following:

l. Cash Book: Bank Balance on 1st Jan. 2001 Rs. 8000: A's drawing 9000: B's drawing Rs. 6000 paid to trade creditors. Rs. 60,000. paid against B/P Rs. 16,000: Wages Rs. 22,000: Salaries Rs. 10,000; Other trade expenses, Rs. 26,51 O; Received from trade debtors. Rs. 91,200; Received against B/P 16,090; Receipts from cash sales 31,620: cash in hand. Rs. 400. (On 31st December 2002). There was no cash in hand on 1st Jan. 2002

2. Particulars of Assets and Liabilities

	1.1.2001 Rs.	31.12.2002 Rs.
A/s Capital	80,000	?
B's Capital	20,000	?
Stock	39,600	50,000
Creditors	50,000	38,710
Debtors	44,000	14,000
B/R	10,000	14,000
B/P	6,000	nil
Premises	40,000	40,000
Furniture	2,400	2,400

2. Other Information: A and B will pay interest on drawing as Rs. 120 and Rs. 60. A and B are entitled to 5% interest on capital. B will get 6% Commission on the net profits remaining after such commission.

Allow 5% depreciation on premises and furniture and create a reserve for bad debts amounting Rs. 2650.

Trading and Profit and Loss A/c
for the year ending Dec. 31, 2002

	Rs.	Rs.		Rs.	Rs.
			By sales:		
To Stock		39,600	Credit	1,00,000	
To Purchases		4,0000	Cash	31,620	1,31,620
To Wages		22,000		....	
To Gross Profit c/d		80,020	By Clsing Stock		50,000
		1,81,620			1,81620
To Salaries		10000	By Gross profit b/d		80,020
To Trade Exp.		26,510	By Interest on Drawings:		
			By Dep: A	120	
Premises	2000		B	60	180
Furniture	120	2,120			
To Reserve for bad debts		2,650			
To Int. On Cap:					

A	4000			
B	1,000	5,000		
To B/s Commission				
33920 6 / 106		1,920		
To Net Profit				
A	19,200			
B	12,800	32,000		
		80,200		80,200

Balance Sheet of A & B, Ason Dec. 31, 2002

Liablities			Rs.	Assts			Rs.
Creditors			14,000	Stock			50,000
Bank overdraft			3,000	Debtors	38,710		
	A	B		Less provision 2,650			36,060
Cap. A/c	80,000	20,000					
+Int.	4,000	1,000		B/R			14,000
+Net Profit	19,200	12,800		Cash			400
	1,03,200	33,800		Premises		40,000	
+Commission		1,920		Less dep.		2,000	38,000
	1,03,200	35,720		Furniture		2,400	
	9000	6000					
Less Drawings	94200	29720		Less depreciation		120	2,280
Less Int. on			94,080				
	120	60	29660				
Draw.	94080	29660	140740	Less depreciation			1,40,740

Working notes:

Cash A/c

	Rs.		Rs.
To Balance	8,000	By A/s Drawings	9,000
To Debtors	91,200	By B/s Drawings	6,000
To B/R	16,090	By Trade Crs.	60,000
To Cash sales	31,620	By B/P	16,000
To Bank Overdraft	3,000	By Wages	22,000
		By Salaries	1,000
		By Trade Exp.	26,510
		By Balance (Cash)	400
	149,910		149,910

Total Debtors A/c

	Rs.		Rs.
To Balance b/d	50,000	By Cash	91,200

To Sales (bal.fig)	1,00,000	By B/Ro	20,090
		By Balance c/d	38,710
	1,50,000		1,50,000

B/R

	Rs.		Rs.
To balance b/d	10,000	By Cash	16,090
To S.drs. (Bal. Fig.)	20,090	By Balance c.d	14,000
	30,090		30,090

B/R

	Rs.		Rs.
To Cash	16,000	By Balance b/d	6,000
		By S.Crs. (bal.fig)	10,000
	16,000		16,000

B/P

	Rs.		Rs.
To B/P	10,000	By Balance b/d	44,000
To Cash	60,000	By Purchases	40,000
To Balance C/d	14,000		
	84,000		84,000

Exercise: From the following particulars, ascertain the opening balance of sundry debtors and closing balance of sundry creditors :

	Rs.
Sundry Creditors (31-03-2001)	20,600
Sundry Debotors (31-03-2002)	37,400
Stock (31-03-2001)	50,000
Stock (31-03-2002)	40,000
During 2001-2002:	
Purchase	1,40,000
Discount allowed to creditors	800
Discount allowed to customers	1000
Cash paid to sundry creditors	1,05,000
Bills payabe in used to them	20,000
Bills receivable received from custormers	35,000
Cash received from them	1,60,000
Bills receivable dishonoured	2000

The rate of gross profit 25% on selling price of the total sales Rs. 35,000 for cash.

6.8 SUMMARY

Single entry system of book-keeping is not a system at all. It means recording transactions not according to well defined rules but according to mere convenience. Under the Double Entry System, a transaction must be recorded with both the aspects. If there is debit, there must be a credit and *vice-versa*. It is not under the single-entry system. Debit and credit may be completed in transactions, while no record at all may be there in respect of a number of transactions. Most transactions are recorded only once without completed double entry. It is all a matter of convenience. Accounts are not maintained. While there is no hard and fast rule; usually only the cash account, bank (sometimes the passbook is treated as sufficient for this purpose) and personal account (that is, account of customers and creditors) are kept. Generally, there will be no accounts to show purchases, sales, assets, incomes and losses and expenses.

6.9 GLOSSARY

Single Entry System: Under this system of accounting only one account gets affected by a transaction.

Cash book: Under single entry system, the cash book is kept recording all the receipts and the payments made in cash.

6.10 ANSWERS TO IN-TEXT QUESTIONS

1. Trail Balance	6. Statement of Affairs
2. Profit or Loss	7. Relevant information will generally be missing
3. Wastage and Misappropriation	8. True
4. True	9. False
5. True	10. True

6.11 SELF-ASSESSMENT QUESTIONS

1. What do you mean by Single Entry System?
2. Write short notes on conversion into double entry system.
3. Explain preparation of trading and profit & Loss account from single entry records with suitable example?

4. Discuss in detail about Cash Sales.
5. Explain the Balance sheet with suitable example

6.12 SUGGESTED READINGS

- *Monga, J R. Financial Accounting: Concept and Applications. Mayur Paper Backs, New Delhi*
- *Goyal, Bhushan Kumar and H.N. Tiwari, Financial Accounting, Taxmann*

LESSON 7

FINAL ACCOUNTS OF NON-FOR-PROFIT ORGANISATIONS

STRUCTURE

7.1 LEARNING OBJECTIVES

- To Understand the meaning and concepts of final accounts of non-for-profit organizations.
- To Explain the use of Receipt and Payment Account
- To Prepare the Receipts and Payments Account
- To Prepare the Income and Expenditure Account
- To Understand the Steps to Prepare Income and Expenditure Account
- To Understand the Steps of Receipts and Payments Account

7.2 INTRODUCTION

The current chapter talks about the preparation of final accounts for the not-for-profit organizations. The not-for-profit organizations include the organizations like schools and hospitals etc. These organization maintain the receipt and payment account and the Income and Expenditure accounts as their final accounts. The accounting procedures followed in the not - for- profit organizations are slightly different from the profit-making organizations which are deeply discussed in the upcoming chapter.

7.3 MEANING OF FINAL ACCOUNTS OF NON-PROFIT

Clubs, schools, hospitals and other non-profit making institutions usually do not keep a full-fledged accounts staff because of the expenses involved. They generally maintain the cash book only. But a Cash book cannot tell us about the financial slate of affairs. For this purpose, it is necessary to compare current expenses with current incomes ascertain which is more: and prepare the balance sheet. This will not be difficult if all accounts are maintained, and a trial balance is taken out. But if only a cash book is there, it will first be necessary to prepare a Receipt and Payments Account.

7.4 RECEIPT AND PAYMENT ACCOUNT

The Receipt and Payment Account is nothing but a summary of the Cash book. All that appears in the cash book appears in this account also, hence-

(1) This account starts with the opening balance of cash in hand und cash at bank (whether as fixed deposit or in current account).

(2) It records all receipts of cash including receipts into bank. Whether the receipt is of capital or revenue nature or whether the receipt relates to the previous, present or future year, it will be entered in the cash book, and hence in the Receipts and payments Account. Building may be sold, Subscriptions may be received for past, present or future years. All proceeds will be entered in this account.

(3) Similarly, all payments, to whichever period they belong and whether of capital or revenue nature, will be recorded in the Receipts and Payments account.

(4) The balance in the account wilt represents actual cash or bank balance in hand at the end of the financial period. Usually, the receipt of cash are more than payments. The following is a specimen of the Receipts and Payments Account:

The Calcutta Sports Club -

Receipts and Payments Account Tor the year ending December 31, 2000

Receipts	*Rs.*	*Payments*	*Rs.*	
To Opening Balances :		By Upkeep of playing fields		2,500
In Hand	850	By Expenses on teams		1,900
At Bank	7,230	By Cricket Expenses		2,000
To Subscriptions for		By Tennis Expenses		4,500
1999	600	By Investment		3,000
2000	11.500	By Office Expenses		1,200
2001	300	By Postage & Stationary		250
To Entrance Fees	1,000	By Audit Fee		200
To Life Memberships	3,000	By Balance c/d		
To Contributions tor Trainings	1,500	In hand	910	
To Sale of Furniture	600	At Bank	10,320	
To Sales of Old Balls	200			11,230
	26,780			26,780

The Receipts and Payments Account DOES NOT give any indication whether current (revenue) expenses are being met out of current (revenue) incomes. There can be a big cash balance, for instance, if the building is sold. But that does not mean that the subscriptions received are sufficient to meet the salaries and other expenses. It is necessary to compare current expenses and current incomes. Continued solvency of any institution, charitable or otherwise, can be ensured only if the receipts are sufficient to meet revenue expenses. As Charles Dickens put it, if income is 20 shillings and expenditure 20 S 6 D., the result will be unhappiness. This is true for all persons and institution. One must not live upon one's capita.

The account which compares current incomes and expenses is known as Income and Expenditure Account. This is a summary of incomes and expenditures of the complete year. This account is prepared on the same lines as a profit and loss account-with incomes on the credit side and expenses on the debit side. If the credit side exceeds the debit side, the difference is known as "surplus" or excess of income over? expenditure. If the debit side exceeds the credit side the difference is "deficit" or Excess of expenditure over income. The words profit or loss are not used in the case of charitable institutions. In the absence of a trial balance, the Receipts and Payments Account will be the basis for preparing Income and Expenditure Account.

IN-TEXT QUESTIONS

1. This account starts with ....of cash in hand und cash at bank (whether as fixed deposit or in current account).
2. The Receipt and Payment Account is nothing but the Cash book.
3. It records all receipts of cash including___________. Whether the receipt is of capital or revenue nature or whether the receipt relates to the previous, present or future year, it will be entered in the cash book, and hence in the Receipts and payments Account.
4. The Receipts and Payments Account DOES NOT give any indication whether current (revenue) expenses are being met out of current (revenue) incomes. True/False
5. There can be a big cash balance, for instance, if the buildings are sold. But that does not mean that the subscriptions received are sufficient to meet the salaries and other expenses. True/False

7.5 DIFFERENCE BETWEEN THE RECEIPTS AND PAYMENTS

(1) Type-Receipts and Payments Account is a real Account whereas the income and Expenditure Account is a nominal account.

(2) **Object-The** object of Receipt and Payment Account is to show the summary of all cash transactions pertaining to a particular period, whereas the object of an Income and Expenditure Account is to show the net results of transactions and workings pertaining to the particular period.

(3) **Nature-Receipts** and Payments Account is virtually a cash book, but Income and Expenditure Account is like a trading and profit and loss Account.

(4) **Content-Receipts** and payment Account records receipts and Payments of both Capital and Revenue nature, whereas Income and Expenditure Account records income and expenditure of only revenue nature.

(5) **Form-Debit** side of the Receipts and Payments Accounts records receipts and credit side records payments. But Income and Expenditure Account's debit side records expenses and losses, and its credit side records income and gains.

(6) **Commencement-The** balance in the beginning of Receipts and Payments Account represents cash in hand in the beginning, whereas in Income and Expenditure Account there is no balance in the beginning.

(7) **Balance at the end-The** balance at the end of Receipts and payments Account show the cash in hand or cash over spent but in Income and Expenditure Account the balance at the end shows excess income over expenditure or vice versa.

(8) **Outstanding** Items-Receipts and Payment Account does not show the income received in advance or outstanding, whereas in the income and expenditure Account, all the incomes and expenditures of the current year are taken into account.

(9) **Balance Sheet-With** Receipts and Payments Account Balance Sheet is not prepared whereas with income and expenditure Account, preparation of the balance sheet is a must.

(10) **Receipt-Receipts** and payments account is the Summary of Cash Book, so it is not necessarily a part of the Double Entry System, but Income and Expenditure Account is necessarily a part of the Double Entry System.

IN-TEXT QUESTIONS

6. Building may be sold, ...present or future years. All proceeds will be entered in this account.
7. Similarly, all payments, to whichever period they belong and whether of______________ will be recorded in the Receipts and Payments account.
8. The balance in the account will represent actual cash or bank balance in hand at the end of the financial period. Usually, the receipt of cash is more than ___________.
9. It is necessary to compare current expenses and current incomes. Continued solvency of any institution, charitable or otherwise, can be ensured only if the receipts are sufficient to meet revenue expenses. True/False
10. As Charles Dickens put it, if income is 20 shillings and expenditure 20 S 6 D., the result will be unhappiness. This is true for all persons and institution. One must not live upon one's capital. True/False

7.6 STEPS TO PREPARE INCOME AND EXPENDITURE ACCOUNT FROM RECEIPTS AND PAYMENTS ACCOUNT

(a) Ignore the opening and closing cash and bank balance.

(b) Ignore capital expenditure and capital receipts. For example, if cash has been realized by sale of investments, the amount will not be credited to Income and Expenditure Account. The amount will be deducted from investments for balance sheet purpose. Of course, if some profit or loss has emerged from the sale of investments, it will be shown in the Income and Expenditure Account. If investments costing Rs 5,000 are sold for Rs. 5,400, Rs. 5,000 will be deducted from investments and Rs. 400 will be credited to Income and Expenditure Account. Similarly, if money has been spent to acquire an asset, say, furniture, the amount will be shown in the balance sheet and not debited to the Income and Expenditure Account.

(c) Revenue receipts or current incomes will be found on the receipts side of the Receipts and Payments Account. These will be credited to the Income and Expenditure Account subject to the following:

(i) Current income relating only to the year concerned will be credited to Income and Expenditure *Ale*. For example, if in 2000 subscriptions have also been received for 1999 and 2001 these amounts should not be credited to the Income and Expenditure *Ale*. The amount for 1999 will extinguish a debt owing to the institution and one for 2001 will be "Subscriptions Received in advance" and will be shown as a liability in the balance sheet. The amount will be treated as income in 2001.

(ii) The amount which is due but not yet received in cash should be brought into account. The amount is added to the income and treated as an asset, cash for which will be received next year.

Illustration 1

In 2000 the amount actually received for subscriptions was Rs.16,800. From the following further information show what amount should be credited to the Income and Expenditure Account as Subscriptions.

	Rs.
Subscriptions Outstanding (for due) on 31st Dec. 1999	1500
1,500 Subscriptions Outstanding (for due) on 31st Dec. 2000	1700
Subscription Received in Advance as on 31st Dec. 2000.	600
Subscriptions for 2001 received in 2000	500

Answer:

The amount to be credited as subscription to the Income and Expenditure Account is Rs. 17,100 arrived at as follows :

		Rs.
Subscription actually received		16,800
Add : Subscription for 2000 received in advance in 1999.	600	
Subscription for 2000 still due	1,700	2,300
		19,100
Less : Subscriptions for 1999 received in 2000	1500	
Subscriptions for 2001 received in 2000	500	2000
Subscription for 2000		17,100

The journal entries* concerned will be as under:

* *Will the student prepare the subscription account?*

Illustration 2.

General expenses paid in 2000 totalled Rs. 9,300. The following additional information is supplied to you.

	Rs
Expenses unpaid on 31st Dec. 1999	800
Expenses prepaid on 31st Dec. 1999	400
Expenses unpaid on 31st Dec, 2000	900
Expenses for 2001 paid in 2000	600

Show the amount of expenses for 2000

Answer :

The expenses for 2000 is Rs, 9,200 calculated as under :

	Rs.	Rs.
Expenses actually paid in 2000		9,300
Add: Expenses for 2000 paid in 1999	400	
Expenses for 2000 not yet paid	900	1,300
		10,600
Less: Expenses for 2001 paid in 2000	600	
Expenses for 1999 paid in 2000	800	
		1,400
Expenses relating to 2000		9,200

The Journal entries (the student will please supply the narration) and ledger account will appear as follows :

Journal

			Rs.	Rs.
2000 Dec.31	Expenses Account To Prepaid Expenses A/c	Dr.	400	400
	Expenses Outstanding A/c To Expenses Account		800	800
	Expenses Account To Expenses Outstanding A/c	Dr.	900	900
	Expenses Prepaid A/c To Expenses A/c	Dr.	600	600

Ledger

Expenses Prepaid Account

		Rs.			Rs.
2000			2000		
Jan. 1	To Expenses b/d	400	Dec. 31	By Expenses A/c	
Dec.31	To Expenses A/c	600		Transfer	400
		1,000	Dec. 31	By Balance c/d	600
					1.000
2001					
Jan. 1	To Balance b/d	600			

Expenses Outstanding Account

		Rs.			Rs.
2000			2000		
Dec. 31	To Expenses A/c	800	Jan. 1	By Balaace b/d	800
Dec. 31	To balance c/d	900	Dec. 31	By Expenses A/c	900
		1,700			1,700
			2001		
			Jan. 1	By Balance b/d	900

Expenses Account

2000	Rs.	2000			Rs.
Dec. 31	To Cash	9,300	Dec.3	By Expenses Outstanding A/c	800
Dec. 31	To Expenses Prepaid	400		By Expenses Prepaid A/c	600
				By Income & Expenditure A/c	
Dec. 31	To Expenses Out-standing A/c	900		Transfer	9,200
		10,600			10,600

Illustration 3. — Calculate the amount to be written in the expenditure side the following information.

	Rs.
Stock of stationary on 1-1-2000	300
Creditor for stationary in 1-1-2000	200
Advances paid for stationary on 31-12-1999	20
Paid for stationary during 2000	1,080
Stock of stationary on 31-12-2000	50
Creditors of stationary on 31-12-2000	130
Advance paid for Stationary in 31-12-2000	30

Solution

		Rs.
Stock of stationary in 1-1-2000		300
+ Stationary received during the year 2000		
Payments made during 2000	1080	
—For last year	–200	
	880	
+Payment made in 1999 though, Stationary received in 2000	+20	
	900	
+ Creditors on 31-12-2000	+130	
	1030	
—Payment made in advance on 31-12-2000	—30	
		1000
Total Stationary		1300
—Stock of stationary on 31 -12-2000		—50
Amount to be transferred to Income and Expenditure A/c		1250

(e) Receipt of non-recurring nature (e.g., life membership) should not be credited to Income and Expenditure Account.

(f) Depreciation and other losses should be ascertained and debited to the income and Expenditure Account.

(g) Total the two sides and put the differences on the shorter side as surplus (if it is to be written on the debit side) or deficit. Surplus is added to the capital fund, deficit is deducted.

Preparation of Balance Sheet: Charitable institutions should prepare a balance sheet also in order to know the financial state of affairs at the end of every year. Balance sheet will not be difficult to prepare if there is a trial balance. But in its absence, take the following steps:

1. Take the previous year's balance sheet. Adjust the figures for fixed assets, for new acquisitions (ascertained by pursuing the payments side of the Receipts and Payments Account) and for sale (ascertained by looking at the receipts). The figure should be further adjusted for depreciation. The figure now resulting will appear in the balance sheet.
2. Go through the receipts and payments and Income and Expenditure accounts and ascertained the amounts of subscriptions and other incomes outstanding (that is due but not yet received) and expenses prepaid. These will be put on the asset side.
3. The amount of cash in hand and bank balance at the end of the year as disclosed by the Receipts and Payments Account will naturally be entered on the assets side.
4. Compare the amount of liabilities as per the previous balance sheet with payments made. If there is any amount still to be paid, it should be entered on the liability side of the balance sheet.
5. Go through the Receipts and Payments and Income and Expenditure Account and a certain income received in advance and expenses outstanding. These should appear on the liability side.
6. Special receipts as disclosed by the Receipts and Payments Account should be shown in the balance sheet as a liability.
7. To the capital fund disclosed by the previous balance sheet, add the surplus (or deduct the deficit), membership fees and entrance fees, if not already entered in the income and expenditure account. (If, in examinations, capital fund is not given, it can be ascertained by deducting liabilities from assets, on the relevant date).

Illustration 4.

The following was Receipts and Payments account prepared by the Treasurer Delhi Cricket Club for the year ended December 31, 2000.

	Receipts	Rs.		Payments	Rs.
2000		Rs.	2000		Rs
Jan. 1	Cash in hand	100	Dec.	Groundsman's fee	750
	Balance at Bank as per			Mowing Machine	1.500
	Pass Book :			Rent of Ground	250
	Deposit Account	2,230		Cost of teas	250
	Current Account	600		Fares	400
	Bank Interest	30		Printing & Office Expenses	280
Dec. 31	Donations & Subscriptions	2,600		Repairs to equipment	500
	Receipts from teas	300		Honorarium to Secretary &	
	Contributions to fares	100		Treasurer for 1999	400
	Sale of Equipment	80		Balance at Bank as per	
	Net Proceeds of Variety			Pass Book :	
	Entertainments	780		Deposit A/c	2,090
				Current A/c	150
				Cash in hand	250
		6,820			6,820

You are given the following additional information :

	On Jan 1,2000		On Dec.31,2000	
(1) Subscriptions due	Rs.	150	Rs.	100
(2) Sums due for printing etc.		100		80
(3) Liability for repairs		300		360
(4) Interest on Deposit A/c not Entered in Pass Book				20
(5) Estimated value of Machinery and equipment		800		1750

(6) For the year ended Dec. 31.2000 the honorarium to the Secretary and

Treasurer arc to be increased by-
a total of Rs. 200 and the grounds man
is to receive a bonus of Rs. 200

You are required to prepare the Income and expenditure account of the year ended December 31, 2000 and Balance Sheet on that date-

Solution:

Notes

(1) Capital fund as on 1st Jan. 2000

Liabilities	Rs.	Assets	Rs.
Honorarium	400	Cash in hand	100
Printing etc.	100	Deposit in Bank	2,230
Amount due for repairs	300	Current A/c	600
Capital Fund (balancing		Subscriptions outstanding	150
figure)	3,080	Equipment	800
	3,880		3,880

(2) Depreciation

Cost of Equipment on Jan. 1,2000		800
Additions		1500
Less : Equipment sold	80	
Value of equipment on hand	1750	
		1830
		470

(3) Repairs Rs. 560 i.e. (500 + 360 – 300)

The Delhi Cricket Club

Income & Expenditure Account for the Year ending Dec., 312000

Expenditure			Rs.	*Income*			Rs.
To Groundsman's fees				By Donation & Subscription:			
	Paid	750					
	Add Bonus due	200	950		Received	2,600	
					Less for 1999	150	
							2,550
To Printing & Office Expenses				By Receipts from teas			300
	Paid	280		by contribution to fare			100
	Unpaid	80		By proceeds of variety entertainment780			
		360		By Interest on Deposit			50
	Less for 1995	100	260				
To Repairs to Equipment			560				
To Honorarian to Secretary and Treasurer			600				
To Depreciation of Equipment			470				
To Surplus — Excess of Income over expenditure			40				
			3,780				3,780

Balance Sheet of the Delhi Cricket club a on December 31,2000

Liabilities		Rs.	*Assets*		Rs.
Expenses Unpaid :			Cash in hand		250
Printing etc.	80		Bank Balances		
Repairs	360		Deposit A/c	2,090	
Bonus to Groundsman	200		Current A/c	150	2,240
Honorariun to Secretary	600	1,240	Interest due		20
Capital Fund :			Subscriptions Outstanding		100
Balance on			Equipment		1,750
1st Jan.	3,080				
Add Surplus	40	3,120			
		4,360			4,360

Illustration 5. Prepare Income & Expenditure Account for the year ending 31-12-2000 and Balance -Sheet as on that date from the following :

Receipts and Payments Account

for the year ended 31-12-2000

Receipts	Rs.	Payments	Rs.
To Balance b/d	2,100	By Printing and Stationary	1,300
To Subscription		By Advertisements	800
1999 (estimated at Rs. 460)		500 By Investment in Govt. Securities at	
2000	5,000	5% On 1 st Nov. 2000 (Interest, payable	
2001	200	on 1st) May and 1st Nov.	8,000
To Donation for Building	5,500	By Building Construction	2,500
To Sports Material		200 By Match Expenses	900
To Rent	1,300	By Creditors for 1999 estimated	
To Entrance Fees	300	at Rs. 750, in full settlement	650
To Match Fund	10,000	By Salaries	1,750
To Locker Rent	350	By Sports Materials	3,000
To Lecture Hall	200	By Honorarium	430
		By Electricity	275
		By Balance c/d	6,045
	25,650		25,650

Additional Information:

	31-12-199 Rs.	31-12-2000 Rs.
Sports Material	430	750
Printing Materials (Dr.)	50	80
Creditors for Printing	80	....
Rent received in advance for 2001	.....	100
Salary of treasurer outstanding	.....	250
Surplus from House Account including Refreshment outstanding		150

Solution :

Income and Expenditure Account for the year ending 31-12-2000

Expenditure		Rs.	*Income*		Rs.
To Printing and Stationary	Rs.		By Subscription		
Payment	1,300		2000	5,000	
Opening bal.	50		1999 Excess received	40	5,040
	1,350		By Sports Material		200
Closing balance	80		By Rent	1 ,300	
	1,270		Advance	100	1,200
Creditors for printing	80	1,190	By Locker Rent		350
To Avertisement		800	By Interest on Govt. Securities		67
To Salaries	1,750		(8000xlxJJ		
Treasurer Salary outstanding	250	2,000	By Income from Lecture Hall 200		
To Sports Material			By Income on final settlement of creditors		100
Opening Balance	430		By Surplus from House A/c		150
+ Purchases	3,000		By Excess of Expenditure over Income		68
Less	3430		(deficit)		
Closing balance	750	2,680			
To Honourariuin		430			
To Electricity		275			
		7,375			7,375

Balance Sheet

As on 31-12-2000

Liabilities		Rs.	*Assets*	Rs.
Subscrition in Advance		200	Cash	6,045
Rent received in Advance		100	Sports Material	750
Salary outstanding		250	Printing Material	80
Donation for Building		5.500	Surplus from House A<c outstanding	150
Match Fund	10,000			
Less Expenses	900	9,100	Investment in Govt. Securities	8,000
Entrance fees		300	Interest from Govt. Securities	67
Capital fund	2,210		Building	2.500
Less Deficit	68	2,142		
		17,592		17,592

Working Note

Balance Sheet as on 1-1-2000

	Rs.		Rs.
Creditors	750	Cash	2,100
Creditors for printing.	80	Subscription outstanding	460
Capital Fund Balancing figure	2,210	Sports Material	430
		Printing Material	50
	3,040		3,040

Illustration 6.

The receipts and payments Account and Income and Expenditure Account of the South Library, South Delhi for the year ended 31 st December, 2000 are as follows :

Receipts and Payment Account

for the year ended 31st December, 2000

Receipt		Rs.	Payments	Rs.
To Balance b/d		700	By Books purchased	1,500
To Subscriptions			By Printing and Stationary	150
1999	400		By Salary	1,250
2000	3,500	3,900	By Advertisement	100
To Interest		400	By Miscellaneous Expenses	320
To Donations for Special Fund		150	By Balance c/d	2,220
To Rent				
1999	260			
2000	130	390		
		5,540		5,540

Income and Expenditure Account for the year ending 31st December 2000

Expenditure	Rs.	Income	Rs.
To Insurance	120	By Interest	380
To Salary	1,300	By Subscription	3,800
To Miscellaneous Expnenses	320	By Rent	260
To Depreciation on Buildings	750		
To Printing & Stationary	150		
To Advertisements	90		
To Excess of Income Over expenditure	1,710		
	4,440		4,440

On enquiry, you were told that Library's assets on I January 2000 included :

Buildings Rs. 17,000, BooksRs. 15,000, Furniture Rs. 1000and Investments Rs.5,000. There were no liabilities on that date.

You are asked to prepare the Balance sheet of the library as on 31-12-1999 and 31-12-2000.

Solution and Notes

1. In Receipts and Payment Accounts there are items pertaining to 1999 and 2000. Since items of revenue nature relating to 2000 will appear in the Income and Expenditure account of 2000, the items relating to 1999 must appear in (he Balance Sheet of 1999.
2. Similar, items of Capital nature will appear in the Balance Sheet of either 1999 or 2000 e.g., Opening Balance of Cash will appear in 1999, Balance Sheet whereas Closing Balance of Cash will find place in Balance Sheet of 2000
3. Items appearing in Receipts and Payments account bull not appearing in Income and Expenditure account are:
   (i) Either receipts in advance or payments in advance, or
   (ii) receipts for previous year or payments for previous year, such items need adjustments (e.g., advertisement)
4. Assets at the end should be taken with their due appreciation in the closing Balance sheet but with the given figures in the Opening Balance Sheet.
5. Capital Fund should be ascertained by preparing Opening Balance Sheet or Closing Balance Sheet should be started with such Capital Fund.

Balance Sheet of South Library, South Delhi
as on 31-12-1999

Liabilities	Rs.	*Assets*	Rs.
Capital Fund	39,360	Cash in hand	700
		Outstanding Subscription	400
		Outstanding rent	260
		Investments	5,000
		Books	15,000
		Furniture	1,000
		Buildings	17,000
	39,360		39,360

Balance Sheet of South Library, South Delhi
as on 31-12-2000

Liabilities		Rs.	*Assets*		Rs.
Capital Fund	39360		Cash in hand		2,220
Add Excess of Income			Outstanding Subscription		300
over Expenditure	1,710	41,070	Outstanding Rent		130
Donations to Special Fund		150	Prepaid Advertisment		10
Outstanding Insurance		120	Investment		5,000
Outstanding Salary		50	Book-Balance	15,000	
Interest received in Advance		20	Add Purchase	15,00	16,500
			Furniture		1,000
			Building	17,000	
			Less Depection	750	16,250
		41,410			41,410

Preparation of Receipts and Payments from Income Expenditure and other Information:

The Receipts and Payments are prepared on the basis of receipts and disbursements made during the year.

Illustration 7.

From the following income and Expenditure and additional information, prepare Receipts and Payments A/c.

Income and Expenditure A/c 31-12-200

Expenditure	Rs.	Income	Rs.
To Salaries	4750	By Subscription	7500
To Audit Fees	500	By Entrance fees	250
To secretaries Honorarium	1000	By Rent of Hall	500
To Printing and Stationary	450		
To Depreciation on Equipment	300		
To surplus	1250		
	8250		8250

Additional Information:

(i) Cash in hand on 31-12-2000 was Rs. 1600

(ii) The salaries outstanding in the beginning and end of2000 were Rs. 400 and Rs. 450 respectively.

(iii) Audit fees for 2000 still due Rs. 60

(iv) The club had equipment in the beginning Rs 2600. At the end of the year, it amounts Rs. 2700 after depreciation.

(v) Rent of Hall still due at the end of2000 Rs. 100

(vi) Subscription due at the end of1999 and 2000 were 600 and 750

(vii) Subscription received in advance in 1999 and 2000 were 450 and 270

Receipts and Payments A/c

For the year ending 31-12-2000

Receipts		Rs.	Payments		Rs.
To balance b/d (balancing figure)		770	By Salaries	4,750	
			Add outstanding	400	
To Rent of Hall		400		5,150	
To Entrance fee		250	Less outstanding at the and of 2000	450	4,700
To Subcriptions	Rs.		By Audit fees	500	
	7,500		Less for 2000 due	60	440
Add for 1999	600		By Printing and stationery		450
	8,100		By Equipment		400
Less for 2000	750		By Secretary's Honorarium		1,000
	7350		By Balance c/d		1,600
Less for 1999	450				
	6900				
Add for 2000	270				
		7,170			
		8.590			8.590

Working Notes

Equipment A/c

Receipts	Rs.	Payments	Rs.
To balance b/d	2,600	By Depreciation	300
To Cash (purchases) Balancing Figure	400	By Balance c/d	2700
	3000		3000

Illustration 8.

From the following information, calculate the Income from subscriptions for the year ending December, 2000 and Show them in Income & Expenditure account and Balance Sheet of a Club,

Receipts Payments

For The year ending Dec.31, 2000

To subscription ;

1999	5,000		
2000	30.000		
2001	6,000	41,000	

Additional Information *Rs.*

(i) Subscriptions outstanding on Dec. 31, 1999	6000
(ii) Subscription outstanding on Dec. 31.2000	5000
(iii) Subscription Received in Advance on Dec. 31. 1999	6000

Solution

Income & Expenditure A/c

for the year ending dec. 31, 2000

	Amount Rs.		Amount Rs.
		By Subscription Received 30,000 Add Due 4,000 Add Received in Advance in 1999 6,000	40,000

Balance Sheet As on 31-12-99

Liabilities	Amount Rs.	Assets	Amount Rs
Subscriptions Received in Advance	6,000	Subscriptions due	6.000

Balance Sheet As on 31-12-2000

Liabilities	Amount Rs.	Assets	Amour
Subcriptions Received in Advance6,000		Subscription due 1995 1,000 1996 4,000	

IN-TEXT QUESTIONS

11. Receipts and Payments Account is a real Account whereas the income and Expenditure Account is a nominal account. True/False
12. The object of Receipt and Payment Account is to show the summary of all cash transactions pertaining to a particular period, whereas the object of an Income and Expenditure Account is to show the net results of transactions and workings pertaining to the particular period. True/False
13. Receipts and Payments Account is virtually a cash book, but Income and Expenditure Account is like a trading and profit and loss Account. True/False
14. Receipts and payment Account records receipts and Payments of both Capital and Revenue nature, whereas Income and Expenditure Account records income and expenditure of only revenue nature. True/False

7.7 SUMMARY

The main motive behind creating a not-for-profit organization is to provide services to the society and its members. Usually, such organizations do not indulge themselves in the business activities and thus their final accounts do not include any profit or loss. Just to maintain the transparency they are bound to maintain the receipt and payment account, Income and Expenditure Account and the Balance Sheet as they are liable to their trustees and the members. The chapter apprises students about the maintenance of such accounts.

7.8 GLOSSARY

Not-for-Profit Organization: The organizations working with the main objective of providing services to its members and the society and the for the profit.

Receipts and Payments Account: A Real account containing all the receipts and Payments done for the services.

Income and Expenditure Account: A nominal account containing all current income and expenses.

7.9 ANSWERS TO IN-TEXT QUESTIONS

1. Opening Balance	9. True
2. Summary	10. True
3. receipts into bank	11. True
4. True	12. True
5. True	13. True
6. subscriptions may be received for past	14. True
7. Capital or Revenue nature	
8. Payment	

7.10. SELF-ASSESSMENT QUESTIONS

1. What do you mean by Final Accounts of not-for-profit Organization.
2. Write short notes on Receipts and Payment Account.

3. Explain Difference between Income and Expenditure account and Receipts and Payment Account?

4. Discuss in detail the Steps to prepare income and Expenditure account from Receipts and Payments Account.

5. "Receipt and Payment account does not show the income received in advance or outstanding". Please comment.

6. Write short note on Real Account

7. What do you mean by "Nominal Account"? Explain by giving examples? Is Income and Expenditure account being a nominal account? If yes, please explain.

8. Explain steps for the Preparation of Balance Sheet for charitable institutions after using Income and Expenditure account

7.11 SUGGESTED READINGS

- *Monga, J R. Financial Accounting: Concept and Applications. Mayur Paper Backs, New Delhi*
- *Goyal, Bhushan Kumar and H.N. Tiwari, Financial Accounting, Taxmann.*

UNIT-IV

LESSON 8

ACCOUNTING FOR BRANCHES AND DEPARTMENTS

Sumita Jain

STRUCTURE

8.1 LEARNING OBJECTIVES

- To understand the concept of recording of transactions of different branches with the Head Office, other branches or with the customers.
- To know how the branches maintain Inland Branch accounts a Foreign Branch accounts.

8.2 INTRODUCTION

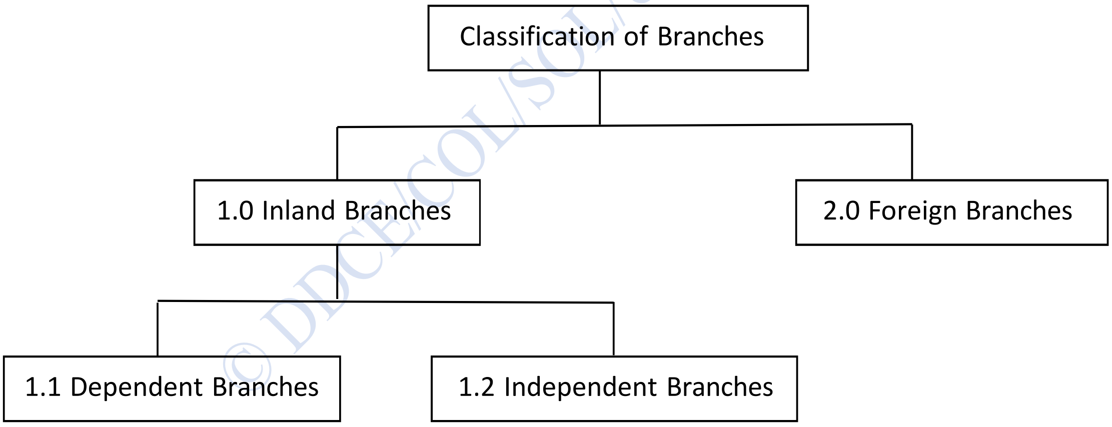
In today's times business generally work on a large scale and when business grows in size, then large organization opt to open local retail shops which are known as Branches which are controlled by Head office. The idea behind Branch concept is to understand the customer better by eliminating middleman. For Example, Bata Shoe Company, Reliance Ltd., Godrej company etc.

8.3 MEANING OF BRANCH

According to Sec. 29 of the Companies Act 1956, "a branch is any establishment carrying on *either* the *same or substantially* the same activity as that carried on by the head office of the company."

8.4 TYPES OF BRANCHES

Further Branches may be classified as follows:



8.5 ACCOUNTING FOR DEPENDENT BRANCHES

Dependent Branches are also known as selling agencies as they sell to customer only those quantity whatever has been given by head office to them. The head office can maintain the accounts of such branches according to any of the following methods:

Methods of maintaining the Accounts of Dependent Branches

- Debtors Method
- Stock and Debtors Method
- Final Accounts Method
- Wholesale Branch Method

DEBTORS SYSTEM

Under this method, the head office makes separate Branch Account for each branch on the basis of its location. Such Branch Account is of nominal kind. Its purpose is to find out profit or loss made by each branch. The journey entries which are passed to record different branch transactions are given below:

JOURNAL ENTRIES UNDER DEBTOR'S METHOD

1.	To record opening balances of Branch Assets	Branch A/c To Branch Assets (Individually)	Dr.
2.	To record opening balances of Branch Liabilities	Branch Liabilities (Individually) To Branch A/c	Dr.
3.	When goods are supplied by the Head Office/another branch to Branch	Branch A/c To Goods sent to Branch A/c	Dr.
4.	When goods are returned by the branch/branch customers directly to the Head office	Goods Sent to Branch A/c To Branch A/c	Dr.
5.	When goods are supplied by the branch to another branch under Instructions of Head office	Goods Sent to Branch A/c To Branch A/c	Dr.
6.	When goods are supplied by the head office but not received by the Branch	Goods in Transit A/c To Branch A/c	Dr.

7.	When the Head Office meats the branch expenses or sends cash to the branch for meeting Its expenses	Branch A/c Dr. To Cash/Bank A/c
8.	When remittances are received by the Head Office from the Branch/Branch Customers	Cash/Bank A/c Dr. To Branch A/c
9.	When remittances are sent by the Branch but not received by the Head Office	Cash-in-transit A/c Dr. To Branch A/c
10.	When balance In Goods sent to Branch Account is transferred	Goods sent to Branch A/c Dr. To Purchases A/c (in case of Trading concerns) Or To Trading A/c (in case of manufacturing concerns)
11.	To record the closing balances of Branch Assets	Branch Assets A/c (individually) Dr. To Branch A/c
12.	To record the closing balances of Branch Liabilities	Branch A/c Dr. To Branch Liabilities (Individually)
13.	To record Profit or Loss (i) If credit side exceeds the debit side (ii) If debit side exceeds the credit side	Branch A/c Dr. To General Profit and Loss, A/c General Profit and Loss A/c To Branch A/c

Format of Branch Account A format of Branch Account is given below:

Branch Account

Particulars	Rs.	Particulars	Rs.
Balance b/d (Opening balances of individual assets at branch) Goods sent to Branch A/c. (At cash or loaded price) Cash /Bank Account (For expenses paid by Head Office) General Profit and Loss Account	xx x xx x xx x xx x xx x xx x xxx	Balance b/d (Opening balances of individual Liabilities at Branch) Bank (remittances to H.O.): by Branch Branch Debtors directly to H.O. Goods Sent to Branch A/c: Returned by Branch	xxx xxx xxx xxx xxx
	xxx		Xxx

**Only one figure shall appear.*

Notes—

(i) If the opening stock has been recorded at loaded price, stock reserve account will be entered in the credit side of branch account with the difference between loaded price and cash price and vice versa.

(ii) If the goods sent to branch account is entered at loaded price, then in the credit side of branch account the same would be entered with the difference between loaded price and cost price and vice versa.

(iii) When goods are returned either by Branch Debtors to the H.O. directly or are sent by one branch to another branch, the entry is made in the same manner as in the case of goods returned by the Branch to the H.O.

Illustration 1 [When All Required Amounts are given]

From the following information, prepare Madras Branch Account in the books of head office for the year ending on 31st March 20X1:

	Rs		Rs
Opening Stock (at cost)	3,56,000	Closing Stock (at cost)	3,76,800
Opening Debtors	28,000	Closing Debtors	1,92,000
Opening Petty Cash	500	Closing Petty Cash	240
Furniture (in the beginning)	12,000	Furniture at the end	?
Opening Creditors	12,000	Closing Creditors	12,00 0
Goods sent to Branch (at cost)	10,44,00 0	Cheques sent to Branch for expenses	99,740
Goods returned by Branch to H.O. (At cost)	17,200	Cash received from Debtors	12,78,000
Goods returned by Customers to Branch	13,800	Cash Sales	64,000

Depreciate the furniture @ 10% p.a.

Solution

Dr. **Madras Branch Account in the Books of H.O.** Cr.

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d:		Balance b/d: (Creditors)	12,000
Stock	3,56,000	Bank A/c (Remittance from Branch) Cash sales 64,00 0	
Debtors	28,000	Collection from Debtors 12,78,0	13,42,00 0
Petty Cash	500		17,200
Furniture	12,000		3,76,800
Goods sent to Branch A/c	10,44,00 0		
Bank A/c (Remittance to Branch)	99,740		

Balance c/d (Creditors)	12,000	00 Goods sent to Branch A/c	1,92,000
Net Profit t/f to General P&L A/c	3,98,800	(Returns) Balance c/d:	240
		Stock	10,800
	19,51,040	Debtors	19,51,040
		Petty Cash	
		Furniture (Rs 12,000 – Rs 1,200)	

8.6 ACCOUNTING TREATMENT OF GOODS RETURNED AND CASH REMITTED BY BRANCH CUSTOMERS DIRECTLY TO HEAD OFFICE

Item	*Treatment in Branch A/c*	*Treatment in Memorandum A/c*
1 Goods returned by Branch customers directly to H.O.	Treat like goods returned by Branch to H.O. and thus, show the Cost/Invoice prince (as the case may be) of these goods on credit side of Branch Account.	Treat like goods returned by Branch to H.O. and thus, show the Cost/Invoice price (as the case may be) of these goods on credit side of Branch Stock Account.

2 Cash remitted by Branch customers directly to H.O.	Treat like cash remitted by branch to H.O. and thus, show on the credit side of Branch Account.	Treat like cash collected from debtors and thus, show on the credit side of Branch Debtors Account.

Illustration 2 [Treatment of Goods Returned and Cash Remitted Directly by Branch Customers Directly to H.O.]

Taking the same information as given in Illustration 3 along with the following information, prepare the Delhi Branch Account.

(iv) Goods returned by Branch Customers directly to H.O. Rs 1,200

(v) Cash remitted by Branch Customers directly to H.O. Rs 28,000

Solution

Dr. **Delhi Branch Account in the Books of H. O** Cr.

Particulars		*Rs*	*Particulars*	*Rs*
Balance b/d:			Balance b/d: (Creditors)	6,000
Stock		1,78,000	Bank A/c (Remittance from Branch) Remittance by Branch	6,43,000
Debtors		14,000	Direct Remittance by Branch customers	28,000
Petty Cash		250	Goods sent to Branch A/c Return by branch	7,800
Furniture		6,000	Direct Return by Branch customers	800
Goods sent to Branch A/c		5,22,000	Balance c/d:	
Bank A/c (Remittance to Branch)			Stock	1,88400
Salaries	30,000		Debtors	96,000
Rent and Insurance	12,000		Petty Cash	120
Petty Cash	7,870	49,870	Furniture (Rs 6,000 – Rs 600)	5,400
Balance c/d (Creditors)		6,000		
Net Profit t/f to General P&L A/c		1,99,400		
		9,75,520		9,75,520

Working Notes

Dr. **(i) Memorandum Branch Debtors Account** Cr

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d:	14,000	Return to Branch	5,700
Credit Sales	7,29,400	Return to H.O.	1,200
		Discount allowed	500
		Bad Debts	1,000
		Cash remitted to H.O.	28,000
		Cash remitted to Branch	6,11,000
		Balance c/d	96,000
	7,43,400		7,43,400

Dr. **(ii) Memorandum Branch Stock Account** Cr.

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d:	1,78,000	Goods sent to Branch A/c:	
Goods sent to Branch A/c	5,22,000	—Return by Branch	7,800
		—Direct Return by Branch Customers [Rs 1,200 × 100/150]	800
		Cost of Net Goods sold [(32,000 + 7,29,400 – 5,700 – 1,200) × 100/150]	5,03,000
		Balance c/d	1,88,400
	7,00,000		7,00,000

IN-TEXT QUESTIONS

1. Inland Branches can be classified into Dependent and _____ branch
2. Under this method, the head office makes ______ for each branch on the basis of its location
3. Which account is debited When remittances are sent by the Branch but not received by the Head Office
4. Which account is debited When goods are supplied by the head office but not received by the Branch

8.7 ACCOUNTING TREATMENT OF GOODS SENT TO ANOTHER BRANCH AND GOODS RECEIVED FROM ANOTHER BRANCH

	Item	*Treatment in Branch A/c*	*Treatment in Memorandum A/c*
1	Goods sent to another branch.	Treat like goods returned to H.O. and thus, show on the credit side of Branch Account.	Treat like goods returned to H.O. and thus, show on the credit side of Branch Stock Account.
2	Goods received from another branch	Treat like goods received from H.O. and thus, show on the debit side of Branch Account.	Treat like goods received from H.O. and thus, show on the debit side of Branch Stock Account.

8.8 WHEN GOODS ARE SENT TO BRANCH AT COST PLUS

Meaning of Invoice Price and Loading

Sometimes, the Consignor does not want to reveal the cost of goods to the Consignee and therefore, invoices goods at a price which is higher than the Cost Price (CP). Such price is known as **'Invoice Price'** (IP) and the difference between the Invoice Price (IP) and the Cost Price (CP) in called **'loading'**.

How to Eliminate/Remove Loading

When goods are sent at invoice price, to ascertain correct profit/loss on consignment, the items recorded at invoice price should be brought down to Cost Price level. For this purpose, the loading included in various items (like Opening Stock, Goods Sent to Branch, Goods Returned by Branch, Closing Stock) should be eliminated by passing the following adjusting entries.

1.	**To remove loading from the amount of Net Goods sent to Branch [i.e., Goods Sent to Branch less Returns by Branch (or Branch Customers) to H.O.]** Goods sent to Branch A/C To Branch A/C	Dr.
2.	**To remove leading from the amount of Closing Stock at Branch** Branch A/c To Branch Stock Reserve A/c The Closing stock at the end of current accounting period becomes the opening stock of the next accounting period. The aforesaid entry will be reversed in the beginning of the next accounting period as follows: Branch Stock Reserve A/c To Branch A/c	Dr.

How to Disclose relevant items after adjusting entries?

After passing the aforesaid adjusting entries, the relevant items will appear in the Branch Account as follows:

Dr. **An Extract of Branch Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Opening Stock	xx	Stock Reserve A/c	xx
(At Invoice price)		(Loading on Opening Stock)	
Goods sent to Branch (at	x	Goods Sent to Branch A/c	x
invoice price)		(Returns at Invoice Price)	
Stock Reserve A/c (loading on	xx	Goods Sent to Branch A/c	xx
Closing Stock)		(Loading on net Goods	
	x	sent to Branch	x
		Closing Stock (at Invoice Price)	
	xx		xx
	x		x
			xxx

TUTORIAL NOTES

(i) Unless otherwise stated, goods sent to branch and branch stocks are deemed to be at invoice price.

(ii) Stock at Branch (at cost to branch) or Stock at Branch at its cost means Stock at invoice price.

Illustration 3 [Calculation of Invoice Price and Loading]

Calculate the invoice price of the Goods sent to branch and the profit included therein in each of the following alternative cases:

(a) Goods sent to branch (at cost) Rs 1,20,000. Goods are invoiced to the Branch at cost plus 25%.

(b) Goods sent to branch (at cost) Rs 2,40,000. Goods are invoiced to the Branch at 25% above the cost.

(c) Goods 3sent to branch (at cost) Rs 4,80,000. Goods are invoiced to the Branch at 125% of the cost price of Head Office.

(d) Goods sent to Branch (at cost) Rs 1,20,000. Goods are invoiced to the branch to give a gross margin of 20% on sale price.

(e) Goods sent to Branch (at cost to Branch) Rs 1,50,000. Goods are invoiced to the Branch at 25% above the cost.

(f) Goods received from H.O. Rs 1,00,000. Goods in transit from H.O. Rs 50,000. Goods are invoiced to the Branch at cost plus 25%.

Solution

Case	Invoice Price = Cost + Profit	Profit (loading) Total Invoice Price × $\frac{\text{Profit}}{\text{Invoice Price}}$
(a)	Rs 1,20,000 + 25% of Rs 1,20,000 = Rs 1,50,000	Rs 1,50,000 × 25/125 = Rs 30,000
(b)	Rs 2,40,000 + 25% of Rs 2,40,000 = Rs 3,00,000	Rs 3,00,000 × 25/125 = Rs 60,000
(c)	Rs 4,80,00 + 25% of Rs 4,80,000 = Rs 6,00,000	Rs 6,00,000 × 25/125 = Rs 1,20,000
(d)	If Sale Price = Rs 100, Profit = Rs 20 and Cost Rs 80 Thus, Rs 1,20,000 × 100/80 = Rs 1,50,000	Rs 1,50,000 × 20/100 = Rs 30,000
(e)	Rs 1,50,000 (at cost to branch means Invoice Price)	Rs 1,50,000 × 25/125 = Rs 30,000
(f)	Rs 1,00,000 + Rs 50,000 = Rs 1,50,000	Rs 1,50,000 × 25/125 = Rs 30,000

Illustration 4 [When Goods-in-transit are there]

A Ltd. had a branch at Kolkata. Goods are invoiced to the branch at cost plus 25%. Branch is instructed to deposit cash every day in the head office account with the bank. All expenses are paid by cheques by the head office except petty cash expenses which are paid by branch manager. From the following particulars, prepare Branch Account in the books of head office:

	Rs		*Rs*
Opening Stock in hand	2,500	Cash remitted to the head office	15,000

Closing Stock in hand	2,000	Furniture purchased by the branch manager	1,200
Opening Sundry debtors	1,400		
Closing Sundry debtors	1,800	Goods received from the head office	17,200
Cash sales for the year	10,800	Expenses paid by the head office	1,640
Credit sales for the year	7,000	Expenses paid by the branch	120
Cost of goods sent to Branch	14,560		

Branch Manager is entitled to a commission of 5% of profit of the branch after charging such commission.

Solution

Dr. **Kolkata Branch Account** Cr.

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d:		Branch Stock Reserve A/c [Rs 2,500 × 25/125)	500
Branch Stock A/c	2,500	Goods sent to Branch A/c [Rs 18,200 × 25/125]	3,640
Branch Debtors A/c	1,400	Cash (remittance)	15,000
Goods sent to Branch A/c (Rs 14,560 + Rs 3,640)	18,100	Balance c/d:	
Bank (expenses)	1,640	Branch Stock in Hand	2,000
Branch Stock Reserve A/c [Rs 3,000 × 25/125]	600	Branch Stock in Transit [Rs 18,200 – Rs 17,2000]	1,000
Branch Manager's Commission [Rs 1,880 × 5/105]	90	Branch Debtors	1,800
Net Profit transfer to General Profit and Loss A/c	1,790	Branch Furniture	1,200
		Branch Cash	1,080
	26,220		26,220

Working Notes

Dr. **(i) Memorandum Branch Debtors Account** Cr.

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d	1,400	Cash A/c (Balancing figure)	6,600
Sales (Credit)	7,000	Balance c/d	1,800
	8,400		8,400

Dr. **(ii) Memorandum Branch Cash Account** Cr.

Particulars	*Rs*	*Particulars*	*Rs*
Sales (cash)	10,800	Cash Remitted	15,000
Debtors	6,600	Furniture	1,200
		Petty Expenses	120
		Balance c/d (Balancing figure)	1,080
	17,400		17,400

Illustration 5 [When Purchases are made by the Branch with H.O. Permission)

Raja (India) Ltd. have a head office and many retail branches which are supplied goods from the head office at 20% profit on sales price. Accounts are kept at head office where expenses (except petty expenses) are paid. Such petty expenses are paid by the branches which are allowed to maintain petty cash balance of Rs 300 on *imprest system*. From the following balances, as shown by the books, prepare Branch Account.

	Rs		Rs
Balance on 1st April 20X1:		Cash purchases by the branch (on permission from head office)	10,500
Petty cash in hand at branch	300		
Stock at branch at its cost	20,000	Credit purchases by the branch (With permission)	9,800
Sundry debtors at branches	5,000		
Sundry creditors at branches	1,200	*Payments made by the head office:*	
Furniture and fixtures at branch	8,000	Rent for one year (paid on 1.7.20X1)	1,800
Rent prepaid (up to 30th June 20X1)	300	Salaries	2,000
Transactions for the year:		Insurance paid for the year ending on 30th June 20X2	360
Goods sent to branch	1.04,000		
Cash sales at branch	64% of Total Sales	*Payments made by the Branch:*	
		Petty expenses	180
Credit sales at branch	45,000	*Balance on 31st March 2012:*	
Allowances to debtors	500	Stock at cost	30,000
Bad debts to be written off	200	Creditors at the end	3,000
		Debtors at the end	9,300

Write off 10% depreciation on furniture. The Branch Manager is entitled to 5% of profit of branch after charging such commission.

Solution

Dr. **Branch Account in the Books of Head Office** Cr.

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d:		Balance b/d: Creditors	1,200
Petty Cash	300	Remittances	1,01,320
Stock	20,000	Stock Reserve A/c (for opening stock)	4,000
Debtors	5,000	Goods sent to Branch (for loading of profit)	20,800
Furniture	8,000	Balance c/d:	
Rent prepaid	300	Stock [Rs 30,000 + Rs 7,500]	37,500
Goods sent to Branch	1,04,000	Debtors	9,300
Bank:		Petty Cash	300
Rent 1,800		Furniture	7,200
Salaries 2,000		Rent Prepaid	450
Insurance <u>360</u>	4,160	Insurance	90
Stock Reserve	7,500		
Balance c/d (Creditors)	3,000		
Branch Manager's Commission [Rs 29,900 × 5/105]	1,424		
Net Profit transfer to General Profit and Loss Account	28,476		
	1,82,160		1,82,160

Working Notes

Dr. **(i) Memorandum Branch Debtors Account** Cr.

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d	5,000	Allowances	500
Sales (credit)	45,000	Bad debts	200
		Cash receivable from debtors (b.f.)	40,000
		Balance c/d	9,300
	50,000		50,000

Dr. **(ii) Memorandum Branch Creditors Account** Cr

Particulars	*Rs*	*Particulars*	*Rs*
Cash A/c (Balancing figure) Balance c/d	8,000 3,000	Balance b/d Purchases	1,200 9,800
	11,000		11,000

Dr. **(iii) Memorandum Branch Cash Account** Cr.

Particulars	*Rs*	*Particulars*	*Rs*
Cash Sales Debtors	80,000 40,000	Purchases Creditors Petty Cash A/c Cash remitted to H.O. (b.f.)	10,500 8,000 180 1,01,320
	1,20,000		1,20,000

Dr. **(iv) Memorandum Branch Petty Cash Account** Cr.

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d Cash A/c (b.f.)	300 180	Petty expenses Balance c/d	180 300

8.9 STOCK AND DEBTOR'S METHOD

Under Debtor method it is not possible to divide the profits into gross profit and net profit and also there is no control over stock and branch account discloses only the final figure of stock and not showing normal and abnormal losses. In order to overcome this difficulty another system adopted known as stock and debtor system. Under Stock and Debtors

Method, in order to exercise more control over the working of a branch, the head office usually maintains the following accounts:

	Accounts	*Purpose*
1.	Branch Stock Account at Invoice Price	To ascertain any shortage or surplus
2.	Branch Debtors Account	To ascertain the closing debtors
3.	Branch Expenses Account	To ascertain the total expenses incurred at the Branch
4.	Branch Adjustment Account	To ascertain Gross Profit/Gross Loss
5.	Branch Profit and Loss Account	To ascertain Net Profit/Net Loss
6.	Goods Sent to Branch Account	To ascertain the net cost of goods sent to branch
7.	Branch Cash Account	To record all cash transactions of the branch
8.	Branch Fixed Assets Account	To record all transactions relating to branch fixed assets

Journal Entries The journal entries which are passed to record different branch transaction are given below:

JOURNAL ENTRIES UNDER STOCK AND DEBTORS' METHOD

1. When goods are supplied by the H.O/another Branch	Branch Stock A/c To Goods sent to Branch A/C	Dr.
2. When goods are returned by the Branch/or when goods are supplied to another branch	Goods Sent to Branch A/c To Branch Stock A/c	Dr.
3. When goods are returned by branch customers directly to H.O.	Goods sent to Branch A/c To Debtors A/c	Dr.
4. When goods are sold on credit	Branch Debtors A/c To Branch Stock A/c	Dr.
5. When goods are sold for cash	Branch Cash A/c To Branch Stock A/c	Dr.
6. When goods are returned by Branch Debtors to branch	Branch Stock A/c To Branch Debtors A/c	Dr.

7. When cash is received by branch from its debtors	Branch Cash A/c To Branch Debtors A/c	Dr.
8. To record bad debts, discount allowed etc.	Branch Expenses A/c To Branch Debtors A/c	Dr.
9. To record branch expenses paid by branch	Branch Expenses A/c To Branch Cash A/c	Dr.
10. To record abnormal loss of Stock [Due to abnormal factors like fire, flood, theft etc.]	Branch Adjustment A/c Branch Profit and Loss A/c To Branch Stock A/c	Dr. [Loading] Dr. [Cost] [Invoice Price]
11. To record normal loss of stock [Due to the inherent nature of the product]	Branch Adjustment A/c To Branch Stock A/c	Dr. [Invoice Price]
12. To record surplus Representing excess of selling price over invoice price	Branch Stock A/c To Branch Adjustment A/c	Dr. [Loading]
13. To remove loading from the net amount of goods sent to branch (i.e., goods sent less returns by branch)	Goods sent to Branch A/c To Branch Adjustment A/c	Dr. [Loading]
14. To remove loading from the amount of closing stock	Branch Adjustment A/c To Stock Reserve A/c	Dr. [Loading]
15. To remove loading from the amount of opening stock	Stock Reserve A/c To Branch Adjustment A/c	Dr. [Loading]
16. To record gross profit made by branch	Branch Adjustment A/c To Branch Profit and Loss A/c **Note** *The entry will be reversed in case of gross loss*	Dr.
17. To record the transfer of branch expenses	Branch Profit and Loss A/c To Branch Expenses A/c	Dr.

18. To record the transfer of branch	Branch Profit and Loss A/c Dr. To General Profit and Loss, A/c **Note** *The entry will be reversed in case of net loss*
19. To transfer the balance in Goods sent to Branch A/c	Goods sent to Branch A/c Dr. To Trading A/c Purchases A/c

The formats of Branch Account, Branch Adjustment Account, Branch Expenses Account, Branch Profit and Loss Account, Branch Debtors Account and Goods sent to Branch Account are given below:

Dr. **1. Branch Stock Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d	xx x	Branch Cash A/c (Cash Sales)	X
Goods sent to Branch A/c	xx x	Branch Debtors A/c (Credit Sales)	x x
Branch Debtors A/c (Return by Customers to Branch)	xx x	Goods Sent to Branch A/c (Returns to H.O.)	xx x
Goods sent to Branch A/c (T/f of goods from another Branch)	xx x	Goods sent to Branch A/c (T/f of Goods to another Branch)	xxx
Branch Adjustment A/c (Excess of Selling Price over Invoice Price) (i.e., surplus)	xx x	Branch Adjustment A/c (Load on Abnormal Loss due to fire etc.)	xxx xxx
		Branch Profit and Loss A/c (Cost of Abnormal Loss due to fire etc.)	xxx
		Branch Adjustment A/c (Invoice Price of Normal Loss)	xxx
		Balance c/d: In hand in transit	xxx xxx
	xxx		Xx x

Dr. **2. Branch Adjustment Account** Cr.

Particulars	Rs	Particulars	Rs
Balance Stock A/c (Load on Abnormal Loss due to Fire, etc.) Branch Stock A/c (Normal Loss)	xxx	Stock Reserve A/c (Load on Opening Stock) Goods Sent to Branch A/c	xxx
Stock Reserve A/c (Load on Closing Stock) Gross Profit t/f to Branch P&L A/c	xxx xxx xxx	(Load on Net Goods Sent) Branch Stock A/c (Excess of Selling Price over Invoice Price) (Surplus)	xxx xxx
	xxx		Xx x

Dr. **3. Branch Expenses Account** Cr.

Particulars	Rs	Particulars	Rs
Salaries	xxx	Branch Profit and Loss A/c	Xx x
Rent	xxx		
Petty Expenses	xxx		
Bad Debts	xxx		
Discount	xxx		
Depreciation	xxx		
	xxx		Xx x

Dr. **4. Branch Profit and Loss Account** Cr.

Particulars	Rs	Particulars	Rs
Balance Stock A/c (Cost of Abnormal Loss) Branch Expenses • To Net Profit t/f to General Profit and Loss A/c	xx x xx x	Branch Adjustment A/c (Gross Profit b/d) Branch Cash A/c (Insurance claim received)/Insurance Co. (claim admitted but not received) • Net Loss t/f to General P&L A/c	Xx x xxx xxx

	xx x		
	xxx		Xx x

* Only one figure shall appear.

Dr. **5. Branch Debtors Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d	xxx	Branch Cash A/c (Cash paid to branch)	xxx
Branch Stock A/c (Credit Sales)	xxx	Bills Receivable A/c	xxx
Bills Receivable A/c (B/R dishonoured)	xxx	Cash A/c (Cash paid directly to H.O.)	xxx
		Branch Stock A/c (Return to Branch)	xxx
		Goods Sent to Branch A/c (Goods returned directly to H.O.)	xxx
		Discount A/c	xxx
		Bad Debts A/c	xxx
		Balance c/d	xxx
	xxx		Xx x

Dr. **6. Branch Sent to Branch Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Branch Stock A/c (Returns)	xxx	Branch Stock A/c (goods sent)	Xx x
Branch Adjustment A/c (Load on	xxx		
	xxx		

net goods sent0 Purchases/Trading A/c	xxx		Xx x

Illustration 6 CAS Ltd. Mumbai has a branch at New Delhi to which goods are sent @20% above cost. The branch makes both cash and credit sales. Branch expenses are met partly from H.O. and party by the branch. The statement of expenses incurred by the branch every month is sent to head office for recording. Following further details are given for the year ended 31st December 20X1:

	Rs
Cost of Goods sent to Branch at cost	2,00,000
Goods received by Branch till 31.12.20X1 at invoice price	2,20,000
Credit Sales for the year @ invoice price	1,65,000
Cash Sales for the year @ invoice price	59,000
Cash Remitted to head office	2,22,000
Expenses paid by H.O.	12,000
Bad Debts written off	750

Balances as on:	*1.1.20X7*	*31.12.20X1*
	Rs	Rs
Stock	25,000 (Cost)	28,000 (invoice price)
Debtors	32.750	26,000
Cash in Hand	5,000	2,500

Required Show necessary ledger accounts in the books of the head office and determine the Profit and Loss of the Branch for the year ended 31st December 20X1

(a) under Debtors Method (b) Under Stock and Debtors Method.

Solution **(a) Under Debtors Method**

Dr. **New Delhi Branch Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d: Stock	30,000 32,750	Stock Reserve A/c	5,000

Debtors	5,000	(Rs 30,000 × 20/120)	40,000
Cash	2,40,000	Goods Sent to Branch A/c [Rs 2,40,000 × 20/120]	
Goods Sent to Branch A/c to			
Bank A/c (Exp. paid by H.O.)	12,000	Bank A/C (Remittance) received from the Branch	
Stock Reserve A/c (on closing stock) (Rs 48,000 × 20/120)	8,000	Cash Sales 59,000 Drs. Collection 1,63,50 0 (Net of expenses) (Rs 2,22,500 – Rs 59,000)	2,22,500
Net Profit Transferred Profit and Loss A/c	16,250	Balance c/d:	
		Stock (including Transit)	48,000
		Debtors	26.000
		Cash	2,500
	3,44,000		3,44.000

Working Notes

Dr. **(i) Memorandum Branch Stock Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d	30,000	Branch Debtors A/c	1,65,000
Goods Sent to Branch A/c	2,40,000	Branch Cash A/c	59,000
Branch Adjustment A/c (Excess of Selling Price over Invoice Price) (Balancing figure)	2,000	Balance c/d	
		Goods in-transit [Rs 2,40,000 – Rs 2,20,000]	20,000
		Stock at	28,000
	2,72,000		2,72,000

Dr. **(ii) Memorandum Branch Debtors Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d	32,750	Bad Debt	750
Branch Stock A/c	1,65,000	Branch Cash	1,71,000

		A/c	26,000
	1,97,750	(Balancing figure)	1,97,750
		Balance c/d	

Dr. **(ii) Memorandum Branch Debtors Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d	5,000	Bank (Remittance to	2,22,500
Branch Stock A/c	59,000	H.O.) Expenses (Paid by	12,000
Branch Debtors A/c	1,71,000	H.O.) Expense (paid by	
Bank A/c (Remittance from H.O.)	12,000	Branch) (Balancing	10,000
		figure) Balance c/d	2,500
	2,47,000		2,47,000

(a) Under Stock and Debtors Method

Dr. **(a) Branch Stock Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d	30,000	Branch Debtors A/c	1,65,000
Goods Sent to Branch A/c	2,40,000	Branch Bank A/c	59,000
Branch Adjustment A/c		Balance c/d	
(Excess of sales over invoice price)	2,000	Goods in Transit	
		(Rs 2,40,000 – Rs 2,20,000)	20,000
		Stock at Branch	28,000
	2,72,000		2,72,000

Dr. **(b) Branch Debtors Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d	32,750	Bad Debt w/o	750
Branch Stock A/c	1,65,000	Branch Cash A/c (b.f.)	1,71,000
		Balance c/d	26,000
	1,97,750		1,97,750

Dr. **(c) Branch Cash Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Balance b/d	5,000	Bank Remittance to H.O.	2,22,500
Branch Stock A/c	59,000	Branch Adjustment A/c (Exp. paid by H.O.)	12,000
Bank A/c (as per contra)	12,000	Branch Adjustment A/c (Balancing figure) (Exp. paid by Branch)	10,000
Branch Debtors A/c	1,71,000	Balance c/d	2,500
	2,47,000		2,47,000

Dr. **(d) Branch Adjustment Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Stock Reserve A/c (on closing stock) (48,000 × 20/120)	8,000	Stock Reserve A/c [30,000 × 20/120]	5,000
Gross Profit c/d	39,000	Goods sent to Branch A/c	40,000
		Branch Stock A/c	2,000
	47,000		47,000

Dr. **(e) Branch Profit and Loss Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Branch Expenses (Paid by H.O. Rs 12,000 and paid by Branch) Rs 10,000)	22,000	Gross Profit b/d	39,000
Branch Debtors (Bad debts)	750		
Net Profit	16,250		
	39,000		39,000

Dr. **(f) Goods Sent to Branch Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Branch Adjustment A/c Purchase A/c (Transfer)	40,000 2,00,000	Branch to Stock A/c	2,40.000
	2,40,000		2,40,000

Illustration 7 [When there are Goods-in-transit and Abnormal Loss]

Rocky (India), Khandwa, opened a Branch at Delhi on 1st April 20X1. The goods were sent by the Head Office to the Branch and invoiced at selling price of the Branch which was 125% of the cost price of the head office.

The following are the particulars relating to the transactions of Delhi Branch:

		Rs
Goods sent to branch (at cost to Head Office)		2.80.800
Sales:		
Cash		1,25,000
Credit		1,75.000
Cash collected from Debtors		1,56,000
Discounts allowed		4,000
Returns from Debtors		5,000
Cash sent to branch for:		
Wages	3,000	
Freight	11,000	
Other Expenses	6,000	20.000
Spoiled cloth in bales written off at invoice price		500
Closing Stock in hand		54,500
Goods received by Branch till date at invoice price		3,50,000

Required Ascertain the profit or loss for the Delhi Branch for the year ended 31st March 20X2 after preparing Branch Stock Account and Branch Debtors Account.

Solution

Dr. **Delhi Branch Stock Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Goods Sent to Branch A/c [Rs 2,80,800 + Rs 70,200]	3,51,000	Branch Debtors A/c (Credit Sales)	1,25,000
Branch Debtors A/c —Returns	5,000	Branch Cash A/C (Cash Sales)	1,75,000
		Branch Adjustment A/c [Rs 500 × 25/125]	100
		Branch Profit and Loss A/c (Cost of spoiled cloth)	400
		Balance c/d:	
		Stock-in-hand	54,500
		Stock-in-transit [Rs 3,51,000 – Rs 3,50,000]	1,000
	3,56,000		3,56,000

Dr. **Delhi Branch Debtors Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Branch Stock A/c (Cr. sales)	1,75,000	Cash A/c	1,56,000
		Discounts A/c	4,000
		Branch Stock A/c (Returns)	5,000
		Balance c/f	10,000
	1,75,000		1,75,000

Dr. **Delhi Branch Debtors Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Branch Stock A/c (Cr. sales)	1,75,000	Cash A/c	1,56,000
		Discounts A/c	4,000
		Branch Stock A/c (Returns)	5,000
		Balance c/f	10,000
	1,75,000		1,75,000

Dr. **Delhi Branch Adjustment Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Branch Stock A/c—Loading	100	Goods sent to Branch A/c [Rs 3,51,000 × 25/125]	70,200
Wages (Treated as Direct)	3,000		
Freight (Treated as Direct)	11,000		
Stock Reserve A/c	11,100		
Gross Profit transferred —to Branch Profit and Loss A/c	45,000		
	70,200		70,200

Dr. **Delhi Branch Profit and Loss Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
Expenses	6,000	Branch Adjustment A/c (Gross Profit)	45,000
Discounts	4,000		
Branch Stock A/c (Cost of Spoiled cloth)	400		
Profit and Loss A/c (Net Profit)	34,600		
	45,000		45,000

8.10 DEPARTMENTAL ACCOUNTING

Meaning and Objectives

Department means different sections under one roof. According to Business Dictionary "Department is a specialized functional area within an organization or division, such as marketing, accounting etc. Generally, every department has its own manager and chain of command."

Departmental Accounting is a system of maintaining accounts for one or more departments of a business unit as efficiency of an organization depends on efficiency of each departmental unit. Departmental accounts help the firm to know about the progress of organization as well as of each and every department and in result helps the management to improve the performance overall.

Objectives of Departmental Accounting

Departmental Accounting has of great importance to management. Its objectives are:

1) Individual results: It helps in finding individual results of various departments and make it easy to compare with each other.

2) Decision Making: It helps in taking decisions regarding expanding, dropping a department.

Future Planning: Proper information is used by the management to make proper plans foe future in respect to particular departments.

Motivational tools: Comparison of results of each department motivate the employees

and also helps in developing competitive spirit among the employees.

Methods of Departmental Accounting

There are two methods of departmental accounting

1. Separate set of books of accounts are maintained for each department: Under this system each department is regarded a separate unit and separate books of accounts are maintained. This method is best suitable for large organizations.

2. Joint accounts are maintained: Under this method a trading and profit & loss account is prepared to know each department result. This method is suitable for small organizations. In this system complete accounting for each department is done by central department.

Difference between Departmental accounting and Branch Accounting

Basis	**Departmental Accounting**	**Branch Accounting**
Location of Branch	All departments are located at one place	Branches are located at different places.
Maintenance of accounts	Under accounting record are maintained by Head Office.	Under independent branch system each branch is itself keeping his accounts
Allocation of expenses	Expenses are allocated on some common basis	No need of allocation
Reconciliation	No need for reconciliation	Independent branches have to be reconciled their accounts with head office.

ALLOCATION OF EXPENSES

There is no universally acceptable basis of allocation. However, the following table shows some suggested measures of Allocation of expenses.

Table explain allocation of expenses

Nature of expenses	**Basis of allocation**
Selling Expenses, Bad Debts, Storage expenses, Discount Allowed, Carriage	Salts Basis
Rent, Rates, Repairs, Insurance	On the basis of Floor Area occupied
Lighting	Lights Points
Power	Horsepower used
Salary	Time spent
Heating and Air conditioning	Consumption pattern
Depreciation, Repairs	Value of assets

Inter Departmental Transfers

In case of Dependent department system output of one department become input for other and accounting for inter department is required. This system is known as Inter department transfers.

Illustration 8

Please prepare a Departmental Trading and Profit and Loss Account & General Profit and Loss Account for the year ended 31-12-2014 of M/s Andhra & Company where department A sells goods to department B on Normal selling price.

Particulars	Dept. A	Dept. B
Opening stock	175,000	-
Purchases	4,025,000	350,000
Inter Transfer of Goods	-	1,225,000
Wages	175,000	280,000
Electricity Expenses	17,500	245,000
Closing Stock (at cost)	875,000	315,000
Sales	4,025,000	2,625,000
Office Expenses	35,000	28,000

Combined Expenses for both Department	
Salaries (2:1 Ratio)	472,500
Printing and Stationery Expenses (3:1 Ratio)	157,500
Advertisement Expenses (Sale Ratio)	1,400,000
Depreciation (1:3 Ratio)	21,000

Solution

M/s Andhra & Company Departmental

Trading and Profit and Loss Account

For the year ended 31-12-2014

Particulars	Dept. A	Dept. B	Particulars	Dept. A	Dept. B
To Opening Stock	175,000	--	By Sales	4,025,000	2,625,000
To Purchases	4,025,000	350,000	By Transfer to B	1,225,000	----
To Transfer from A	175,000	1,225,000	By Closing Stock	875,000	315,000
To Wages	1,750,000	280,000			
To Gross Profit c/d		1,085,000			
Total	**6,125,000**	**2,940,000**	**Total**	**6,125,000**	**2,940,000**
To Electricity Expenses	17,500	245,000	By Gross Profit b/d	1,750,000	1,085,000
To Office Expenses	35,000	28,000			
To Salaries (2:1 ratio)	315,000	157,500			
To Printing & Stationery (3:1 Ratio)	118,125	39,375			
To Advertisement Exp. (Sales Ratio 40.25 :26.25)	847,368	552,632			
To Depreciation (1:3 Ratio)	5,250	15,750			
To Net Profit	411,757	46,743			

Total	**1,750,000**	**1,085,000**	**Total**	**1,750,000**	**1,085,000**

General Profit and Loss

Account For the year ended

31-12-2014

Particulars	**Dept. A**	**Particulars**	**Dept. B**
To Stock reserve (Dept. B) To Net Profit c/d	81,667 376,833	By Departmental Net Profit b/d Dept. A411,757 Dept. B46,743	458,500
Total	**458,500**	**Total**	**458,500**

IN-TEXT QUESTIONS

5. Difference between the Invoice Price (IP) and the Cost Price (CP) in called ____________.
6. Department is a specialized functional area ______ an organization or division.
7. ______ expenses allocate on the basis of Horsepower used.
8. Rent, Rates, Repairs, Insurance expenses allocate on the basis of ________

8.11 SUMMARY

Branch Accounting means recording of transactions of different branches with the Head Office, other branches or with the customers. When the business become large in size and its level of operations expand with the time then businesses open their local shops known as retail shop or branches which are part of Head Office, that controls all the branches. So, Head Office is the place through which all the branches are controlled. The idea behind opening a branch is to eliminate middleman and reached the customers directly

There are two types of branches mainly classified for the purpose of accounting namely

1) Inland Branches 2) Foreign branches. Inland branches are further classified into two parts: a) Dependent Branches b) Independent Branches.

The accounts of branches may be kept in any one of the following methods:

(i) Debtors' system
(ii) Stock and Debtor System
(ii) Final Account System
(iv) Wholesale Branch System

Under Debtor System, the head office prepares a separate account for each branch on the basis of its location such as Bombay branch, Delhi branch and so on A branch account is a nominal account. In this system it is not possible to divide the profits into gross profit and net profit and most unfortunate drawback is the absence of control over the stock. In order to overcome this difficulty, the head office may adopt another method which is known as stock and Debtor System. It is a comprehensive system in which the head office has to prepare a number of accounts for each branch.

8.12 GLOSSARY

Branch: It is defined as a part or a division of main office or a business.

Debtor: A person who owes money.

Dependent Branches: They are also known as selling agencies as they sell to customer only those quantity whatever has been given by head office to them.

Answer to In-Text Questions

1. Independent	5. Loading
2. Separate Branch Accounts	6. Within

3. Cash-In-Transit 4. Good-In-Transit	7. Power 8. Floor Area

8.13 SELF-ASSESSMENT QUESTIONS

THEORY QUESTIONS

Q.1 Explain Stock and Debtor Method under Branch Accounting.

Q.2 Differentiate between Debtors System and Stock and Debtors System under Branch Accounting.

Q.3 Explain the accounting treatment of normal and abnormal loss of stock in branch accounting under Stock and Debtor system.

Q.4 Define Departmental Accounting and its objectives.

PRACTICAL QUESTIONS

Question 1 [Calculation of Credit Sales, Normal Loss and Manager's Commission]

Rosy (India) Ltd. of Delhi operates a retail branch at Madras. The head office makes all the purchases, and the branch is charged at cost price plus 50%. All cash received by the Madras branch is remitted to Delhi. Branch expenses are paid by the branch out of an imprest account which is reimbursed by Delhi H.O. monthly.

The branch keeps a sales ledger and certain essential subsidiary books, but otherwise all branch transactions are recorded by H.O. Debtors' balances were Rs 4,000. Branch stock Rs 6,000.

During the ended 31st March 20X2, the following branch transactions were made:

	Rs		*Rs*
Goods received from Delhi	15,000	Cash received from debtors	4.800
Cash Sales	6,900	Debtors written off as irrecoverable	250
Goods returned to Delhi	300	Cash discounts allowed to debtors	100
Authorized reductions in selling	150	Closing Debtors	10,150

price of goods sold		Branch Debtors' cheques returned dishonoured	5,000

A consignment of goods despatched to the branch on 28th March. with a selling price of Rs 180 was not received until 5th April, and had not been included in stock figure, which at selling price was Rs 7,290.

The expenses relating to the branch for the year ended 31st March 20X2 amounted to Rs 1,810.

Branch Manager is entitled to a commission of 5% of profits after charging such commission.

Note: Any stock unaccounted for is to be regarded as normal wastage and pilferage

Required Write up the necessary ledger accounts according to stock and debtors' system.

Question 2 [Treatment of Abnormal Loss, Goods-in-transit, Goods Sent to Another Branch]

Tulsian & Co. has two retail sales branches, X and Y, selling goods supplied to them by the company's central warehouse. All such supply of goods is charged at fixed selling price of cost *plus* 50 per cent. Sales are mainly for cash, but the Branch Managers are authorised to give limited credit in appropriate cases. Statement of accounts are sent by the Head Office to credit customers at monthly intervals with the request that they remit direct to Head Office where entire accounting is centralised. On 31st March 20X2, summarised branch statements show the following particulars in respect of the transactions of the branch X:

	Rs		*Rs*
Opening Stock at cost to Branch	2,67,000	Cash Sales	32,000
Opening Debtors	14,000	Goods returned by branch to Head Office	11,700
Cash remitted to H.O. by Branch credit customers	28,000	Goods returned by credit customers to H.O.	1,200
Goods returned by customers to branch	5,700	Cost of Goods sent to branch by H.O.	5,22,000
Goods transferred by X branch to Y branch	45,000	Cash remitted by customers to Branch	6,11,000
Bad Debts written off	1,500		

	Goods received by Branch till date at invoice price 7,80,00

The amount due by Branch credit customers as on 31st March 20X2 was Rs 96,000 and apart from goods (of the sale value of Rs 6,600) lost in transit from Head Office to branch, the actual stock in that date was in agreement with the book figures. A claim was made against the carrier in respect of lost stock and the sum of Rs 6,400 was accepted in full settlement. The Branch Manager is entitled to a commission of 5% of profit of the branch after charging such commission.

Required **Record** the whole of the foregoing in ledger accounts in the Head Office books

8.14 SUGGESTING READINGS

- *Monga, J. R., & Bahadur, R. (2022) Financial Accounting: Concepts and Applications. Scholar Tech Press, New Delhi.*
- *Tulsian, P. C. (2016). Financial Accounting. S Chand Ltd., New Delhi.*
- *Goyal, B. K., & Tiwari, H. N. (2021). Financial Accounting. Taxmann Publication, New Delhi.*
- *Horngren, C. T., & Philbrick, D. (2014). Introduction to Financial Accounting, Pearson Education, London.*
- *Kumar, A. (2018). Financial Accounting. Singhal Publication.*

LESSON 9

LEASE TRANSACTIONS: CONCEPT & CLASSIFICATION

Sumita Jain

STRUCTURE

9.1 LEARNING OBJECTIVES

- To know the meaning of Lease, its features, advantages and disadvantages
- To understand the types of leases
- To know about the accounting treatment of operating and financial lease
- To understand the difference between sale and lease transactions

9.2 INTRODUCTION

The lease is a contractual agreement whereby one party which is also called lessor, gives the right to use an asset to another party which is also called lessee or tenant, on payment of a fixed amount on regular basis. The definition of a lease includes agreements for an asset which contain a provision giving the hirer an option to acquire title to the asset upon the fulfilment of agreed conditions. These agreements are commonly known as hire purchase agreements. Hire purchase agreements include agreements under which the property in the asset is to pass to the hirer on the payment of the last instalment and the hirer has a right to terminate the agreement at any time before the property so passes."

9.3 MEANING OF LEASE

Collins dictionary "*defines lease as a legal agreement by which the owner of a building, a piece of land, or something such as a car allows someone else to use it for a period of time in return for money.*

AS-19 deals with accounting policies applicable to all types of lease agreement. "According to Sec 19 *"A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time."* Thus, a lease is a transaction between an owner of the property and a person that will use the property for a stated period of time at a specified series of payments. The owner of the property is known as the lessor and the person using the property is the lessee".

9.4 FEATURES, ADVANTAGES & DISADVANTAGES LEASE

Features of Lease

1) It is an agreement.
2) There are two parties one is called Lessor and Lessee.
3) In return of the assets there is a payment.
4) In lease agreement right to use an asset is given.
5) Lease agreement is given for a period of time.

Three Important Elements of Lease

(i) Lease Agreement: For getting lease of a property an agreement must be signed by both the parties to the lease i.e., by Lessor and Lessee.

(ii) Two Parties: There are two parties' lessor and lessee. Lessor is the person who owns the property and provides to the lessee whereas lessee is the person who get right of an immovable property and pays the rent for it.

(iii) Lease Charges: It is the consideration received by the lessor from lessee and includes Interest on the lessor's investment, Depreciation, Charges borne by the lessor, e.g., as repairs, maintenance, insurance, etc.

Advantages of Leasing

1. **Saving of Capital**—A business can save money by not purchasing an asset and instead taking it on lease.
2. **Availability of capital**—Lease often requires less amount of investment as compared to other options available
3. **Good option for starting new business**—For starting a new business, leasing is a good option to start.
4. **Ownership remains with lessor**—Leasing helps in the acquiring of an asset without necessary capital investment. Under this system of lease, ownership of the asset remains with the lessor and the lessee enjoys full control over the asset in his possession.
5. **Less Formalities**—Formalities in taking an asset on lease involved are much less than in case of borrowing from financial institutions.
6. **Technical Support -** Sometimes lessee also get support in terms of technical terms from lessor.
7. **Guard against Obsolescence**—In case of technology business, leasing is always good because in technology business, technology become obsolete very frequently. In case of leasing the risk of the asset becoming obsolete due to technological advancements is borne by the lessor.
8. **Amount of Rent**—Amount of lease payable by Lessee for using the assets is fixed throughout the period even if the value of assets changed.
9. Tax benefits—Leasing provides tax benefits to both the lessor and lessee as well.
10. **Improvements in Liquidity**—Leasing enables the lessee to improve liquidity position of themselves by gong for lease back technique.

Disadvantages of Leasing

1. **Restrictions in terms of flexibility**—The lessee cannot do changes or improvements in the asset or in agreement of lease without prior permission of the lessor. The lessor may also create some restrictions on the lessee which creates problem and hurdle in smooth conduct of business.
2. **Finance Lease is non-cancellable**—A finance lease is non-cancellable. So, Cancellation of lease is possible only at a very heavy cost, so if the asset become obsolete it become a loss asset.
3. **No benefits from increase in value—If the value of the assets is increase purchasing will be better option than leasing.**
4. **Debt financing v/s Lease financing**—Lease financing costs more than debt financing.

IN-TEXT QUESTIONS

1 Where one party gives the right to use an asset to another party is called _____

2. _______ deals with accounting policies applicable to all types of lease agreement

3. The definition of a lease includes ________for an asset
4. A finance lease is non ________
5. If the value of the assets is _________ purchasing will be better option than leasing

9.5 IMPORTANT TERMS USED IN LEASE AGREEMENT

The following terms are used in AS-19 with the meanings given:

a) **Date of the Lease:** The date of lease is decided between two dates namely first one is the date of lease agreement and second is the date when both the parties agreed on lease terms and conditions whichever is earlier.

b) **Lease period:** It is the total time period for which asset has been taken by Lessee on lease

c) **Non-cancellable Lease:** A lease is called a non-cancellable lease when there is a clause in lease agreement that lease agreement would not be cancelled in normal cases, only in exceptional cases it can be cancelled such as.

(a) Upon the happening of some contingency; or

(b) If both the parties agree on a new lease agreement for same assets

(c) With the approval of the lessor.

d) **Fair Value:** It is an amount on which both the parties agree to exchange the assets.

e) **Economic Life:** Life of an asset sometime also called as Economic Life of assets can be understood as the time period for which the assets remain useable or beneficial for users or in terms of production units to be obtained from assets.

f) **Useful Life:** Useful life of a leased asset is either:

(a) the term over which the leased asset is expected to be used by the lessee; or

(b) the number of production or similar units expected to be obtained from the use of the asset by the lessee.

g) **Residual Value:** Value of assets at the end of its life known as Residual Value of asset.

9.6 CLASSIFICATION OF LEASE

Lease generally means the use of other's property on payments of certain amount in instalments for a certain period of time. However, the lease transaction can be classified into two broad categories, namely (1) Operating lease (2) Financial lease. We are classifying the lease into two main types of leases on the basis of risk and reward associated with the leased asset. Risks include the possibilities of losses because of technological obsolescence and of variations in return due to changing economic conditions. Rewards may be—

– The profitable operation over the economic life of the asset,

– Realization of residual value, or

– Gain from appreciation in value.

Finance Lease

"Financial Lease is a lease that transfers all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred". Finance Lease is also called Capital lease. Generally, it is a long-term lease. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than its form.

The basic features of a financial lease are:

i) The lessor may or may not provide service, insurance and maintenance of leased asset.

ii) The lease is not cancellable by the lessee before the date of the agreement.

iii) The minimum amount payable at the beginning of the lease period is at least 90% of the cost of leased assets.

iv) Usually at the end of term of lease, lessor owns the asset.

Operating Lease

"Operating lease is a non-pay out lease wherein the owner (Lessor), permits the user (Lessee), to use of an asset for a particular period which is shorter than the economic life of the asset without any transfer of ownership rights. The Lessor gives the right to the Lessee in return for regular payments for an agreed period of time" ***According to AS-19, "Lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership".***

Indirect direct costs such as maintenance cost, insurance charges etc. is bearded by lessor and also the other expenses and recognized as an expense over the lease term on the same basis as the lease income.

Just like any other agreement of rent, in case of lease agreement also lease shown as an expense in the profit and loss account. At the end of the lease period, the asset is neither transferred to the lessee nor does he have the right to purchase the asset instead the leased asset is given to the lessor at the end of the lease period.

The lease period is normally short and may not be adequate to recover the cost of asset

Operating lease has following features:

(a) Operating Lease agreement is subject to cancellation before the expiry of lease period.

(b) Risks and rewards incidental to the ownership of asset are borne by the lessor.

(c) As compared to finance lease, Operating lease is short in term of time period of lease

(e) Time period of lease as compared to life of assets is short.

(f) At the end of the lease the lessor owns the asset.

IN-TEXT QUESTIONS

6. ___________ is the total time period for which asset has been taken by Lessee on lease
7. ______ is an amount on which both the parties agree to exchange the assets.
8. _________ is a lease that transfers all the risks and rewards incident to ownership of an asset.
9. ___________ is also called Capital lease.
10. Lease is classified as an _______if it does not transfer substantially all the risks and rewards incident to ownership leasing

9.7 DIFFERENCE BETWEEN OPERATING AND FINANCING

Basis	Financial Lease	Operating Lease
1. *Definition*	"A lease is classified as a finance lease if it transfers all the risks and rewards incident to ownership to the lessee."	"Lease is classified as an operating lease if it does not transfer all the risks and rewards incident to ownership to the lessee."
2. *Ownership*	At the end of lease period possession as well as its ownership rights get transferred	Ownership of the asset remains with the lessor for the entire lease period.
3. *Nature*	Finance lease is a sort of loan agreement in which the lessor plays the role of financier.	Operating Lease is similar to a rental agreement.
4. *Maintenance expenses*	The liability for repair, maintenance and insurance of equipment rest with the lessee.	The lessor maintains the leased asset and pays for expenses such as insurance, support staff, etc.
5. *Obsolescence*	Lessee bears the risk of obsolescence.	Lessor bears such risk.
6. *Duration*	In Compared to an operating lease, a financial lease is long-term in nature.	The lease term in case of operating lease is shorter than the economic life of the asset.
7. *Flexibility*	Agreement terms and conditions are flexible and subject to change	An operating lease is more flexible as compared to the finance lease.
8. *Option to purchase*	Financial lease allows the lessee to have a purchase option.	In operating lease, the lessee does not have any option to buy the asset during the lease period.
9. *Example*	Costly assets such as Plant and Machinery, Land, Office Building, aircraft, etc.	Assets like Car, Computers, Laptops, etc.
10. *Tax Benefit*	Operating lease is similar to renting hence, lease payment is considered as expense. No depreciation can be claimed.	Lessee can claim interest and depreciation both because financial lease is treated like a loan.

9.8 PRACTICAL

Illustration 1: [Classification of Lease]

Classify the following into either Operating or Finance Lease:

1. Lessee has the option to purchase the asset at lower than the fair value, at the end of the lease term.
2. Economic life of the asset is 8 years, lease term is 7 years, but asset is not acquired at the end of the leased term.
3. Economic life of the asset is 7 years, lease term is 3 years, but the asset is of special nature and has been procured only for use of the lessee.
4. Present value of minimum lease payment is ₹ – X. Fair value of asset is ₹ Y

Solution:

1. Finance Lease
2. Finance Lease
3. Finance Lease
4. Finance Lease only if X = Y or if X is substantially = Y; else it will be Operating Lease.

Illustration 2 (Calculation of Minimum Lease Payment)

You are required to compute the minimum lease payment in the following independent situations where Mr. and Mr. B are the Lessor and Lessee respectively:

(a) Monthly lease rent = ₹ 20,000, Lease term 5 years, Mr. Z a third party provides a guarantee on behalf of Mr. B that ₹ 70,000 will be paid as residual value.

(b) Monthly lease rent = ₹ 40,000 for 36 months, together with 3% of the sales revenue per annum. Expected sales revenue = ₹ 5,00,000 lakh. Mr. B guarantees to pay Mr. A ₹ 30,000 as residual value of the asset.

(C) Monthly lease rent = ₹ 2,00,000 for 36 months, Mr. Y has choice to purchase the asset at a certain date for ₹ 3,00,000. The fair value of the asset on that date is ₹ 4,50,000.

Solution:

Minimum Lease Payment (MLP) is calculated in each of the above independent cases are as under:

Cases and Computation	MLP
(a) Total Lease Rent Payable = ₹ 20,000×12×5 = ₹ 12,00,000 Residual value guaranteed by a third party (Mr. Z) = ₹ 70,000	For Lessee = ₹ 12,70,000 For Lessor = ₹ 36,70,000
(b) Total Lease Rent Payable ₹ 40,000×36 = ₹ 14,40,000 Residual value guaranteed by Mr. Y, the Lessee himself = ₹ 30,000 **Note:** *Contingent Rent is ignored.*	For Lessor = ₹ 14,40,000 For Lessor = ₹ 7,50,000
(c) Total Lease Rent Payable = ₹ 1,00,000×36 = ₹ 36,00,000 Purchase Option Price (₹3,00,000) or Fair Value of the asset (₹4,50,000) at the date of exercise of option, whichever is less = ₹ 3,00,000	For Lessee = ₹ 39,00,000 For Lessor = ₹ 39,00,000

9.9 ACCOUNTING TREATMENT OF FINANCE LEASE

Transactions are recorded in the books of accounts according to their substance and financial reality and not only on the basis of legal aspects. While the legal reality of finance lease is that the lessee has no legal rights over leased assets, but the financial reality is that the lessee has acquired the economic benefits of leased assets and in return an obligation to pay for that right an amount equal to fair value of assets and finance charges also. While recording finance lease in the financial statements of lessee the following points should be followed—

1. Lease is both an asset as well as a liability for lessee.
2. Both Lease Asset and Lease Liability are recorded in the Balance Sheet.
3. The Lease Asset depreciated like any other long-term asset.
4. The lease liability is amortizing like a note, where lease payments are separated into principal repayments and interest expenses.
5. There are both finance charge as well as reduction of liability.

Note—

(i) If lease transactions are not reflected in the lessee's balance sheet, the economic life and the level of obligations are destroying financial ratios. It is better to show finance lease in lessee's balance sheet on asset and liabilities side both.

(ii) Initial direct cost is incurred in connection with specific leasing activities, as in negotiating and securing leasing arrangements.

The assets and liabilities in lease payments has to be recognized in balance sheet at same amounts.

It is not appropriate to present the liability for a leased asset as a deduction from the leased asset in the financial statements. The liability for a leased asset should be presented separately in the balance sheet as a current liability or a long-term liability as the case may be.

Treatment of Depreciation

A finance lease gives rise to a depreciation expense for the asset as well as a finance expense for each accounting period. The depreciation policy for a leased asset should be consistent with that for depreciable assets which are owned, and the depreciation recognized should be calculated on the basis set out in Accounting Standard.

The depreciable amount of a leased asset is allocated to each accounting period during the period of expected use on a systematic basis consistent with the depreciation policy the lessee adopts for depreciable assets that are owned. If there is reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise, the asset is depreciated over the lease term or its useful life, whichever is shorter.

TREATMENT OF OPERATING LEASES IN THE BOOKS OF LESSEES

1) Lease payments are recorded as expenses in profit and loss statement unless you have a better method to record in operating lease.
2) Under this method neither the Leased asset nor leased liability is on the Balance Sheet.
3) Lease payment are recorded as expenses when paid.
4) Leased asset is not recorded in the Balance Sheet.
5) Liability of lease is not recorded in the Balance Sheet.

9.10 ACCOUNTING TREATMENT OF OPERATING LEASE

TREATMENT OF OPERATING LEASES IN THE BOOKS OF LESSEES

Journal Entries

1. **For Rent Expenses**

   Rent Expenses A/c Dr.

To Lessor A/C

(On a straight-line basis over the lease term i.e., Total Expenses/Lease Period)

2. For Payment of Lease Rent

Lessor A/C Dr.

To Bank A/C

3. For transfer of Lease Rent to Profit and Loss A/c at the end of the year

Profit and Loss A/C Dr.

To Rent Expenses A/c

TREATMENT OF FINANCE LEASES IN THE BOOKS OF LESSOR

While recording finance lease in the financial statements of lessor the following points should be followed—

1. In the books of lessor leased asset should be recorded as receivable of equal amount to net investment of the lease in case of finance lease.
2. The payment should be recognized as interest expenses and principal repayments.
3. The interest would be treated as Income.
4. The principal repayment would reduce the value of receivable in Balance Sheet.
5. Lessor wants to distribute income in leases term in a systematic manner. This income allocation is basically based on a basis having same periodic return on the net investment of the lessor outstanding in case of finance lease.
6. Lease payments relating in an accounting period, excluding costs for services, are reduced from both the principal and the unearned finance income.

TREATMENT OF FINANCE LEASES IN THE BOOKS OF LESSOR

While recording finance lease in the financial statements of lessor the following points should be followed—

4. In the books of lessor leased asset should be recorded as receivable of equal amount to net investment of the lease in case of finance lease.
5. The payment should be recognized as interest expenses and principal repayments.
6. The interest would be treated as Income.
4. The principal repayment would reduce the value of receivable in Balance Sheet.

5. Lessor wants to distribute income in leases term in a systematic manner. This income allocation is basically based on a basis having same periodic return on the net investment of the lessor outstanding in case of finance lease.
6. Lease payments relating in an accounting period, excluding costs for services, are reduced from both the principal and the unearned finance income.

OPERATING LEASES IN THE BOOKS OF LESSORS

While recording operating lease in the financial statements of lessor the following points should be followed—

1. The lessor will recognize leased asset on its balance sheet under fixed asset heading.
2. Lessor will claim depreciation on leased asset.
3. Costs incurred in earning the lease income are recognized as an expense.
4. Initial direct costs spend to earn revenues from an operating lease can be distributed as income over the leased term and are recognized as an expense in the statement of and loss in the period in which they are incurred.
5. The depreciation of leased assets shall be on a basis that is consistent with the normal depreciation policy, which the lessor is following

Accounting Treatment of Operating Lease in the Books of Lessor

Journal Entries

1. For Recording of Lease Rent Income

Operating Lease Receivable A/c	Dr.
To Lease Rental Income A/c	

2. For receipt of Lease Rental

Bank A/C	Dr.
To Operating Lease Receivable A/c	

3. For Depreciation

Depreciation A/C	Dr.
To Asset A/c	

4. For transfer of Rent Income to Profit and Loss A/c at the end of the year

Lease Rental Income A/c	Dr.
To Profit and Loss A/C	

5. For transfer of Depreciation to Profit and Loss A/c at the end of the year

Profit and Loss A/C	Dr.

To Depreciation A/c

Illustration 3: [Determining Nature of the Lease]

Determine either they are Finance Lease or Operating Lease from the following information:

(a) Lessor's cost of property leased ₹ 2,50,000

(b) Lesser is expecting a return of 16% p.a.

(c) Period of lease is 4 years

(d) Estimated residual value of the asset at the end of the period is 4% of the cost of asset which was paid by the lessee.

(e) Rental paid in advance at the beginning of the year ₹ 1,30,000

(f) Lease rent paid in the beginning of 2nd, 3rd and 4th Year are ₹ 80,000, ₹ 40,000 and ₹ 25,000 respectively.

Solution:

Calculation of Present Value of Minimum Lease Payment (MLP)

Year	MLP (₹)	Discount Factor (16%)	Present Value (₹)
Beginning of 1st	1,30,000	1.0000	1,30,000
Beginning of 2nd	80,000	0.8621	68,968
Beginning of 3rd	40,000	0.7432	29,728
Beginning of 4th	25,000	0.6407	16,018
End of 4^{th}	10,000	0.5522	5,522
Total	2,85,000		2,50,236

Determining nature of the lease—

Cost price or fair value of the asset = ₹ 2,50,000

Present Value of Minimum Lease Payment = ₹ 2,50,236

Investment in lease = ₹ 2,85,000

it is a case of finance lease.

Working Note

(1) P.V. Factor (P) = $\frac{1}{(1+i)^n}$

Where, $i = \frac{r}{100} = \frac{16}{100}$ and n = Period

P.V. Factor at the end of 1st, 2nd, 3rd, and 4th year = $\frac{1}{(1+.16)^1};\frac{1}{(1+.16)^2};\frac{1}{(1+.06)^3};\frac{1}{(1+.16)^4}$

= 0.8621; 0.7432; 0.6407; 0.5522

OPERATING LEASES IN THE BOOKS OF LESSORS

While recording operating lease in the financial statements of lessor the following points should be followed—

3. The lessor will recognize leased asset on its balance sheet under fixed asset heading.
4. Lessor will claim depreciation on leased asset.
3. Costs incurred in earning the lease income are recognized as an expense.
4. Initial direct costs spend to earn revenues from an operating lease can be distributed as income over the leased term and are recognized as an expense in the statement of and loss in the period in which they are incurred.
5. The depreciation of leased assets shall be on a basis that is consistent with the normal depreciation policy, which the lessor is following

Accounting Treatment of Operating Lease in the Books of Lessor

Journal Entries

1. **For Recording of Lease Rent Income**

   Operating Lease Receivable A/c Dr.

   To Lease Rental Income A/c
2. **For receipt of Lease Rental**

   Bank A/C Dr.

   To Operating Lease Receivable A/c
3. **For Depreciation**

   Depreciation A/C Dr.

   To Asset A/c
4. **For transfer of Rent Income to Profit and Loss A/c at the end of the year**

   Lease Rental Income A/c Dr.

   To Profit and Loss A/C
5. **For transfer of Depreciation to Profit and Loss A/c at the end of the year**

   Profit and Loss A/C Dr.

To Depreciation A/c

Illustration 3: [Determining Nature of the Lease]

Determine either they are Finance Lease or Operating Lease from the following information:

(a) Lessor's cost of property leased ₹ 2,50,000

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(f) Lease rent paid in the beginning of 2nd, 3rd and 4th Year are ₹ 80,000, ₹ 40,000 and ₹ 25,000 respectively.

Solution:

Calculation of Present Value of Minimum Lease Payment (MLP)

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Beginning of 1st	1,30,000	1.0000	1,30,000
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Total	2,85,000		2,50,236

Determining nature of the lease—

Cost price or fair value of the asset = ₹ 2,50,000

Present Value of Minimum Lease Payment = ₹ 2,50,236

Investment in lease = ₹ 2,85,000

it is a case of finance lease.

Working Note

(1) P.V. Factor (P) = $\frac{1}{(1+i)^n}$

Where, i = $\frac{r}{100} = \frac{16}{100}$ and n = Period

P.V. Factor at the end of 1st, 2nd, 3rd, and 4th year = $\frac{1}{(1+.16)^1};\frac{1}{(1+.16)^2};\frac{1}{(1+.06)^3};\frac{1}{(1+.16)^4}$

= 0.8621; 0.7432; 0.6407; 0.5522

9.11 ACCOUNTING FOR SALE AND LEASE BACK

A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor, e.g., XY Ltd. sold a typing Machine having WDV of ₹ 30 Lakhs to YZ Ltd. for ₹ 75 Lakhs and the same typing Machine was leased back by YZ Ltd. to XY Ltd.

The lease payments and the sale price are not dependent on each other. The accounting treatment of a sale and leaseback transaction depends upon the type of lease involved, i.e., whether it is a Finance Lease or an Operating Lease.

If a sale and leaseback lead to you to finance lease—

- Any excess or deficiency of sales proceeds over the carrying amount should be deferred and amortized over the lease period in proportion to depreciation of the leased asset.

If a sale and leaseback transaction leads to operating lease—

Case I

It is clear that the transaction is established at fair value: (Sale Price = Fair Value)

Any profit or loss should be recognized immediately.

Case II

If the sale price is below fair value: (Sale Price < Fair Value)

Any profit or loss should be recorded immediately

Exception: If the loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used.

Case III

If the sale price is above fair value: (Sale Price > Fair Value)

The excess over fair value should be deferred and amortized over the period for which the asset is expected to be used.

Note: *For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognized immediately.*

Illustration 4: [Sale and Lease Back]

X Ltd. sold a machinery having WDV of ₹ 20 Lakhs to Y Ltd. for ₹ 25 Lakhs and the same machinery was leased back by Y Ltd. to X Ltd. The lease back is operating lease. Comment if—

(a) Sale Price of ₹ 25 lakhs are equal to the fair value.

(b) Fair Value is ₹ 30 lakhs.

(c) Fair Value is ₹ 22.50 lakhs and Sale Price is ₹ 19 lakhs.

(d) Fair Value is ₹ 20 lakhs and Sale Price is ₹ 25 lakhs.

(e) Fair Value is ₹ 23 lakhs and Sale Price is ₹ 25 lakhs.

(f) Fair Value is ₹ 17.5 lakhs and Sale Price is ₹ 19.5 lakhs.

Solution:

Sl. No.	Profit/Loss	Treatment
(a)	Profit ₹ 5 Lakhs ₹ (25 - 20) lakhs	X Ltd. should immediately recognise profit in its books.
(b)	Profit ₹ 5 lakhs ₹ (25-20) lakhs	X Ltd. should immediately recognise profit in its books.
(c)	₹ Loss 1 lakhs X ₹ (20 - 19) lakhs	Ltd. should immediately recognise the Loss in its books, provided such loss is not compensated by future lease payment.
(d)	Profit ₹ 5 lakhs ₹ (25 - 20) lakhs	Profit should be deferred and amortised over the lease period.
(e)	Profit ₹ 3 lakhs ₹ (23 - 20) lakhs	Profit of ₹ 3 lakhs should be immediately recognised and the balance profit of ₹ 2 lakhs (25 lakhs - 23 lakhs) should be amortised/ deferred over the lease period.
(f)	Loss ₹ 2.5 lakhs ₹ (20 - 17.5) lakhs	X Ltd. should immediately recognise the Loss of ₹ 2.5 lakhs in its books. Profit of ₹ 2 lakhs (19.5 lakhs - 17.5 lakhs) should be amortised/deferred over the lease period.

9.12 IND AS 116 (LEASE)

According to Ind AS 116, Leases, is applicable for accounting periods beginning on or after April 1, 2019. Ind AS 116, Leases, replaces the existing standard Ind AS 17, Leases, and interpretation/ guidance contained in its appendices. New Ind AS 116, Leases, is based on IFRS 16 Leases which is an outcome of the joint project of IASB of IFRS Foundation and FASB, US National Standard-setter.

Leasing is a well-known and long-established form of obtaining finance. The new standard on leases ushers in a substantial change in the accounting for operating leases by lessees and few improvements in the disclosure related aspects for lessors accounting. The key changes in lessees accounting relate to introduction of single lease accounting model by elimination of classification between operating and finance leases, and recognition of gain/loss for sale and lease-back transactions. In the new lease accounting model for lessee's majority of leases will be recognized on balance sheet by recognizing a lease liability with a corresponding 'right-of use' asset. Ind AS 116 will have an impact on all three components of the financial statements. The extent of impact would vary for each industry depending on the financing and leasing structures prevalent in that industry.

1.12 DIFFERENCE BETWEEN IND AS-116 AND AS-19

Distinction between Ind AS -116 and AS-19 is as follows—

Basis of Difference	Ind AS-116	AS – 19
Scope and Coverage	Land is covered under this Standard. Ind AS 116 covers specific provisions relating to the right to use assets in a sub-lease as well.	The scope of standard specifically excludes lease agreement to use land. No specific provisions relating to sub-lease is there in AS-19.
Definition of Lease	A lease is the contract that conveys the right to control the use of an identified asset for a period of time in exchange for consideration.	A lease is a contract in which the lessor gives to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.
Accounting and Presentation in Financial Statement by lessee	Lessee will record assets and liabilities for all leases within 12 months, unless the underlying asset is of low value.	Under operating lease, asset is not recorded in books and a lease payment is recognized as

		expense in the profit and loss account.
Treatment of Initial Direct Cost – Finance Lease	It means that the gains/loss should be deferred and amortized over the lease term. The proportion/ratio term is not defined.	Para 48 of AS-19 states with Profit/ Loss arising from such transaction has been deferred and spend over the lease term in proportion to the depreciation of the leased asset.
Treatment of Initial Direct Cost – Operating Lease	Initial direct costs incurred by lessors in negotiating and arranging an operating lease shall be added to the carrying amount of the leased asset and recognized as an expense over the lease term on the same basis as the lease income.	The lessor has a choice to defer the booking of cost and allocate to income over the lease term in proportion to the recognition of rent income or are recognized as an expense in the statement of profit and loss in the period in which they are incurred.
Lease Modification	Initial Direct Cost is to be in the initial counting of the net investment in the lease and reduce the amount of income recognized over the lease term. The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the net investment in the lease; there is no need to add them separately.	Initial direct costs are either recognized at the same time in the profit and loss statement or allocated against the finance income over the lease term.
Classification of Lease in Hands of Lessee	Ind AS 116 deals with lease modification and its accounting.	No treatment.
Definition of Residual Value	Not Defined	Residual value is fair value of the asset at the end of the lease term.
Difference between Finance lease and operating lease	There are no two classes as operating or finance Lease of lessee and the Lessee will follow single Lease Accounting.	Leases is recognized according to classification into Operating and Finance Lease.

9.13 SUMMARY

The lease is a contractual agreement whereby one party which is also called lessor, gives the right to use an asset to another party which is also called lessee or tenant, on payment of a fixed amount on regular basis.

AS-19 deals with accounting policies applicable to all types of lease agreement.

A business can save money by not purchasing an asset and instead taking it on lease. Lease often requires less amount of investment as compared to other options available. For starting a new business, leasing is a good option to start but there are certain disadvantages also like the lessee cannot do changes or improvements in the asset or in agreement of lease without prior permission of the lessor. The lessor may also create some restrictions on the lessee which creates problem and hurdle in smooth conduct of business. Or a finance lease is non-cancellable. So, cancellation of lease is possible only at a very heavy cost, so if the asset become obsolete it become a loss asset or if the value of the assets is increase purchasing will be better option than leasing**.**

However, the lease transaction can be classified into two broad categories, namely (1) Operating lease (2) Financial lease. Operating lease is an agreement of lease wherein the owner (Lessor), permits the user (Lessee), to use of an asset for a particular period which is shorter than the economic life of the asset without any transfer of ownership rights. Financial Lease is an agreement of lease that transfers all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred. Finance Lease is also called Capital lease. Generally, it is a long-term lease.

There is another option available which is called Sale and Lease back option. A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor.

9.14 GLOSSARY

Lease: It is a contractual agreement whereby one party which is also called lessor, gives the right to use an asset to another party which is also called lessee or tenant, on payment of a fixed amount on regular basis.

Fair Value: It is an amount on which both the parties agree to exchange the assets.

Economic Life: Life of an asset sometime also called as Economic Life of assets can be understood as the time period for which the assets remain useable or beneficial for users or in terms of production units to be obtained from assets.

Residual Value: Value of assets at the end of its life known as Residual Value of asset.

"**Financial Lease**: It is a lease that transfers all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred.

Operating lease: It is a non-pay out lease wherein the owner (Lessor), permits the user (Lessee), to use of an asset for a particular period which is shorter than the economic life of the asset without any transfer of ownership rights.

Answer to In-Text Questions

1. Lessor	6. lease period
2. AS-19	7. lease amount
3. land	8. finance lease
4.Cancellable	9. finance lease
5. high	10. operating lease

9.15 SELF-ASSESSMENT QUESTIONS

State True or False.

(a) Lessor is the person who owns the property or makes the property available to the lessee. True

(b) AS-19 classifies lease into two categories, Finance Lease and Operating Lease. True

(c) Under operating lease, the lessee gets the option to purchase the asset. False

(d) Lease other than finance lease is called operating lease. True

(e) Financial lease is a revocable contract.

(f) Operating lease is usually of a shorter period.

Answer

(a) True (b) True (c) False (d) True

(e) False (f) True

II. THEORETICAL QUESTIONS

1. Explain the concept of lease.
2. Discuss different types of Leases.
2. Differentiate between operating and financial lease. **[B.Com., D.U.]**

3. What are the advantage and disadvantages of leasing.
4. Define operating lease. List out its features.
5. Define finance lease and its treatment in books of Lessor as well as Lessee in detail.
6. Define Sale and Lease back transaction and its treatment in books of accounts.
7. Differentiate between Ind AS-116 and AS-19.

9.16 SUGGESTED READINGS

- *Monga, J. R., & Bahadur, R. (2022) Financial Accounting: Concepts and Applications. Scholar Tech Press, New Delhi.*
- *Tulsian, P. C. (2016). Financial Accounting. S Chand Ltd., New Delhi.*
- *Goyal, B. K., & Tiwari, H. N. (2021). Financial Accounting. Taxmann Publication, New Delhi.*
- *Horngren, C. T., & Philbrick, D. (2014). Introduction to Financial Accounting, Pearson Education, London.*
- *Kumar, A. (2018). Financial Accounting. Singhal Publication.*

UNIT V

LESSON 10

COMPUTERIZED ACCOUNTING SYSTEM

Sumita Jain

STRUCTURE

10.1 LEARNING OBJECTIVES

- To know the use of computerized accounting software
- To understand the procedure of company creation
- To know about features of computerized accounting software
- To understand the process of Creating Accounting Ledges and Groups
- To know about Ledgers and their Heads.

10.2 INTRODUCTION

The Computerized accounting system provide various advantages to the business enterprise like speed, accuracy, reports, reduction in paperwork and searching of information, as and when required.

10.3 OBJECTIVES OF COMPUTERIZED ACCOUNTS

Computerized accounts by using any popular accounting software

There are many advantages of using computerized accounting systems. Some of them are given below:

1. **Speed:** Computerized accounting provides accounting information at very high speed.
2. **Accuracy:** Accurate accounting is only possible with computerized accounting
3. **Up to date:** All data entries and postings, helps in to maintain up to date Data.

4. **Backup of Data is possible:** Backup of the data can be taken, and this data can be restored as and when required.

5. **Quick Analysis of Records**: Quick analysis of the record can be possible with computerized accounting.

10.4 CREATING A COMPANY

This is the beginning screen of Tally software. When you press the Tally software Tally screen will appear and that screen will disappear all few second and you will find new screen after few seconds. This screen is shown in fig 1.1

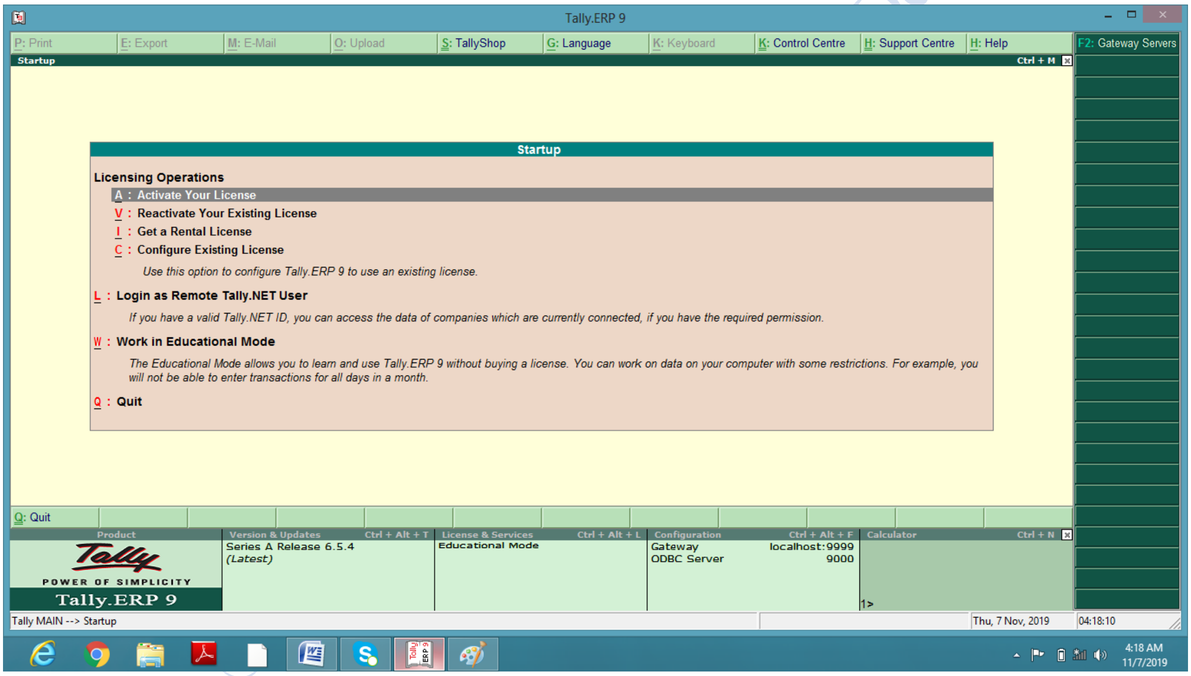


Fig 1.1: Shows the start-up screen of the tally software

The above figure shows the start-up screen. In this screen following options has been shown.

1. Licensing operator

2. Login as remote Tally .NET User

3. Work in Educational Mode

You have to select third option of **Work in educational mode** to begin with Tally software. You can also press Alt+W shortcut key to go directly to this option. After selecting this option one more screen will appear and that will lead you to create company. In that screen you will find six options. Out of these six options you must select Create Company option to create a company. After selecting that option, you will have one more screen to create a company. Figure1.2 is showing how to create company. The following information be provided like name of the Company used in tally software and address, country etc. This screen is further divided into two parts shown in fig 1.2 and 1.3

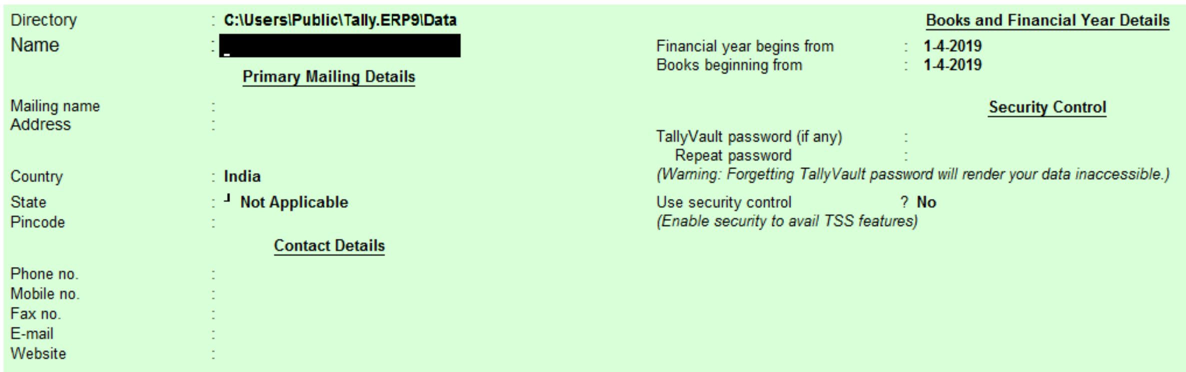


Fig1.2: Create Company by providing following information

Label Name	**Description**
Directory	It is a folder where you want to save the created Company The default folder option can be modified by pursuing the backspace key.
Name	Name of the company This name appears in the list of companies for selection and all the internal reports, and this is mandatory.
Mailing, it Get name printed invoice	By Default, mailing name is same as name of Company one can alter this name also.
Address	Enter the address of the Company here & then press enter to add another line. This option is also printed on hard copy reports. It is optional
Currency symbol	enter the symbol here
Maintain	You can choose Accounts only, inventory only Accounts with inventory option.

Financial year	Enter the beginning of financial year
Books beginning	
Tally Vault Password	By default, it says no if said to yes, if asks for tally vault password. This password restricts the access of only authorized uses.
Use security control	By default, it is no. If it is said to yes, it asks for the name of uses who would be accessing the data related to the Company Every time, uses menus to access to the Company a password is reqd. for authorization.

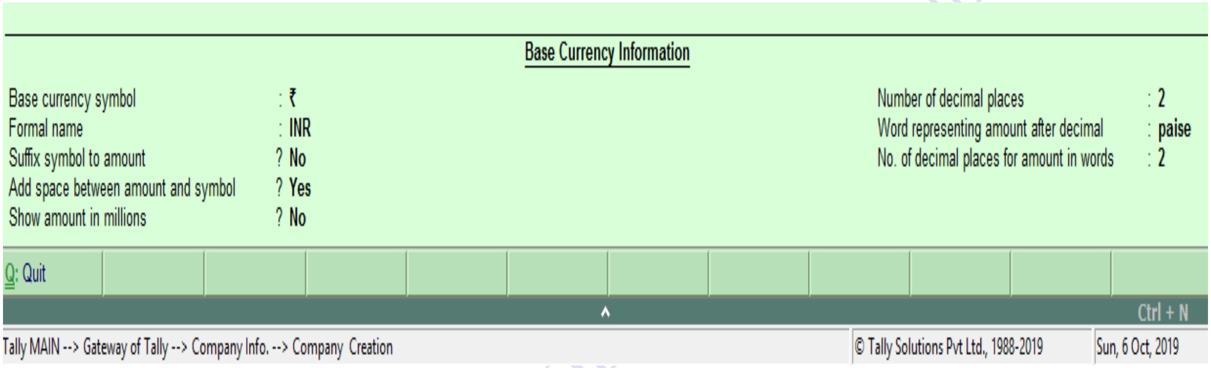


Fig 1.3: Base (Basic) Currency Information

Base Currency Symbol	Description of the currency symbol which you have entered in the upper part displays here. You can only see it.
Formal Name	Enter the formal name of the currency like INR, US Dollar
No. of Decimal places	Enter the no. of digits you want to display after decimal pt. e.g., for rupee is 2.
Is symbol suffixed to amts.	Write Yes/No
Symbol for Decimal portion	0 or 2
Show amts in millions	Yes/No
Put a space between amt. & symbol	Yes/No

Decimal Places

The Company information seen also provides for some other function related to Company shutdown i.e., shut company.

This option unloads a loaded Company The same Company can be reloaded in the future to work on it again. This does not mean deleting a Company create a new Company using following details.

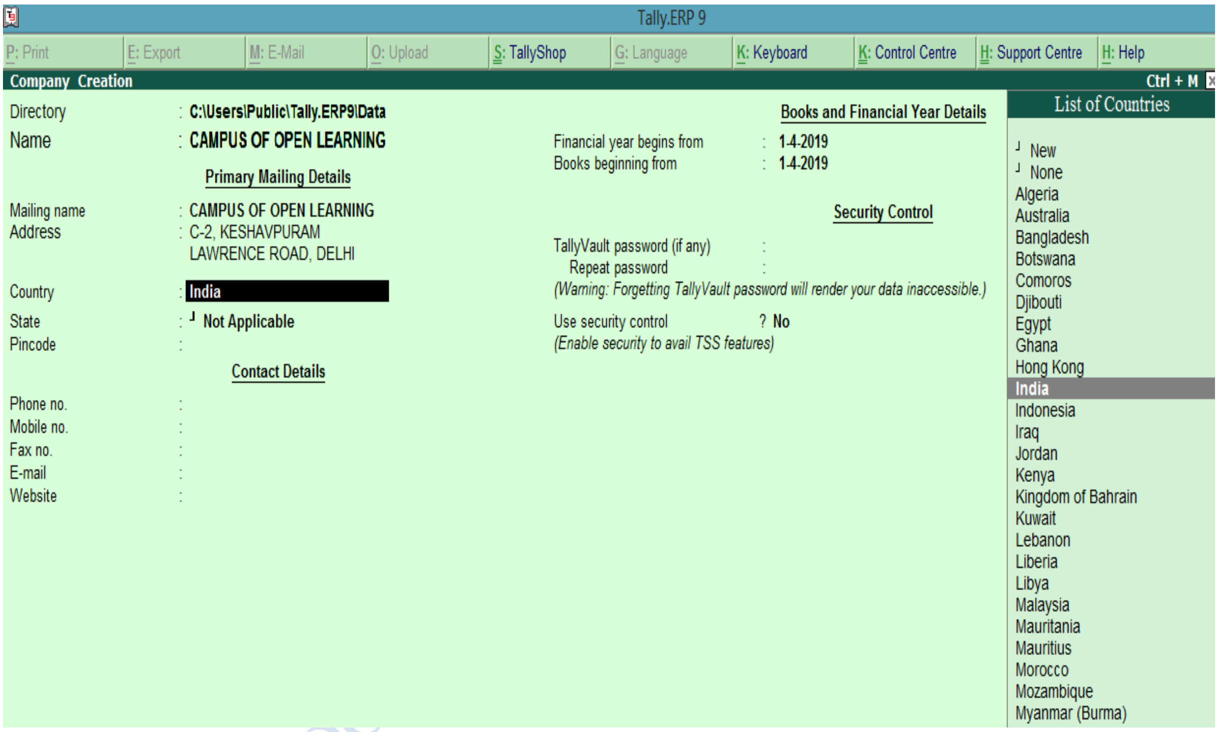


Fig1.4 Showing List of Countries

Fig :1.4 shows how to give details in of the Company

Name	-	Campus of Open Learning
Address	-	C-2, Keshav Puram, University of Delhi, Delhi-110032
State	-	Delhi
Telephone	-	6578995
Mob. No.	-	9810506070
email id	-	
Currency symbol	-	

Financial Year - 01-04-2018& books beg. date is also same

- The Company maintains Accounts with inventory; however, it does not want password protection.
- The Company wants a space between the amount & the symbol. New company created shown in fig 1.5.

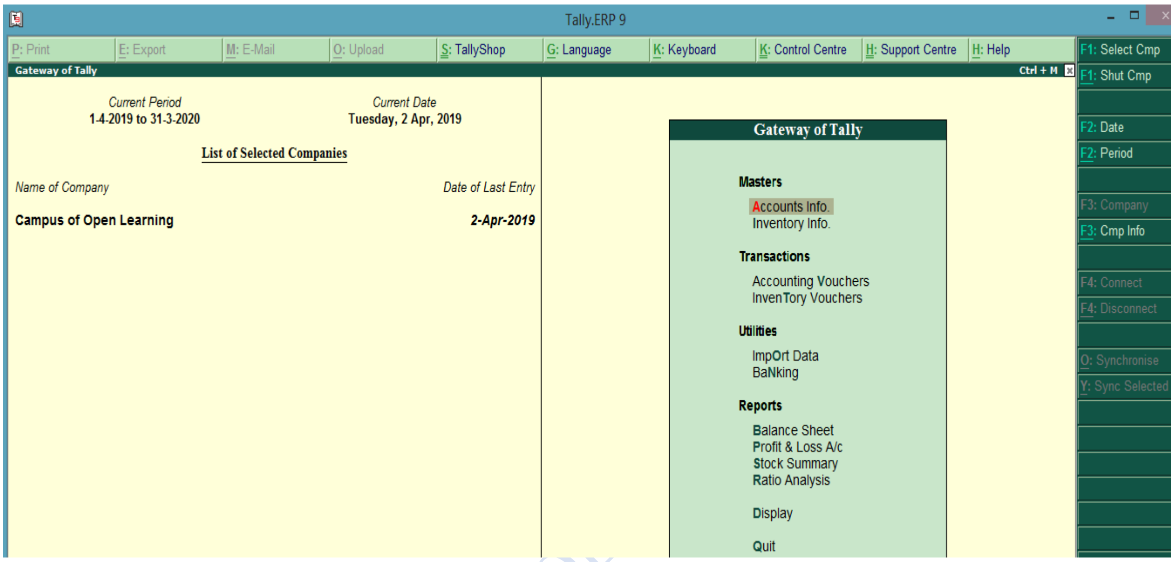


Fig 1.5: showing New Company has been created

IN-TEXT QUESTIONS

1. __________ of the data can be taken in computerized accounting software
2. _____________of the record can be possible with computerized accounting
3. You can press _____ shortcut key to go directly to Work in educational mode option.
4. The Company maintains Accounts with inventory; however, it does not want ____________.

10.5 SHORT CUT KEYS USED AT THE GATEWAYS OF TALLY

After creating the company, in case you want to change the definition of the company, use the buttons on the Button bar. These are shown below.

Buttons at Gateway of Tally Related to Company

Buttons	Keys	Description
Fl: Select Company	F1	Shortcut key helps you to load a company. For the selected company from the list of companies and you will be able to enter transactions.
Fl: Shut Company	Alt + F1	Shortcut keys help you to delete the company by selecting the company.
F2: Date	F2	Shortcut key helps to change the current date
F2: Period	Alt + F2	Shortcut keys help to change the beginning and the ending dates of the financial period.
F3: Company	F3	Shortcut key is disabled by default. (It can be enabled when you create more than one company. This button helps you to select a company for which you want to enter the transactions.)
F3: Company Information	Alt + F3	Shortcut keys activate the 'Company Info.' Menu. It is explained below this table in Fig 9 named: Company Information screen.
F4: Connect	F4	Shortcut key helps in connecting with Tally. NET
F4 Disconnect	Alt +F4	Shortcut key helps in disconnecting with Tally. NET
F11: Features	F11	Shortcut key helps in selecting and modifying different features of a company.
F12: Configure	F12	Shortcut key helps in setting up of different configurations (options and combinations) of a company.

Table T1: Showing Shortcut Keys used in Gateway of Company / Companies

Before you start with the second step of Group Formation/Creation, it is important that you understand Company- Info. (Alt + F3), F11: Features (F11), and F12: Configure (F12) buttons in detail, since they he in setting up different features and configuration of the company.

F3: Company Info Screen

Once the company is created, by pressing the E3: (Alt + F3) button the tally takes you to Company Info Sc as shown in Fig. 10.

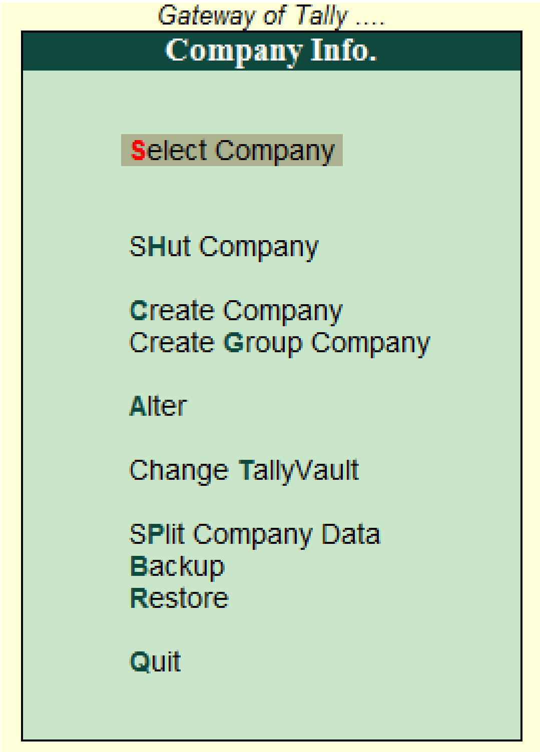


Fig: 1.6 Company Info Screen

Company Info Screen having following options are explained below:

Select Company: This is used to select a company from the list of created companies

Connect Company: This is used to connect to the company stored in Tally Vault.

Shut Company: This is used to delete the company from the list of created companies.

Create Company: This is used to create a company by filing in its details relating to name of the company, office address, type of company and so on.

Shut a company: This is used to select some other company to work with, you can unload the current company from the memory.

Create Group Company: This is used to create a company with a number of subsidiary companies.

Alter: This is used to make changes in the definition of the selected company of Alteration of the company's information.

It is some advice from Tally advice is to you not to alter the **Financial Year From** when making the changes else it may affect the entered data in the previous year’s books. It is also recommended not to change the **Financial Year From** when making the changes tally software it may affect the entered data in the previous year’s books.

Security Control: This is used to change the administrator and the respective password.

Change Tally/ Vault: This is used to help you make a company password protected.

Split Company Data: This is used to help you to split a company's financial year in to two halves.

Backup: This is used to save the companies and their related transactions in an external storage say a pen drive or any other device like external Hard Disk.

Restore: This is used to retrieve the saved companies and their related transactions from the external storage say a pen drive or a portable hard disk.

Quit: This is used to help you to switch back to the previous window i.e., Gateway of Tally.

F11: Features Button

At lower right bottom of the Gateway of Tally screen, while pressing this button different features of a company can he selected or modified (as showing in Fig. 1.7). This button is available in almost all the screens of Tally. ERP 9 enabling the user to modify it as and when your requirements change.

Fig 1.7: Company Features is specific to the current company only.

When we click on Accounting Features it opens a screen with number of options shown in Fig 1.7. The options are categorized as General, Outstanding Management. Cost/ Profit Centres Management, Invoicing, Budget and scenario Management, Banking Features and other Features and each option has sub-feature under it.

14.1 Total Short Cut Keys used in Tally for various options

Shortcut Key Details

1. Alt+F1- Shut Company, Detail Report
2. F1- Select company from Gateway of Company
3. F2- Change Date
4. Alt+F2- Change Period
5. F3- Switch between open more than one company
6. Alt+F3- Company Info (For Shut Company, select another company, Alter Company info, create company, Backup and Restore)
7. F4- Contra Entry Voucher
8. F5- Payment Voucher
9. F6- Receipt Voucher
10. F7- Journal Voucher
11. F8- Sales Voucher
12. F9- Purchase Voucher
13. Alt+C- Online Mater Creation
14. Ctrl+ Enter- Master Alteration
15. Ctrl+ A- Accept
16. Alt+E- Export
17. Alt+P- Print
18. Alt+D- Delete
19. Esc-Quit from current screen
20. Ctrl+N- Calculator

21. Alt+F4- Purchase Order
22. Alt+F5- Sales Order
23. Alt+F8- Delivery Note
24. Alt+F9- Receipt Note

10.6 ACCOUNTING FEATURES

Company: **Campus of Open Learning**

Accounting Features

General	
Maintain accounts only	? No
Integrate accounts and inventory	? Yes
Use Income and Expenses A/c instead of Profit and Loss A/c	? No
Enable multi-currency	? No
Outstanding Management	
Maintain bill-wise details	? Yes
For non-trading accounts also	? No
Activate interest calculation	? No
Use advanced parameters	? No
Cost/Profit Centres Management	
Maintain payroll	? No
Maintain cost centres	? No
Use cost centre for job costing	? No
Maintain more than one payroll or cost category	? No
Use pre-defined cost centre allocations in transactions	? No
Show opening balance for revenue items in reports	? No

Invoicing	
Enable invoicing	? Yes
Record purchases in invoice mode	? Yes
Use debit and credit notes	? No
Record credit notes in invoice mode	? No
Record debit notes in invoice mode	? No
Budgets and Scenario Management	
Maintain budgets and controls	? No
Use reversing journals and optional vouchers	? No
Banking Features	
Enable cheque printing	? Yes
Set/alter transaction types	? No
Set/alter banking features	? No
Set/alter post-dated transaction features	? No
Other Features	
Enable zero-valued transactions	? No
Maintain multiple mailing details for company and ledgers	? No
Set/alter company mailing details	? No
Enable company logo	? No
Mark changed vouchers	? No

Fig 1.8: General Accounting Feature

Accounting features are very important in Tally these are used to various management and namely as:

10.6.1 General

Integrated Accounts and Inventory

This is used on the Balance Sheet and Profit & Loss Account. If set to Yes, it extracts the stock/inventory balance figures from the inventory records and provides information in the Stock registers from the Balance Sheet.

Income/Expense Statement instead of P&L

This option is by default set as No. If running non-trading business and you want to enter records in Income and Expenditure statement, say yes. All menu options under Gateway of Tally would not show P/L Account which is needed for trading account.

Allow Multi-currencies

Allow multi currencies and record a transaction in foreign currency set this option to yes. This makes the Currency option available at accounts information menu.

10.6.2 Outstanding Management

Maintain Bill-wise Details

For Maintain balances bill by bill. Such a preparation helps us in allocating the payment to the required invoice further help in maintaining outstanding amounts like an instalment to be paid or a loan is to be received esp. for non-trading account also, a yes displays an additional option named Default Credit Period.

Activate Interest Calculation

Calculate interest on the outstanding invoices and the ledger balances. The interest is calculated only when you tell Tally about the interest rate and the style of calculation Using advanced parameters, when there is fluctuation in interest rate, set this option to yes.

10.6.3 Cost/Profit Centres Management

Maintain Payroll

Please set this option to Yes if you want to maintain Payroll information for the selected company.

Maintain Cost Centres

Maintaining the cost centres or the departments managing costs or expenses.

Use Cost Centre for Job Costing

Tracing income and expenses relating to a job.

More than One Payroll/Cost category

For multiple cost and payroll categories.

Show Opening Balance for Revenue Items in Reports

This helps in showing the opening balance for the cost centres that were allocated to the Ledgers or grouped under Income and Expenses Group.

10.6.4 Invoicing

Allow Invoicing

This helps in automatic calculation of duties and taxes by setting an invoice format for sales and purchase vouchers.

Enter Purchases in Invoice Format

This is in continuation to the above, where Tally gives the option for voucher class under the purchase voucher types.

Use Debit/Credit Notes

Again, this helps in the display of voucher types like the Debit Note and Credit Note.

Use Invoice Mode for Credit Notes and Use Invoice Mode for Debit Notes

They help in creating a credit notes and Debit Notes in Invoice Mode.

10.6.5 Budget & Scenario Management

Maintain Budgets and Controls

Set this option to Yes, to create multiple budgets. Budget option is available in Accounts Info. Menu.

Use Reversing Journals & Optional Vouchers

The Scenario option is displayed in Accounts Info menu. One can record in the Reversing Journal without affecting the books.

10.6.6 Banking Features

Enable Cheque Printing

Yes, select YES in this option to enable Cheque Printing. Refer Cheque Printing for details.

Alter Banking Features

Yes, select YES in this option to alter features with respect to Banking,

10.6.7 Other Features

Allow Zero Valued Entries in Voucher

If needed to make any voucher entry whose monetary transaction value is 0, respond yes.

Maintain Multiple Mailing Details for Company & Ledgers

Yes, select YES in this option to maintain multiple mailing details for your company and ledgers. Refer Multi Address for details.

Set/Alter Company Mailing Details

If this option is set to Yes, Tally. ERP 9 will allow you to alter the Create/Alter Address Types.

Enable Company Logo

This option allows you to print the company's logo on the selected vouchers, reports and invoices.

For our illustration, wherever the option is changes, it has been stated at the end of the option, otherwise the default option is taken.

The function key F2, F3 and F6 will display Inventory feature, Statutory and Taxation features and Add-ons features.

IN-TEXT QUESTIONS

5. _________ key is used to Select company from Gateway of Company
6. _________ key is used to Switch between open more than one company
7. _____________ key is used for Online Mater Creation
8. __________ is used to save the companies and their related transactions in an external storage
9. You can press _________ shortcut key to go directly to Work in educational mode option.
10. __________Shortcut keys activate the 'Company Info

Configure Button

F12: Configure Button

On clicking this button, a menu appears on the screen giving different configurations (options or combinations) of the company. Once we click/press the button, the following menu appears on the screen setting up various configurations (as shown in Fig. 1.9).

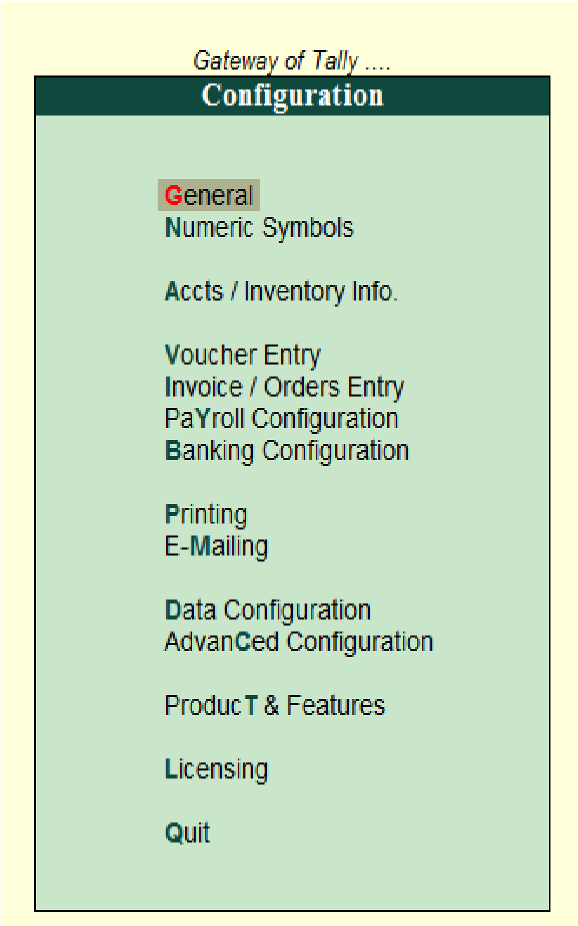


Fig: 1.9 Configuration of the Company

As we observe at the screen there are different configurations, our discussion is restricted to some important configurations discussed below. However, we can set the configuration at our discretion.

10.7 GENERAL CONFIGURATIONS USED IN TALLY

The options are to change the General Configuration in tally of the company where it asks about the place of the company, name, date format, currency format, table's column format type of business and the format of the statements associated to the business. They are shown in the Fig. 1.10 and discussed below.

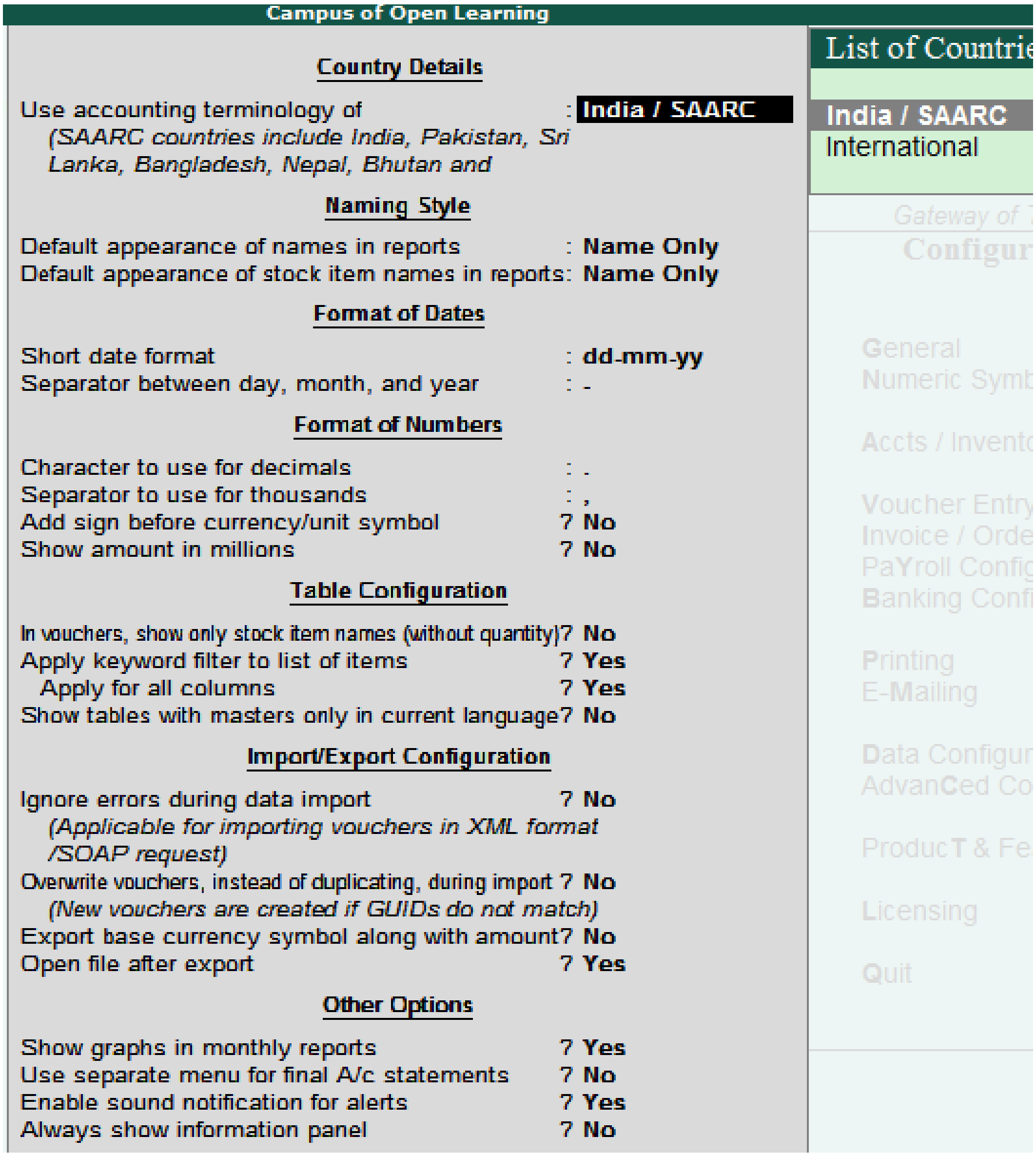


Fig 1.10: General Configuration

10.7.1 Country Details

Use Accounting Terminology: Accounting Terminology in terms of tax is different in Asia and Europe. For example: it is VAT in Europe, Sales Tax in Asia. At the time of company creation, Tally will ask for respective tax no. i.e., VAT Reign Number or Inter-state sales tax number and for a country in America use Indian/Asia option.

10.7.2 Naming Style

Default appearance of Names in Reports helps us in deciding how the name is to be displayed on the report / Ledger / stock item.

10.7.3 Styles of Dates

Styles of Short Date: You can select date in either of the 3 formats namely Indian (dd-mm-yy), American (mm-dd-yy) and Japanese (yy-mm-dd).

Separator Used in Short Date: Default short date is hyphened i.e., 01.04.2019. You can customize to dot (.) or colon (:) or slash (/) i.e., 01.04.2020 etc.

10.7.4 Configuration of Numbers

(i) Decimal Separator to Use: By default, dot (.) is used to represent decimal character (e.g., 999.99). You can change the decimal character if needed.

(ii) Thousand Separator to Use: By default, comma (,) is used as a thousand separator. You can change this too.

(iii) Put Signs before Currency/Unit Symbols: This option controls how signed number would be displayed. Default no displays negative number say 1000.00 in brackets i.e. (1000.00). Setting yes would make negative amount appear as (-) 1000.00

(iv) Show Numbers in Millions (and not lakhs): Responding yes would change the format in millions from lakhs (e.g., 99,999,999.99).

When the user selects the option named Numeric under Configuration screen in fig. 13, it displays the numeric configuration screen shown in fig. 15. Through this option you can configure Numeric symbols. The default settings are no, normal users and for our illustration) do not alter it. For special circumstances, alteration may be needed. You can configure symbols for positive and negative numbers, debit and credit amounts by changing their prefix or suffix.

The various options under Numeric symbols are discussed below. If one uses the default settings in combination, the numbers will be displayed as in the example. The various options under Numeric symbols are discussed below.

10.7.5 Table Configuration (Ctrl + Alt + F12 from Gateway of Tally)

(i) Use Common Table for Stock Items: During the voucher entry, only the stock item name is displayed if it is set to yes.

(ii) Use 'Reducing List' for Tables: This helps in reducing the size of the list when a search is made by the user. The search is based on full or partial search keywords provided like Company name, Ledger name, Item name etc.

(iii) Apply for All Columns: This again helps the user in searching from the only the first column (no option) or all the columns (yes option).

(iv) Show tables with master's only in Current Language: The default language is English. If you want to select, then it only gives the option for selecting the Indian language from the button bar at the top of this option. The button is L: Language.

10.7.6 Import/Export Options

(i) Ignore Errors & Continue during Data Import: If you want to import the error data written in XML format, set this option to yes. This will help in importing of the data written in XML Format.

(ii) Overwrite Vouchers During Import: Overwrites the data in the vouchers while importing, if set to Yes.

(iii) Export Base Currency Symbol along with Amount: Export of the currency symbol along with the amount into XML format.

10.7.7 Other Options

Show Monthly reports with Graphs: Shows graph and reports, but if your report does not contain space for graphs, set it to No.

Use Separate Menu for Final A/c Statements: Use to separate final account options to appear separately, set this option to yes.

Tally Alert using Beeps: A beep will be played by Tally ERP 9, whenever the user saves the company transactions or deletes it or quit it.

Always Show Info Panel: This option is always for display of information panel.

10.8 NUMERIC SYMBOL

Through this option you can configure Numeric symbols (Fig. 1).

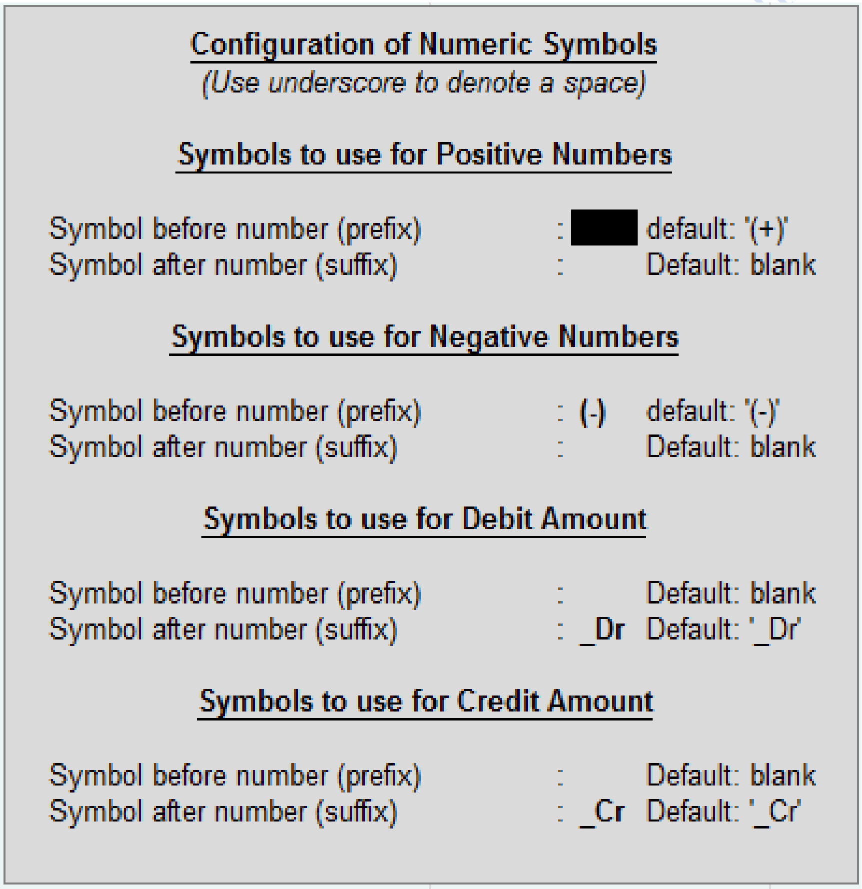


Fig 1.11: Shows configuration of numeric symbols

All default settings are so can be used by normal users and they do not alter it but for special illustrations / alterations it can be alter.

Symbols for positive and negative numbers, debit & credit amount by changing their prefix or suffix.

The various options used for numeric symbols as shown in configuration screen above can be used as under:
The various options under Numeric symbols are.

Field	Default Settings	Example
Symbols to user for Positive Numbers		
Symbols before Numbers (Prefix)	(+)	(+) 250.00
Symbols after numbers (Suffix)	Blank	(+) 250.00
Symbol during SDF Export (Prefix)	- (a white space)	250.00
Symbols to use for Negative Numbers		
Symbol before numbers (Prefix)	(-)	(-) 250.00
Symbol after numbers (Suffix)	Blank	(-) 250.00
Symbol during SDF Export (Prefix)	-(a negative sign)	-250.00
Symbols to use for debit amounts		
Symbol before numbers (Prefix)	Blank	250.00
Symbol after numbers (Suffix)	- Dr. (Dr. after a bank space)	250.00 Dr.
Symbol during SDF Export (Prefix)		-250.00
Symbols to use for credit amounts		
Symbol before numbers (Prefix)	Blank	(-) 250.00
Symbol after numbers (Suffix)	-Cr. (Cr. after a blank space)	250.00 Cr.
Symbol during SDF Export (Prefix)	Blank	250.00

Fig 1.12: Numeric Symbol

10.9 ACCOUNTS/ INVENTORIES

ACCOUNTS/INVENTORIES INFORMATION

This allows to configure Accounts and Inventory Masters.

10.9.1 Master Configuration

Once we click on Accounts/Inventories Information button,

`Tally MAIN --> Gateway of Tally --> Configuration --> Master Configuration`

Master Configuration screen with various options is displayed (shown in the Fig. 1.13) which are discussed below.

Master Configuration

Provide aliases along with name	? **Yes**
Provide language aliases for name	? **No**

Accounts		**Inventory**	
Provide advanced information in masters	? **Yes**	Allow advanced entries in masters	? **No**
Provide addresses for ledger accounts	? **Yes**	Provide part numbers for stock items	? **No**
Provide contact details	? **No**	Add description for stock items	? **No**
Add notes for ledger accounts	? **No**	Add remarks for stock items	? **No**
Add description for ledger accounts	? **No**	Use alternate units for stock items	? **No**
		Enable standard rates for stock items	? **No**
		Specify default ledger allocation for invoicing	? **No**
		Enable component list details (Bill of Materials)	? **No**
		Provide address for Godowns	? **No**

Fig 1.13: Master Configuration for Accounts and Inventory

Allow Aliases along with Names: Alias is the nickname for a master both accounts and inventory master. Setting this option to Setting this option to yes will asks for alias name at company creation screen.

Allow Language Aliases along with Names: This helps in setting the alias name for the language selected by the user at the company creation screen.

10.9.2 Accounts Master

Allow Advanced Entries in Masters: Setting this option to yes will ask few more queries than the normal in group or ledger creation screen.

Use Addresses for Ledger Accounts: A number of ledgers like customer ledger, debtor ledger or the bank account require the mailing details of the company. Set this option to Yes to enter the Name, Address, State, PIN Code and PAN / IT No. in this section. The mailing details also become part of the printed reports.

Use Contact Details: This option helps in specifying the details of Contact person (if any) in the ledger creation screen. The details may be the Name of the Contact Person, Telephone Number, Fax Number and the E-Mail Id.

Add Notes for Ledger Accounts: If you want to keep notes for ledger accounts say what type of expense to enter in expense ledger or payment behaviour of a party, set this option to Yes.

10.9.3 Inventory Masters

Allow Advanced entries in Masters: Setting this option to Yes will specify the behavior of the Stock Item, in the Stock Item Master.

Use Part Numbers for Stock Items: Set this option to Yes, to enter the Part Numbers of the Stock Item.

Use Description for Stock Items: Set this option to Yes to enter any Description of the Stock Item in the Stock Item Master.

Likewise, other options are self explanatory.

10.10 LEDGERS AND THEIR HEADS

LEDGERS	HEADS	LEDGERS	HEADS
O/P Stock	Stock in Hand	Drawings	Capital
Purchases	Purchases	Custom Duty	Direct Exp.
Purchase Ret.	Purchases	B/R	Current Assets
Wages	Direct Exp.	B/P	Current Liabilities
Power	Direct Exp.	Depreciation	Expenses indirect
Sales	Sales	GST /CGST / SGST /IGST Payable	Current Liability
Sales Returns	Sales	Furniture	Fixed Assets.
Sales Returns	Sales	Furniture	Fixed Assets.
Office Salaries	Indirect Expenses	Computer	Fixed Assets
Rates & Taxes	Indirect Expenses	Machinery	Fixed Assets
Insurance	Indirect Expenses	Loose Tools	Fixed Assets
Printing & Stat.	Indirect Expenses	Investment in Bonds	Investment
General Exp.	Indirect Expenses	Preliminary Exp.	Indirect Expenses
Dis. allowed	Indirect Expenses	Income Tax	Capital
Dis. Received	Indirect Income	Loan and Advance	Current Assets
Carriage outward	Indirect Expenses	Share Investment	Investment

Fur. Ins. Prem.	Indirect Expenses	Prepaid insurance	Current Assets
Interest Paid	Indirect Expenses	Advance received from customer	C.L.
Carriage Inward	Direct Expenses	Salary payable	C.L.
Interest Received	Indirect Income	Accrued Exp.	Current Assets
Capital a/c	Capital	Bank Charge	Indirect Expenses
Long Term Investment	Investments	Bill Drawn	"
Debenture	Secured Loan	Donation & Charity	"
Advertisement	Indirect Expenses	I.O. Loan	"
Freight	Direct	Legal charges	"
Bank over-draft	C.L.	Loss by Fire	"
Bank	Bank	Office lighting	"
Investment	Investment	Petty Exp	"
Rent paid	Indirect exp.	Salary	"
Rent Received	Income	Sales Tax	"
Deprecation	Indirect Exp.	Telephone charges	"
Secured Loan	Secured Loan	Suspense	Suspense
Impact Duty	Direct Exp.	Misc. Exp.	Indirect Exp
Royalty	" "	bad Debts Rec.	Indirect Inc.
Excise Duty	Duties & Taxes	I.O. Drawings	"
Service Tax	"	I.O. Invest.	"
TDS	"	Life Insurance	Capital
Stock	Stock in Hand	Any party to whom have given loan	Loan & adv. (Assets)
Goodwill	Current Assets	General Res.	Retained Earnings

Maintenance Audit Fees	Indirect Exp. "	Any party from whom we take loan	Loan & adv. (liability)
Security Deposit	Current Assets	Loan from bank Final Institution	Secured Loan
Elect. Deposit	"	Loan taken from others	Unsecured Loan
Rent "	"	Any Security Deposits	Current Assets

We shall now explain the remaining three steps namely, Group Formation, Ledger Creation, Voucher creation including stock items as well as creation of Final Accounts with the help of an illustration given below:

10.11 CREATING GROUPS (UNDER ACCOUNT INFO.)

When the user clicks on Accounts Info. option, Fig. 1.14. Tally asks for creation of Groups, Ledger, Vouchers. Let us begin with formation of groups.

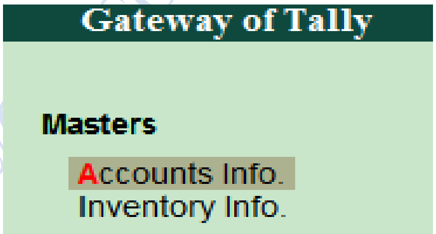


Fig 1.14: Account Information

Let us first understand the concept of Group from general viewpoint as well as the viewpoint of Tally ERP.

The general concept of accounts divides the accounting heads into four entities namely Liabilities, Assets, Income and Expenditure. The Groups (the accounting Quick Setup groups) are the sub-classifications of these four entities. This sub-classification tells the Type of information and its Amount.

The groups and sub-group are decided in hierarchy. This type of arrangement helps in automatic preparation of the final accounts. In the Fig. 1.15, the formation of sub-groups and sub-sub-groups has been shown in hierarchy (tabbed to the right in different rows) for the entity named Expenditure. Each tab indicates the sub-group under the previous group. An example of hierarchy of account can be seen in Fig. 1.15

Expenditure Account					
	Employee Expenses				
		Salaries and Wages			
			Salaries		
				Managerial Salary	
				Technical Staff Salary	
			Wages		
				Permanent Workers Wages	
					Time Rated Workers Wages
					Piece Rated Worker Wages
				Temporary Workers Wages	
					Apprentice Wages
		Bonus			
			Statutory Bonus		
			Ex Gratia		
		Incentive			
			Production incentive		
			Attendance Incentive		
	Administrative Expenses				

Fig. 1.15: Hierarchy of Groups

Note: The Bold words are the names of the ledger accounts.

Further, formation of a group decides whether the ledger account would be a revenue item, something that will affect the Profit and Loss Account or a capital item, i.e., whether it will become part of the Balance Sheet.

Tally sets 34 predefined account Groups called Reserved Groups (that cannot be deleted) as shown in Fig. 1.16

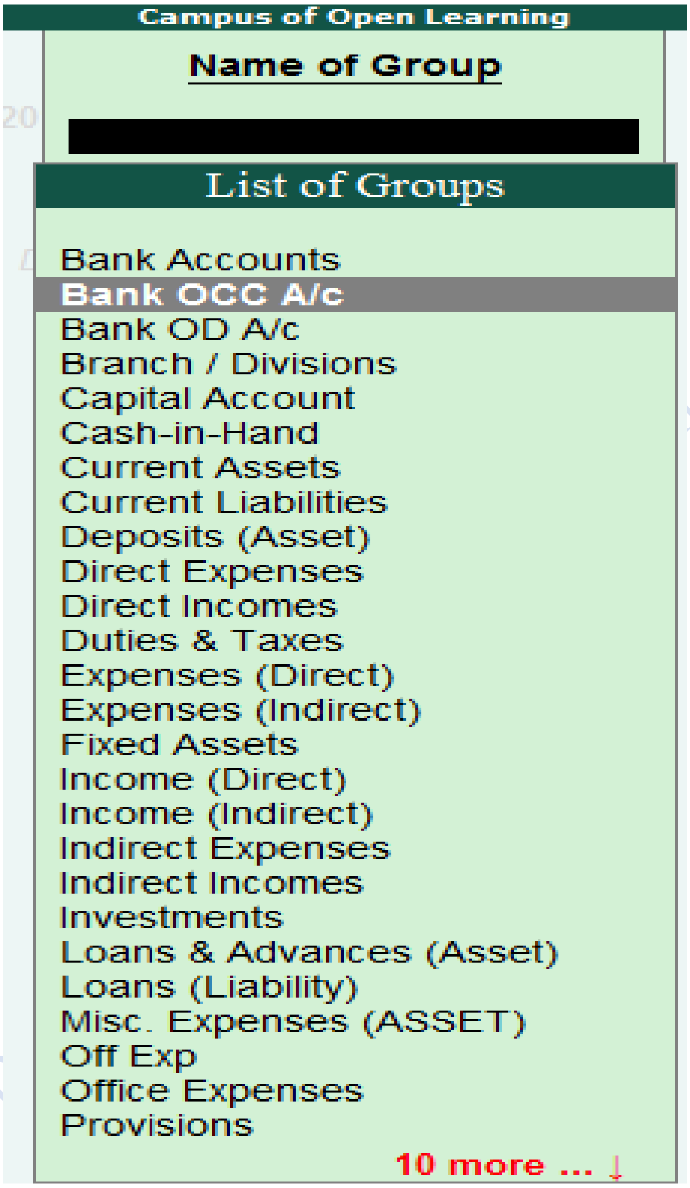


Fig 1.16: Hierarchy of Groups

The topmost 15 groups are called Primary Groups. The groups determine whether the ledger is a revenue item (effecting the Profit and Loss Account) or a capital item (to appear in the Balance Sheet).

These primary groups have been shown below under the head, reserved groups for the final accounts.

10.12 SUMMARY

The Computerized accounting system provide various advantages to the business enterprise like speed, accuracy, reports, reduction in paperwork and searching of information, up to date, Backup of Data is possible, Quick Analysis of Records as and when required. The general concept of accounts divides the accounting heads into four entities namely Liabilities, Assets, Income and Expenditure. The Groups are the sub-classifications of these four entities. This sub-classification tells the Type of information and its Amount

10.13 GLOSSARY

Tally: Tally is an accounting software.

Decimal Places: iCompany information seen also provides for some other function related to Company shutdown i.e. shut company.

Invoicing: It shows the total detail of sale and purchase method of payment, any dues etc.

Cost/Profit Centres: It is a unit of company responsible for maintaining cost and revenue records.

10.14 ANSWERS TO IN-TEXT QUESTIONS

1. Ample	6.F3
2. Analyses	7. Alt+C
3. Alt+W	8.Alt+F3
4. Password Protection	9.Alt+W
5. F1	10. Alt+F3

10.15 SELF-ASSESSMENT QUESTIONS

Exercise 1. Multiple Choice Questions (MCQ)

1. **There are many advantages of using computerized accounting systems. Some of them are not an advantage:**
   1. Speed: Computerized accounting provides accounting information at very high speed.
   2. Accuracy: Accurate accounting is only possible with computerized accounting

3. Up to late: All data entries and postings, helps in to maintain up to date to late Data.
4. Backup of Data is possible: Backup of the data can be taken, and this data can be restored as and when required.

2. Which options are not available on the screen while opening tally software:

1. Licensing operator
2. Login as remote Tally .NET User
3. Work in Educational Mode
4. Office Mode

3. Currency Information in Tally are not mentioned

1. Base Currency Symbol
2. No Decimal Places
3. Is Symbol suffixed to amounts
4. Symbol for Decimal Portion

4. Keys not used in Company

1. F1 to Select Company
2. Alt + F1 shortcut keys help you to delete the company by selecting the company.
3. F2 not for date
4. Alt + F2 for Period

5. Company Info Screen not having following explained below:

1. New Company: This is used to New a company from the list of created companies
2. Connect Company: This is used to connect to the company stored in Tally Vault.
3. Shut Company: This is used to delete the company from the list of created companies.
4. Create Company: This is used to create a company by filing in its details relating to name of the company, office address, types of company and so on.

6. Which Shortcut key is not for voucher entry?

1. F4: - Contra Entry Voucher
2. H5: - Payment Voucher
3. F6: - Receipt Voucher

4. F7: - Journal Voucher

7. Cost/Profit Centres Management having no features.

1. Maintain Payroll
2. Maintain Cost Centre
3. Use Cost Centre for Job Costing
4. Not More than One Payroll/Cost category

8. Table Configuration with (Ctrl + Alt + F12 from Gateway of Tally)

1. Use Common Table for Stock Items
2. Use 'Reducing List' for Tables:
3. Apply for All Columns:
4. Not showing tables with master's only in Current Language

9. Import/Export Options does not cover

1. Ignore Errors & Continue during Data Import
2. None of Them
3. Export Base Currency Symbol along with Amount
4. Overwrite Vouchers during Import

10. Other Options (for display of information)

1. Show Monthly reports with Graphs
2. Use Separate Menu for Final A/c Statements
3. Tally Alert using Beeps
4. Always Show Info Panel
5. All of them

11. The options are to change the General Configuration in tally of the company where it asks about the place of the company are

1. Name
2. Date format
3. Currency format
4. All of them

12. What covers in General Configuration

1. Country Details
2. Naming Style
3. Styles of Dates
4. Configuration of Numbers
5. All of them

Ans. 1. (3), 2. (4), 3(3), 4(3), 4(1), 6(2), 7(4), 8(4), 9(2), 10(5), 11(4), 12(5)

Exercise 2: Mix and Match the following

Name	It is a folder where you want to save the created Company The default folder option can be modified by pursuing the backspace key.
Directory	Name of the company This name appears in the list of companies for selection and all the internal reports, and this is mandatory.
Address	By Default, mailing name is same as name of Company one can alter this name also.
Mailing, it Get name printed invoice	Enter the address of the Company here & then press enter to add another line. This option is also printed on hard copy reports.

Ans. 2. 1(b) 2(a) 3(d) 4(c)

Exercise 3: Fill in the blanks

1. It is a folder where you want to save the created Company The default folder option can be .... by pursuing the backspace key.
2. Name of the company. This name appears in the list of companies for selection and all the internal .... and this is mandatory.
3. By Default, mailing name is same as name of .... one can alter this name also.
4. Enter the address of the Company here & then press enter to add another line. This option is also .... on hard copy reports. It is optional
5. You can choose .... only, inventory only Accounts with inventory option.

Ans 3. 1 (modified)**, 2** (reports)**, 3** (Company)**, 4** (printed)**, 5** (Accounts)

Exercise 4: Short Question Answers

Q. 1 Explain keys are used in company?

Q.2 Write any 10 shortcut keys are used in Tally for various options.

Q.3 What are the advantages of using computerized accounting system? Name them.

Q.4 Define steps to create company?

Q.5 Which options are available on the screen while opening tally software? Name them.

Company Creation

Jindal Pvt. Ltd., Bengaluru based company associated with trading electronics goods (e.g., Mobile, Laptop and computer peripheral etc.).

Step-1. Company Creation

Create a company in Tally.ERP 9 as per below given details.

Company Name – Jindal Pvt. Ltd.

Address – ABC Road, Bengaluru, Karnataka, India

Financial Year – 01-04-2019

Book Beginning – 01-04-2019 (we can change)

Before Starting Computerized accounting, we will be able to understand following in the different lessons of this unit.

Illustration: 2

Step-2. Master Creation (Accounting and Inventory)

Create last year closing ledgers as per given below details

Jindal Pvt. Ltd.

Balance Sheet

1 April 2019 to 31 March, 2020

Liabilities	**Amount**	**Assets**	**Amount**
Capital	5,00,000	Plant & Machinery	1,75,000
Loan from HDFC	2,50,000	Furniture	1,50,000
Outstanding Salary	25,000	Building	2,00,000
Sundry Creditors	65,000	Cash	50,000

Profit & Loss	1,55,000	Investment in Govt. Bond	1,40,000
		Kotak Mahindra Bank	1,40,000
		Sundry Debtors	70,000
		Closing Stock	70,000
Total	**9,95,000**		**9,95,000**

Details of Debtors:

Debtors Name	Bill No.	Bill Date	Amount
Raj Distributors	JPL-001	01-02-2019	30,000
Sharma Brothers	JPL-002	02-02-2019	40,000

Details of Creditors:

Creditors Name	Bill No.	Bill Date	Amount
Surya Traders	ST-004	01-01-2019	55,000
Sudhir Enterprises	SE-005	02-02-2019	10,000

Closing Stock Details:

Stock Group	Godown	Stock Item	UOM	Qty.	Rate	Amount
Mobile	Shop-1	Samsung S6	Pcs	4	12,000	48,000
Computer Peripherals	Shop-2	RAM 4GB	Pcs	5	2,000	10,000
	Shop-2	Motherboard	Pcs	2	4,500	9,000
	Shop-1	Keyboard	Pcs	5	500	2,500
	Shop-1	USB Mouse	Pcs	2		250

Illustration 3:

From the following transactions of Ravi Pvt. Ltd., write up a journal in proper form, post a ledger, take out a Trial Balance and prepare final accounts using Tally.

2019			
August	1	**Assets:** Cash in hand 1200: Cash at bank 2,300. Stocks of goods 5,000. Plant and Machinery 12,000. Furniture ₹500.	1,000

		M/s Jindal Bros. owe 2,500 M/s Bindal Bros. owe 3.500. **Liabilities:** Loan 3,000: sum owing to Jackson Bros. Ltd.,	
August	2	Bought goods on credit from Samuel & Co.	500
August	3	Sold good for cash to Dhiraj & Co.	200
August	4	Sold good to Jindal Bros on credit.	1,000
August	5	Received from Jindal Bros. in full settlement of amount due on January 1.	1,450
August	6	Payment made to Jackson Bros. Ltd. By cheque and they allowed discount.	975
August	9	Old furniture sold for cash	25
August	10	Bought good for Cash	50
August	11	Bindal Bros. paid by cheque; the cheque deposited in the bank	375
August	12	Paid for repairs to machinery	1250
August	13	Bought goods of Jackson Bros. Ltd.	50
August	13	Paid carriage n these goods	500
August	16	Received cheque from Jindal Bros.: and the cheque deposited in bank	25
August	16	Discount allowed to them	450
August	17	Paid cheque to Jackson Bros. Ltd.	25
August	18	Bank intimates that cheque of Jindal Bros, has been returned unpaid.	500
August	19	Sold goods for cash to VKay Bros.	300
August	21	Cash deposited in bank	250
August	24	Paid Municipal Taxes in cash	500
August	25	Borrowed from UK Co. Ltd. for erecting own premises. Money deposited with bank for time being	5,000
August	25	Sold goods to Narain Bros. and discount allowed	500
August	26	Old Newspaper sold	25
August	28	Paid for advertisements	10
August	30	Paid rent by cheque	50
August	30	Paid salary for the month	75

August	30	Drew out of bank for private use	150
August	30	Jindal Bros. becomes insolvent, a dividend of 1 rupee is received.	250
August	30	An amount written off as bad debts in 2018 has been recovered	75
		Closing Stock	4,000

The following is the composition of stock in hand:

Items	Group	Quantity	Unit Price	Amount
Tonner	Printer	5	200	1000
Cartridge	Printer	4	200	800
Power Cable	Computer Accessories	20	50	1200
Printer Cable	Computer Accessories	10	100	1000
				4000

Details of Debtors and Creditors are given below:

Debtors	Amount ₹	Creditors	Amount ₹
Sunita	250	Smriti	600
Anita	200	Tanu	1100
Prateek	500	Preeti	300
Anu	950	Ravi	950

Prepare final accounts of Ravi Pvt. Ltd and give details regarding stock in hand, debtors and creditors.

10.16 SUGGESTED READINGS

- *Monga, J R. Financial Accounting: Concept and Applications. Mayur Paper Backs, New Delhi*
- *Goyal, Bhushan Kumar and H.N. Tiwari, Financial Accounting, Taxmann*

LESSON 11

GROUPS AND LEDGERS

Sumita Jain

STRUCTURE

11.1 LEARNING OBJECTIVES

- To know how to create vouchers
- To understand the formation of Balance Sheet and various reports namely as Profit and Loss Account, Cash Book and Balance sheet etc.

11.2 INTRODUCTION

Ledger is the actual account head under which the transactions are identified. It is advised that one should first jot down all the accounts that one wish to create on the paper and then start placing them under appropriate group, else you may not be able to enter transactions properly in vouchers. The general concepts of Accounts divide the accounting heads into four entities.

1. Liabilities 2. Assets 3. Income. 4 Expenses

The groups are the sub-classification of these 4 entities. This sub class tells the type of info & amount.

11.3 RESERVED GROUPS THAT CO INTO BALANCE SHEET

BALANCE SHEET

Liabilities

1. Capital Account
    - Reserves and Surplus (Retained Earning)
2. Loans (Liability)
    - Bank OD Accounts
    - (Bank OCC Accounts) Secured Loans
    - Unsecured Loans
3. Current Liabilities
    - Duties and Taxes
    - Provisions
    - Sundry Creditors

Assets

4. Fixed Assets
5. Investments
6. Current Assets
    - Bank Account
    - Cash-in-hand
    - Deposits (Asset)
    - Loans and Advances (Asset)

Stock-in-hand
Sundry Debtors

7. Branch/Division
8. Miscellaneous Expenses (Asset)
9. Suspense Account

Reserved groups that go into Profit & Loss Account:

Income

10. Sales Account
11. Direct Income
12. Indirect Income

Expenses

13. Purchase Account
14. Direct Expenses
15. Indirect Expenses

Creation of Single/Multiple Groups

In order to create groups single or multiple go to:

Gateway of Tally → Accounts Information → Groups

Under Groups sub-option, options for creation, display and alteration of groups (single/multiple) are provided, as shown in Fig. 11.1.

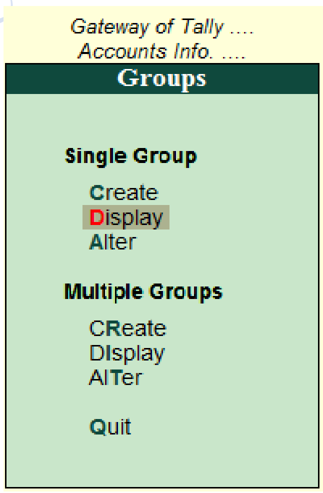


Fig 11.1: Creation of Single/Multiple Groups

(a) Single Group

In order to create single group, go to:

Gateway of Tally → Accounts Information → Groups Single Group → Click Create button

Screen with the name of active company at the top (See Fig. 2.2) appears.

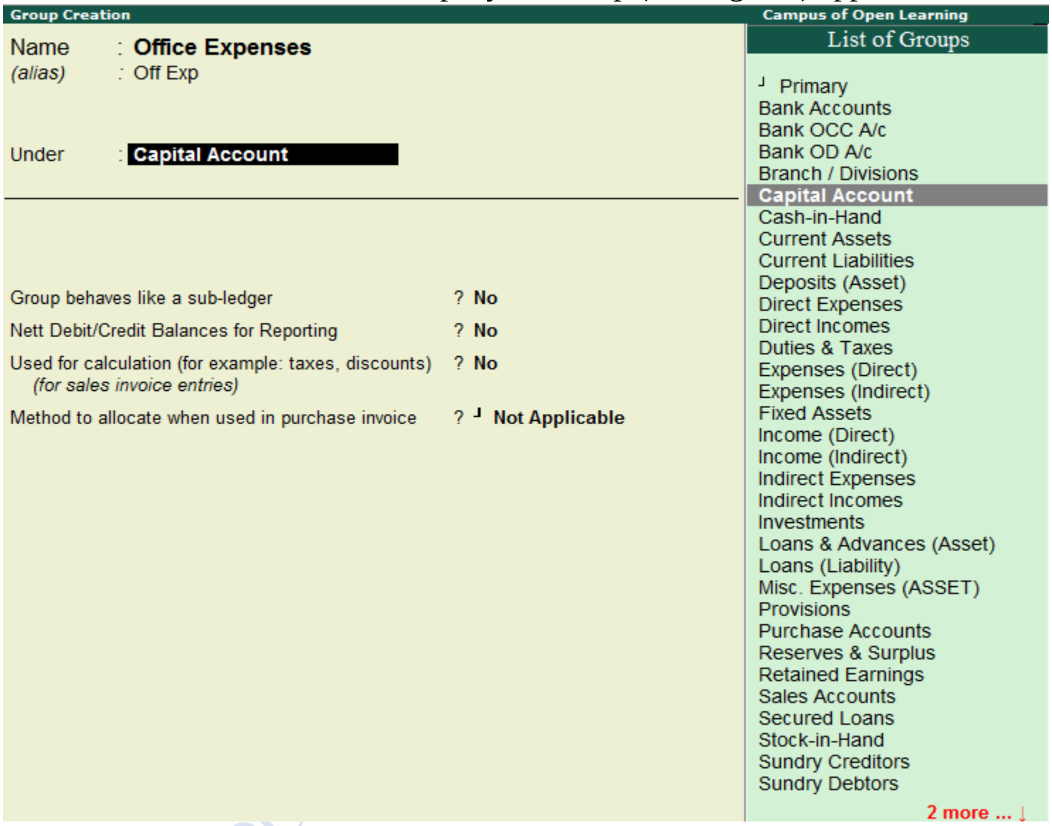


Fig.11.2: Single Group Creation Screen

It asks for the following:

Label Names	Description
Name	The name of the group one wishes to create.
(alias)	One can also give a new name to the already existing group either pre-defined or already created. Then the user has the option of using the group by its predefined name or the alias name.
Under	Asks where the user wants to insert the group. This displays the list of already existing groups along with their aliases.

Example	Advertising Expenses with the alias as 'Adv Exp' is created under indirect Expenses Group.

Display: Displays all the Groups created on company formation whether pre-defined or user defined.

Alter: click alter, if you intend to change the details of the groups already created (see Fig. 2.3). Through group alteration screen, you cannot change the head of the group.

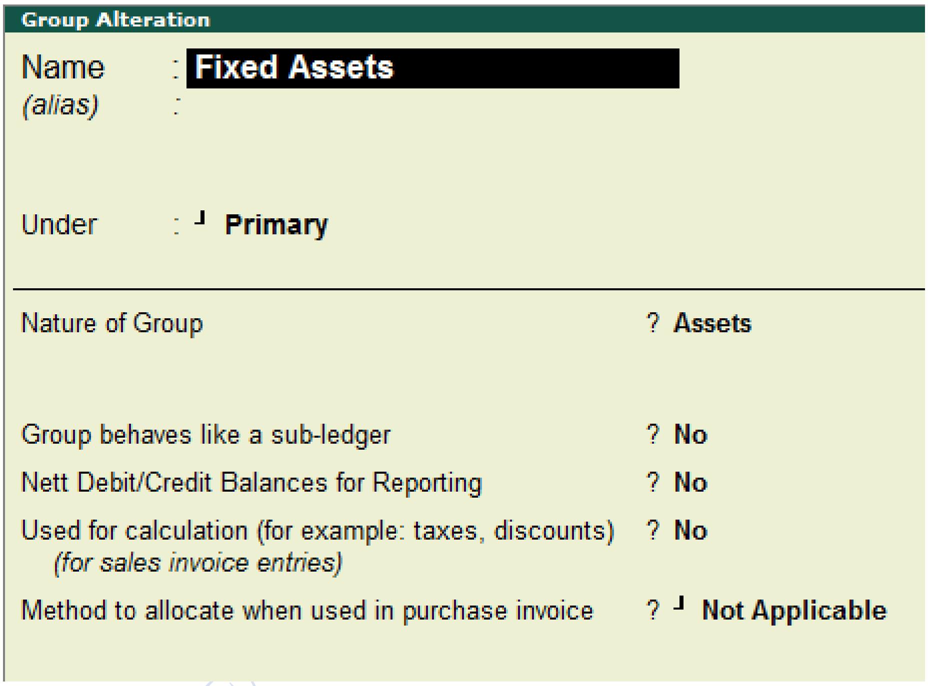


Fig. 11.3: Alteration Screen

Example 2

Create a Single group: Reserve and Surplus under the Capital Account.

Solution

Step 1: Gateway of Tally → Accounts Information → Groups → Single Group

→ Click Create button

Step 2: Enter the name Reserve and Surplus under the heading 'Name'

Step 3: Enter Undistributed Profit under the heading '(alias)'

Step 4: Select Capital Account in the heading 'Under'. Press Enter and Select Yes to create Single group (see Fig.11.4).

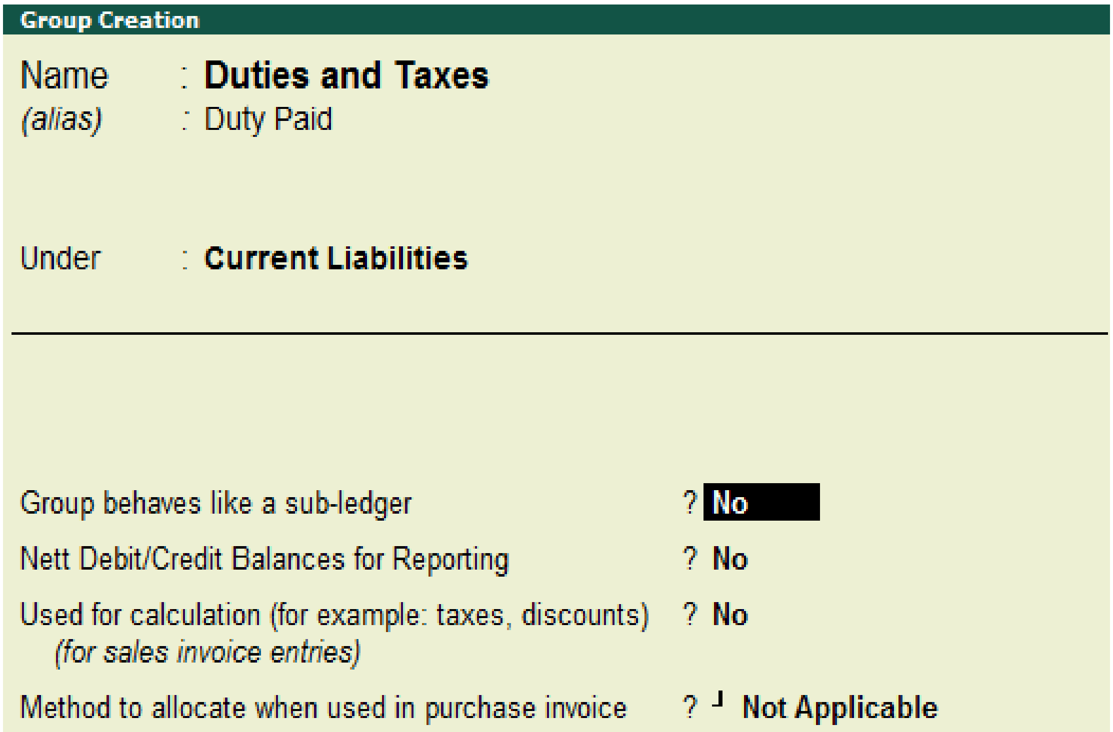


Fig. 11.4: Single Group Creation

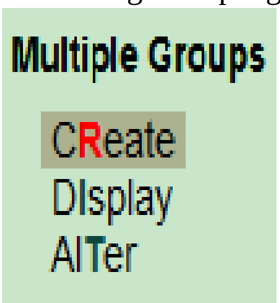
Problem 2:

Create a single group: Accounts Receivables under Current Assets.

(b) Multiple Groups

The process of creating multiple groups is same as of creating single groups, however it gives you an option of creating multiple subgroups under a group. In order to create Multiple groups, go to:

Gateway of Tally → Accounts Information → Groups → Multiple Groups → Click Create button Screen with the option of creating multiple groups appears (See Fig.11.5)



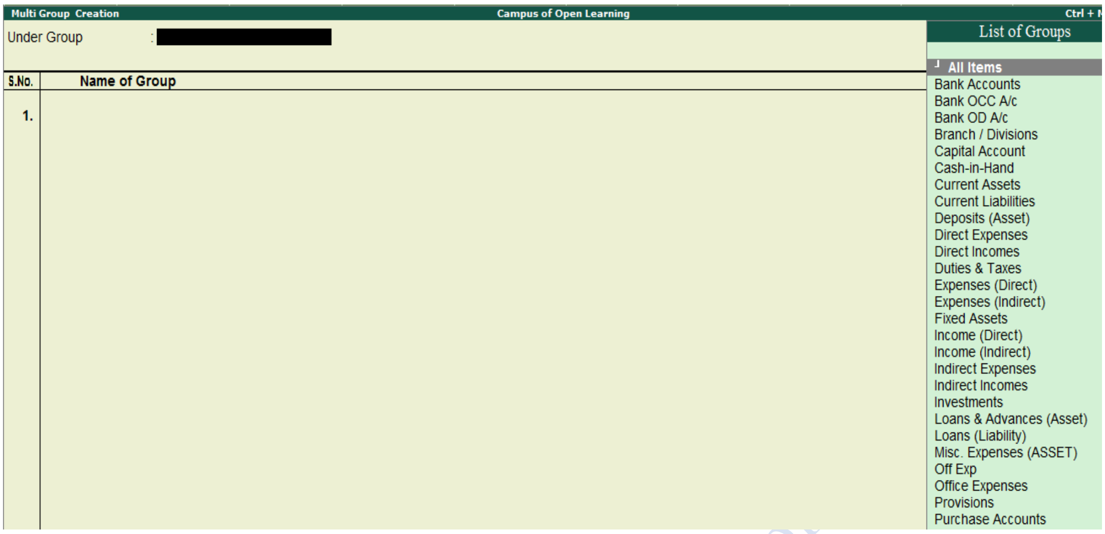


Fig. 11.5: Multiple Group Creation Screen

The option of Display and Alter remains same and has been explained under the heading Single group.

Example 3

Create Multiple groups using following items:

Prepaid Expenses and Accrued Income under Current Assets.

Solution

Step 1: Gateway of Tally → Accounts Information → Groups Multiple Group → Click Create button

Step 2: Select Current Assets from the List of Groups for the heading Under Groups

Step 3: Under the column Name of Group' enter Prepaid Expenses as S. No. 1 and Accrued Income as S. No. 2

Step 4: Press Enter and except Yes to create multiple groups.

The Display and Alter options are similar to one already discussed under Single Group option.

Note: There is no need to create any group other than one formed by Tally at company's creation. We will use the given groups and form ledgers under them for our illustrations.

Since we have already created a company Scholar Tech Press, the accounting process leading to Final accounts is being explained with the help of following illustration.

IN-TEXT QUESTIONS

1. Miscellaneous Expenses comes under ________ head of Balance Sheet.
2. The process of creating multiple groups is same as of creating _________ groups
3. Advertising Expenses with the alias as 'Adv Exp' is created under _______Group
4. Gateway of Tally → Accounts Information → ___________→ Click Create button

11.4 LEDGER CREATION WITHIN GROUPS

Ledger is the actual account head under which the transactions are identified. It is advised that one should first jot down all the accounts that one wish to create on the paper and then start placing them under appropriate group, else you may not be able to enter transactions properly in vouchers.

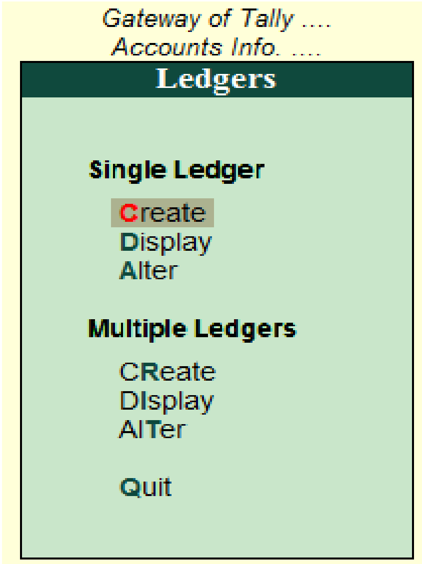
In an existing company, previous years final accounts (Balance Sheet and Profit and Loss Account) may guide you. If it is new company where the Books Beginning from and Financial Year From date are same, you should create all the ledgers appearing in the Balance Sheet as at the previous date with opening balance. **Fig 11.6 Ledger Screen.** Also create ledgers appearing in Profit and Loss Account but with zero (0) opening balances unless there is a difference in the dates of Books Beginning from and Financial Year From.

In our present illustration the ledger accounts that may be needed are Capital Account (Capital Account), Sales Account (Sales Account), Purchases Account, Bank Account (Bank Account), Cash Account, Jacob Bros. Ltd. Account (Sundry Creditor), Narain Bros. Account (Sundry Debtors), B. K. Bros. Account (Sundry Debtors), Discount Allowed Account (Indirect Expense), Repairs Account (Indirect Expenses), Cartage Account (Indirect Expenses), Municipal Taxes Account (Indirect Expenses), Advertisement Account (Indirect Expense), Rent Account (Indirect Expense), Salaries Account (Indirect Expense), Bad Debts Account (Indirect Expense), Discount Received Account (Indirect Income), Sundry Receipts Account (Indirect Income), Bad Debt Recovered Account (Indirect Income), Furniture Account (Fixed Asset), Loan Account (Loans (Liability)]. The brackets indicate the group under which the accounts will be created.

To create various ledger accounts in Tally:

Go to Gateway of Tally → Accounts Information → Ledger

When one selects ledger from the menu items, it opens another screen with various sub-options to create, view and alter ledgers under two categories: Single Ledger and Multiple Ledger as shown in Fig 11.6



Single Ledger

Create: Creates new ledger other than the 2 ledgers created by Tally at the time of creation of a company i.e., Cash Account and Profit and Loss Account. You can create additional cash account (e.g., Loan (Owings) Account, Petty cash account, Cash-at-branch, Cash-in-transit) etc. if required.

To create single ledger:

Go to Gateway of Tally → Accounts Information → Ledgers → under Single Ledger click Create the following screen (see Fig. 11.7) will open.

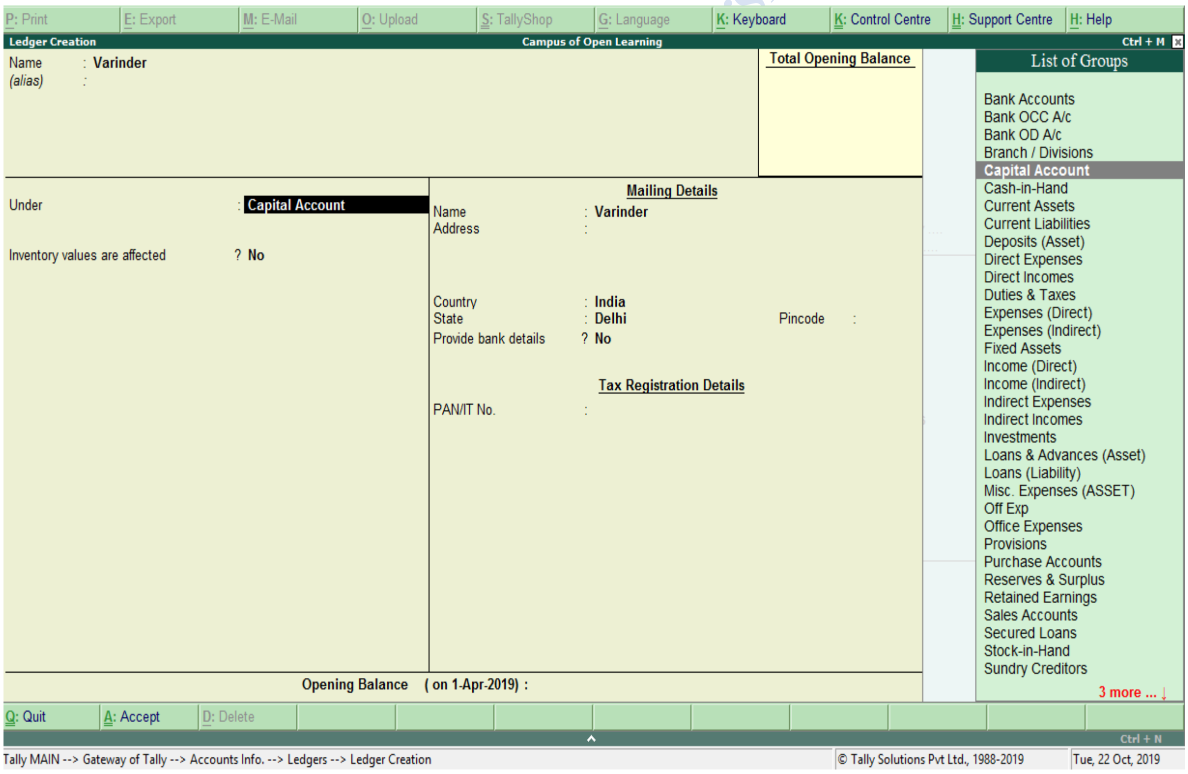


Fig. 11.7: Ledger Creation Screen

The options under Ledger Creation screen shown in Fig. 11.8 are discussed below:

Label Names	Description
Name	Enter the name of the ledger one wishes to create. This name appears in all selection lists and all internal reports, books of accounts etc. For our illustration, we have created an account in the name of Jacob Bros.
(alias)	One can also give a new name to the ledger account. Then the user has the option of using the ledger by its name or the alias. For the illustration, we have not given another name for Jacob Bros account.
Under	Select the parent group for the ledger from List of Groups. If the group is non-existent, you can create new groups by pressing Alt + C. This will bring group creation screen as explained under group creation step. Upon creation of the group, cursor will return to the ledger creation screen picking the newly created group. For the present illustration, Sundry Creditor group has been selected from the list as shown in Fig 2.8.
Maintain Bill by Bill	This option will come for creditors' ledger account and debtors' ledger accounts only. Since we have created a creditor's account, therefore we are getting this option. Say yes if you want to see the records bill wise.
Effective date for	This option will appear when you are creating a Bank ledger account. It asks for a date when you would like to reconcile the Cash Book and the Passbook when they differ.
Opening Balance	This will appear in all types of ledger accounts. It prompts you to enter an amount, which will be reflected at the top right corner of the screen. The amount so entered will be recorded for the date at which the books are beginning from (displayed for instant reference). When you enter the amount. also enter D (for Dr) or C (for Cr). Tally also inserts the sign according to the primary group under which the ledger has been selected. If you press enter at this prompt, no amount will be recorded. In the illustration, the transaction on 1 April 2015 relates to the opening balance. These amounts will be entered at the time of creation of ledger accounts. Once all the entries are filled in u ledger creation, press enter.

Name	This and the rest of the labels below will appear on the right side of ledger creation screen. It promotes one to enter the mailing name. Tally ERP 9 displays the ledger account name by default with a cursor, meaning that changes are possible. This name appears in all external documents (e.g., invoice, reminder letter, confirmation statement, cheque etc.)
Address	This will appear on the right side only when you have said "yes" in the master configuration screen for the option "Use Addresses for Ledger Accounts (see Fig. 16). This prompts one to enter the address of the party. The party can be a debtor a creditor, the business, the bank etc. When you have finished entering in the first row, press enter to go to the second row to enter the complete address.
State	This asks for the state in which the address of the party is.
Pin Code	Write the pin code of the address.
Provide Bank Details	This is needed when you need to receive money or make payment. Therefore, in case of debtor or creditor provide the address of the bank through which the transaction of money will take place.
Income Tax No.	Enter income tax no. (PAN/GIR) for the party. This information is printed on confirmation statement.
Sales Tax No.	Enter the party's sales tax registration details. If the party is within the state, enter local sales tax Registration Certification Number. This information can be optionally printed in documents like invoice, delivery and Receipt notes. Debit and Credit Notes.

On pressing enter, "Accept Yes or No" message appears on the bottom right corner of the screen. Press Y or click on yes to save the new ledger created. A blank screen would appear to enter particulars of next ledger. To quit, press Esc to quit with confirmation (Quit? Yes or no) or press Ctrl + Q to quit without confirmation.

Display: Select this option to view account ledgers individually. List of ledgers would be displayed to select the ledger you wish to view. There is no scope of alteration in this case.

Alter: Modifies ledger accounts individually (as shown in Fig. 11.8). List of ledgers would be displayed to select the ledger you wish to alter from the list.

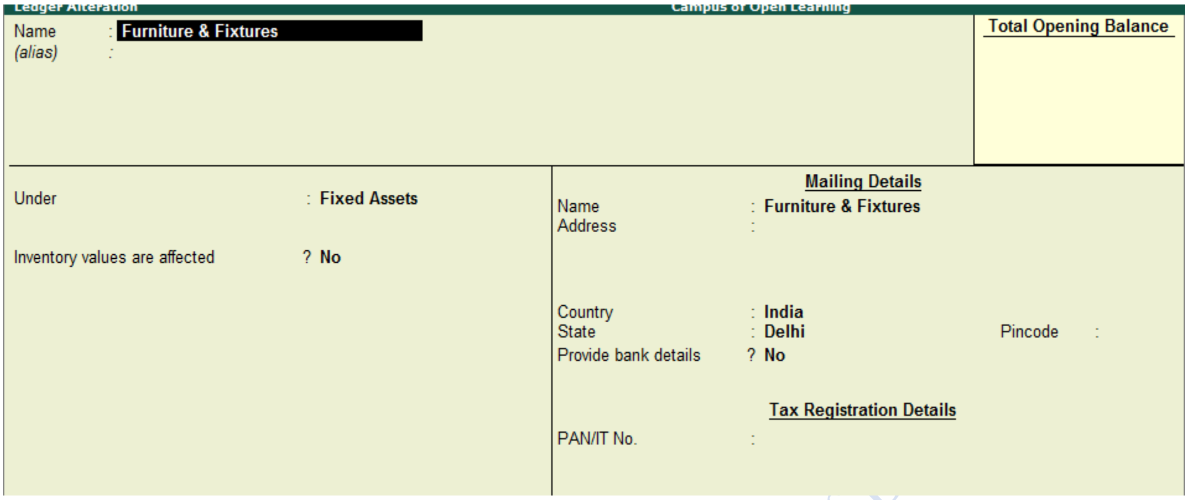


Fig.11.8: Ledger Account Alteration Screen

11.4.1 Multiple Ledgers

Create: This screen makes the work of the accountant easier. It helps one to create multiple ledgers account under one group selected from the list. On selection of this option, a screen appears as shown in Fig. 2.9. In the upper portion select the parent group under the heading "Under Group' and at the bottom columnar table, one can move from insertion of "Name of the Ledger" to the "Under" column by pressing TAB key and so on it reaches the second row for the creation of the second ledger account. Once you have created multiple ledgers Click Enter and press Yes to save them.

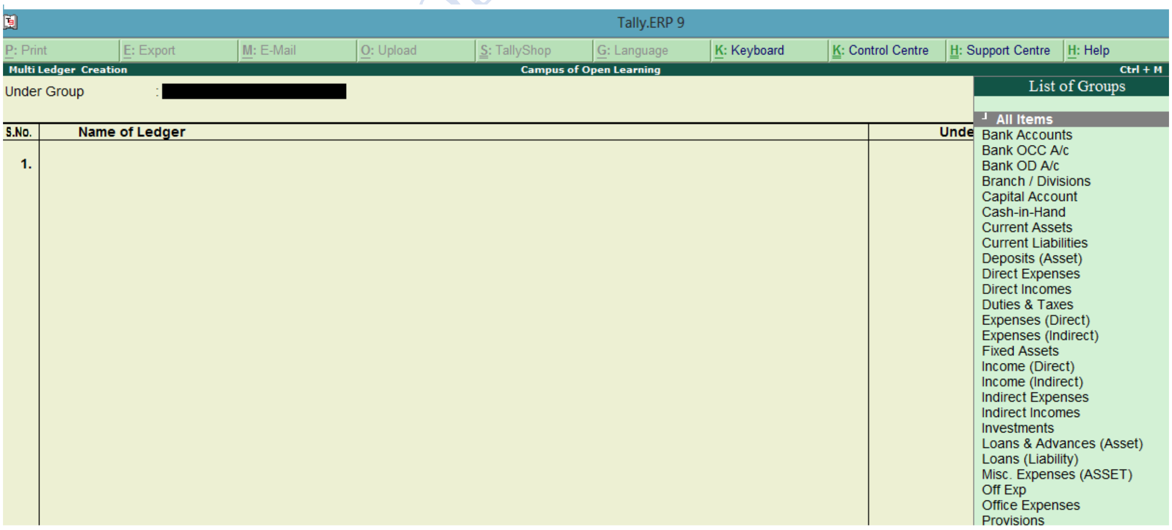


Fig. 11.9: Multiple Ledger Creation screen with Filled Entries

Let us discuss the labels needed for creation of multiple ledgers screen below.

Label names	Description
S. No.	Serial Number of the entry is displayed for reference; however, cursor does not move here. This is auto generated.
Name of the ledger	Enter the name of the ledger you are creating.
Under	If you have selected a group in "Under Group" label at the top, the cursor will not prompt here. It will jump to the next column when you press TAB key. If one has selected "All Items" in under group label, cursor will display a list of groups to select from for each ledger entry.
Opening balance	Dr/Cr Enter the opening balance for the ledger, if any, At Dr/Cr field enter D or C. If you have opted to maintain bill-wise balance for the company, bill-wise allocation screen would appear on entering opening balance for any ledger. On pressing enter, cursor would return to the Fig. 2.9 to make you enter the details of the next ledger account.
Thus, one can create multiple ledgers in one single entry screen. To terminate further entry press, enter on blank line and respond yes to the query Accept? Yes or No.	

Display: This option will display the ledger accounts created under the selected group. This does not show let you make any changes.

Alter: It helps the user to alter multiple ledger accounts while on the same screen. This screen functions just like the Multiple ledger Creation screen as shown in Fig. 2.9 except that the ledger accounts are already displayed, cursor is placed on the first entry, and it moves from one entry to another when the user presses a TAB key. This screen also lets the user, create new ledger accounts.

11.4.2: Buttons on Multiple Ledger Screen

F4: Parent: This button enables you to change the parent group in "under group" option.

F8: Skip details: This button lets you skip the opening balance. When you create new ledgers in mid-year. opening balance would be naturally zero (0) Skipping the opening balance column will help you in creating the ledger accounts faster.

11.5 Groups Formation, Types of Groups and Group Formation

The general concepts of Accounts divide the accounting heads into four entities.

1. Liabilities
2. Assets
3. Income
4. Expenses

The groups are the sub-classification of these 4 entities. This sub class tells the type of info & amount.

The groups / subgroups are decided in a hierarchy. This arrangement helps in automatic preparation of final ac/s.

	Expenditure A/c
Groups	Employees Salary &wages
Subgroups	Salaries
	Wages
Groups	Incentives
Subgroups	Monetary
	Non-Monetary
Groups	Bonus
	Statutory

Formation of a gap decides whether a ledger a/c would be a revenue item or capital item.

Ledger A/c

Revenue	Capital
Item	Item
(Will affect the P/L a/c)	(will become factory B/S)

Tally set 34 per defined groups/ Accounts, these are called reserve groups, (these cannot be deleted).

The topmost 15 groups are called primary groups.

Liabilities

1. Capital A/c

   Reserves & surplus (Retained Earnings)

2. Loans – Recovery Geps

   Bank O/

   Secured Loans

   Unsecured loans

3. Current Liabilities

   Duties & Taxes

   Processions

   Sundry Creditors

Assets

4. Fixed Assets

5. Investments

6. Current Assets

   Bank A/c

   Cash in Hand

   Deposits

   Loans & Advances

   Stocks in Hand

   Sundry Debtors

7. Branch / Division

8. Mis. Expenses

9. Suspense Accounts

Reversed Groups that go into P/L a/c (Reserve Nature)

* Income

10. Sales a/c

11. Direct Income

12. Indirect Income

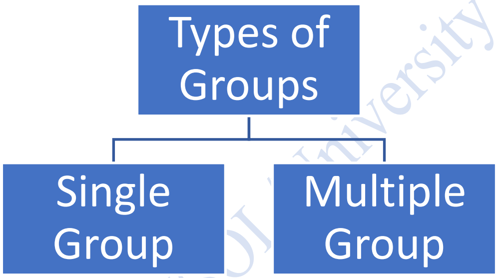
* Expenses

13. Purchases

14. Direct Expenses

15. Indirect Expenses

TYPES OF GROUPS



Single Group: Here the uses can create only one group at a time.	**Multiple Groups**: The uses can create more than one group on the same screen.

Primary Groups are divided into subgroups & and subgroups is a collection of ledger Accounts of related transactions.

For eq. Answer that –

Creation of Ledgers

Tally creates two ledger a/c

Automatically – cash a/c & P/L a/c automatic voucher entries (recording of transactions) will only be possible if it is related to these two Accounts, so you have created all other ledger Accounts except these.

The only thing left in our Group creation is maintaining inventories. To create the different types of inventories we need to follow these steps:

Step 1: Create Sock Groups

As per our illustration, we first need to create the four Stock Groups of "Bed sheets", "Blankets", "Napkins" and "Towels". To create these groups, go to see figure 11.26:

Gateway of Tally → Inventory Info → Stock Groups → Single Stock Group → Create

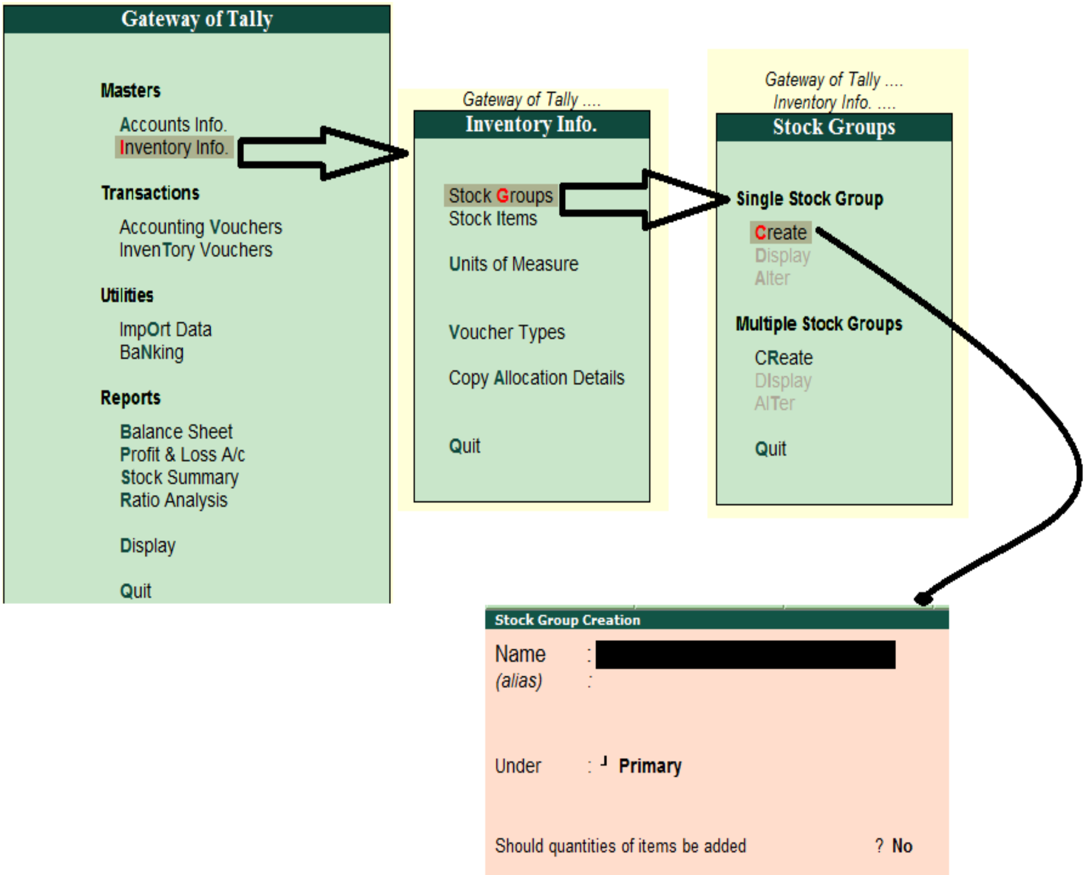


Fig.11.10: Create Single/Multiple Stock Group

Fill the required details. As per our illustration we will type Bed sheets under the name heading (as shown in Fig. 2.10) and press Yes to save the group. Similarly, we will create other groups namely, Blankets, Napkins, Towels and press Yes to save the groups.

Step 2: Create Stock Items

After the groups have been created, we need to create the stock items. However, before creating stock items it is advisable, we should first define the units of measurement. For this we need to go to see fig 11.11:

Gateway of Tally → Inventory Info → Units of Measure → Create

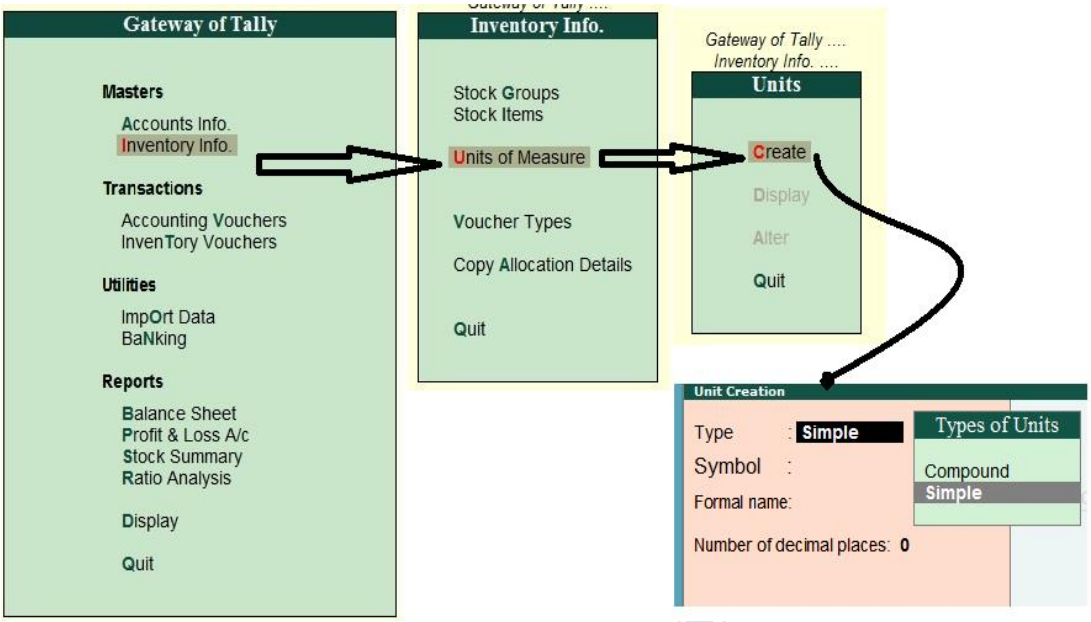


Fig. 11.11: Units of Measure

As per our illustration the units of measurement have been set to Nos. (see Fig. 2.11)

Now we can create Stock items, for this we need to go to:

S. No	Name of the Item	Under	Units	Open Qty	Rate	Per	Amount
1	Lan Card	Computer	Nos.	10	9,000	nos.	90,000
2	Tonner	Printer	Nos.	5	500	nos.	2,500
3	Router	Computer Hardware	Nos.	5	10,000	nos.	50,000

Gateway of Tally → Inventory Info → Stock Items → Single Create/Multiple Create (as per your choice)

As per our illustration there are multiple stock items and hence, we will use "Multiple Stock Items" option. Here we will select "All Items" under the heading "Under Group" and fill the rest of the information and press Yes to save the stock items.

IN-TEXT QUESTIONS

5. With the help of Create option one can Creates new _______
6. Gateway of Tally → ________ → _________→ Single Create/Multiple Create
7. Primary Groups are divided into ______ & and subgroups are a collection of ______ of related transactions.
8. Tally set ______. per defined groups/ Accounts, these are called reserve groups.

11.6 VOUCHERS

In manual accounting, the transactions are recorded through the Journal Entries & in computerized accounting, it is done through voucher entry.

Voucher – It is a document which is needed to support a transaction

Eq. Sales Bill copy

Cheque Book Slip

Counter foil

Record Slip

Pay-in-slip

Pay register etc.

We can say that voucher contains details of a transaction.

For e.g. A withdraws cash worth 10,000 from OD account & 30,000 from current account on same date from HDFC Bank.

Although both are cash withdrawal transactions from some bank would be entered into two separate voucher – those are 2 separate source docs.

Types of Vouchers

I. Contra voucher – This is a type of voucher for entering fund transfer transaction where net inflow southern are equal i.e., net effect is 0.

   In this case, you can enter transaction between cash & bank a/c only for e.g., cash sent to bank

   Bank a/c Dr.

To Cash a/c

II. Payment Voucher – All transactions related to payment by cash or bank from part of Payment voucher e.g. – Purchase, expenses, loans & advances given, acquisition, payments loan or advances taken by you etc.

Eq. Purchase of goods 1000

Purchase a/c Dr.

To Cash

Amt. paid for Repairs

Repairs a/c Dr.

To Cash a/c

III. receipt voucher – see inflow of money in cash or the Bank though bank is recorded through receipts voucher. E.g., Income from Dr. Loans & Advances Income from refund of loan.

IV. Journal vouchers

This is an adjustment voucher, used for non-cash – transactions – for e.g., depreciation, Received for liabilities Income Receivables.

In Journal vouchers, an entry is passed when you want to adjust amount between 2 or more ledger Accounts without affecting cash or bank Accounts

V. Sales voucher any sales transaction whether goods or services are entered sales voucher.

In case of cash sales, you receive payment immediately by cash / bank & there is no need to create ledger separately for buyer.

VI. Purchase voucher any purchase transaction which is done for a good/ service.

In case of cash purchase, no separate ledger of vendor is required.

VII. Credit Note (CN) voucher by default CN is not available, if a activate the option, then go to features, you can select the voucher by clicking F7 or F8.

Debt Not voucher – By default, DN were not available, if you want to activate the option then go to features, you can select the voucher of F7 or F9.

A credit note is issued at time of sales return if you grant him credit.

Body Part of voucher fig shown in 11.13

Transactions are entered in body fact of voucher. it has a no. of fields.

1. To/By or Dr/Cr.

This is predefined for 1st voucher entry for subsequent entries cursor asks for selection.

2. Ledger A/c (select)
3. Amount.
4. Narration

In manual accounting the transactions are recorded through the journal entries. In computerized accounting, it is done through voucher entry. A document is needed to support a transaction called a voucher. Copy of sales bill, slip of cheque book, counter foil, record slip, pay-in-slip, pay register etc. are the examples of the voucher. A voucher contains the details of the transaction.

Example: Cash is withdrawn for 50,000 from OD Account and 60,000 from Current Account on the same day from Bank of Baroda. Although both are cash withdrawal transactions from the same bank, the transactions would be entered in two separate vouchers, as there are two separate source documents one for each account.

Voucher entry: To create a Voucher, click on Voucher Entry under Gateway of Tally (See Fig. 34). You will get the voucher screen as shown in Fig 35.

Voucher header: Generally, the header of voucher entry screen looks like as shown in Fig 35, displaying the Voucher Type, Voucher Number, Voucher Date and Day of Voucher.

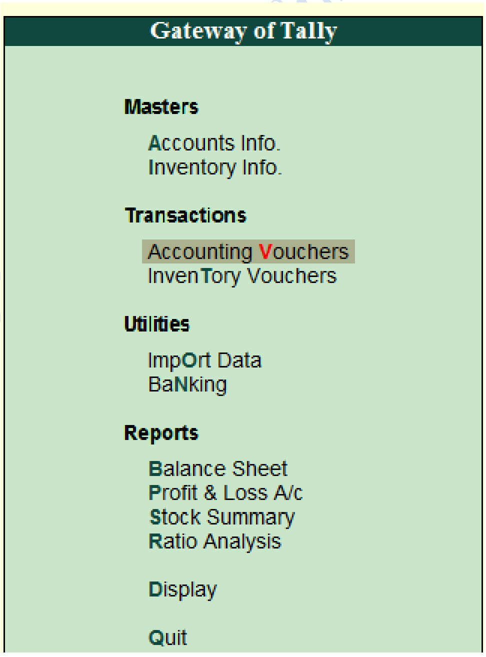


Fig. 11.12: Voucher Creation Screen

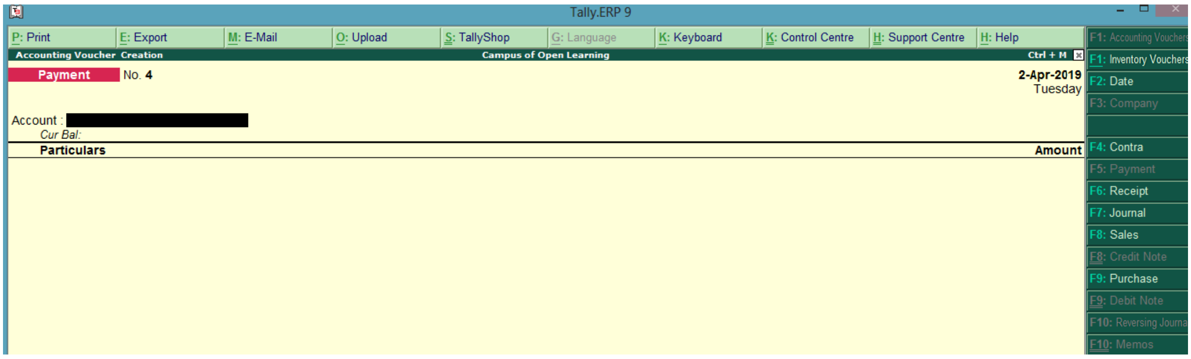


Fig. 11.13: Voucher Creation Screen

The meaning of labels in payment voucher are as under:

Label Name	**Description**
Voucher type	Shows the type of voucher selected. By default, it selects the Payment voucher. One can change it to the type he needs by clicking on the button on the right-hand side related to the voucher type.
Voucher number	To identify a voucher uniquely, w number is provided by the user or by Tully, according to the settings in Voucher Types under Accounts Info.
Reference	Reference becomes part of the voucher header, in sales, purchase, debit and credit notes.
Date of the Voucher	Date is displayed in date-month-year format at the top right corner. For ex. 01.04.2019 is displayed as 01-04-2019. By default, the current date at the gateway is automatically taken as the date of the voucher. To change the voucher date, press F2 button. It prompts you to change the voucher date. This date continues to appear for the subsequent vouchers till you change it.
Day of the Voucher	Day of the voucher is displayed just below the date for convenience.
Effective Date	Effective date also sometimes become part of the voucher, when there is need to calculate the due date/interest from any other date than the voucher date.

11.6.1 Types of vouchers

In manual accounting all accounts are maintained in Primary books, which are broadly Cash book and Journal. Journal is further sub-divided into Sales (to record sales transactions), Purchase (to record purchase transactions), Debit Note (to record purchase return, rebates/

discounts earned and to debit a party). Credit Note (to record sales return, rebates/ discounts given and to credit a party).

To keep the consistency with the manual accounting, Tally provides the following pre-defined types of vouchers:

Voucher Types

Sales	Receipts	Memo
Purchase	Payment	Reverse
Debit note	Contra	
Credit note		

Application

To record the non-cash transactions (normally entered in journals)	To record (cash and bank transactions)	Special journal for exclusive purposes.

Voucher Selection

The user can select the voucher type through following steps:

Gateway of Tally → Masters → Accounts Info. → Voucher Types → Display

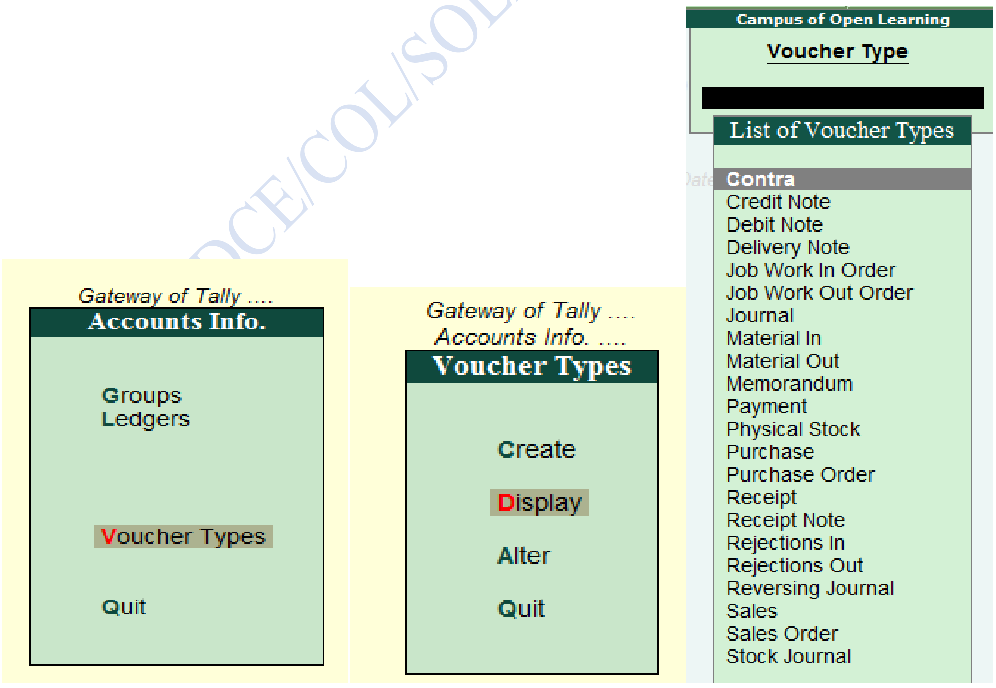


Fig. 11.15: List of Voucher Types

The above list shows many types of vouchers. We will discuss those that are needed in Accounts only Books.

Contra Voucher: Contra Voucher is for entering Fund Transfer transaction where net Inflow and Outflow are equal i.e., net effect is zero. In Contra Voucher you can enter transaction between cash and bank accounts (ledger placed under groups: Cash-in-hand, Bank Accounts and Bank OCC) only.

Payment Voucher: All transactions related to payment (by cash or through bank) are recognized in Payment Voucher. Such payments can be towards purchase, expenses, acquisition of Fixed Assets due to the creditor, loans/ advances given by you, or payment of loans/ advances taken by you earlier etc.

Receipt Voucher: All inflow of money (in cash or through Bank) are recorded through Receipt Voucher. Such receipts may be towards any income or from your debtors or loans/advances or refund of loans/advances given earlier etc. The Voucher is similar to payment voucher except that you debit cash or bank accounts and credit the ledger from which you receive.

Journal Voucher: Journal voucher is an adjustment voucher, used for non-cash transactions like adjustment between Ledger accounts, Provision for Liabilities, Income Receivables, Depreciation and all other provisions are common examples of Journal voucher. In Journal Voucher an entry is passed when you want to adjust amount between two or more ledger accounts, without affecting Cash or Bank Accounts.

Sales Voucher: Any sales transaction (whether goods or services) is entered in Sales Voucher. In case of Cash sales, you receive payment immediately by cash or by cheque or credit card and there is no need to create a separate ledger for the buyer who has paid immediately).

Instead of creating one Party ledger and debiting or crediting in that ledger, one can also select Cash or Bank Account (with whom you deposit cheque) or Credit Card Organization. The entry would appear in Sales Register and Cash (Bank) book.

Purchase Voucher: Any purchase transaction (whether goods or services) is entered in Purchase Voucher. In case of cash purchase, you make payment immediately by cash or by cheque and you do not need to track outstanding (as the payment has already been made so there is not needed to create a separate ledger for the vendor whom you have paid immediately). Instead of making one Purchase Voucher crediting the party and another Payment voucher and debiting the party, you can create a composite purchase voucher. In the first entry, instead of Party Ledger, you can select Cash or Bank accounts (the bank account on which you issued cheque). The entry would appear in Purchase Register as well in Cash (or Bank) Books.

Credit Note: By default, Credit Note would not be available. If you activate the option Use Debit/Credit Notes for the company under Features, you can select this voucher upon clicking either F7: Journal or F8: Sales Buttons.

A credit note is generally issued when a buyer returns some goods that you sold him (Sales Return) or if you grant him credit due to rate difference or discount/rebate etc. and now you like to square off a debit balance.

Debit Note: By default, Debit Note would not be available. If you activate the option Use Debit/Credit Notes for the company under Features, you can select this voucher upon clicking either F7: Journal or F9: Purchase Buttons.

A Debit Note is generally entered when you make purchase return or have short-billed a customer, or your supplier have granted credit to you on account of rate difference or discount etc.

Body of the Voucher

Transactions are entered in the body part of the voucher. It has a number of fields as given below. In order to move from one field to another, you can press Tab key.

1. **To/By (or Dr/Cr)** is pre-decided to first voucher entry according to the voucher selected i.e., the cursor does not move here. For the subsequent voucher entries, the cursor asks for selection of Dr or Cr in the first column. Upon its selection, the cursor moves to the Debit or Credit Amount Column. However, for Sales, Purchase, Debit Note and Credit Note vouchers, subsequent entries are also pre-decided.

   To select By or to press B or T respectively. If you press any other character, an error message will appear. You can instead select Dr or Cras D or C after responding yes to the query "Use Cr/Dr instead of to/By during entry in Configure button on the bottom right side of the voucher creation screen.

2. **Ledger Account:** Upon selecting to/By cursor moves to the Particulars column on pressing Tab key. Here you are required to select the ledger account under which the transaction and the amount will be entered.

   To select the ledger, type the initial charter of the ledger, a pop-up list showing all the valid ledger accounts for the entry will appear on the right-hand side of the screen. Use arrow keys to move up or down the list and press enter to select the ledger.

   In case the ledger you wish to transact is not given in the list, you can create new ledger by going backwards in steps.

3. **Amount:** Depending on the selection of Dr. or Cr., cursor will move to the respective Amount column. Type the transaction amount. In case you need to calculate, you can press Ctrl + N in order to move the cursor to the Calculator at the bottom part of the

screen. Here you can type your values and operators in order to perform calculation. On pressing enter, the calculated figure is automatically returned to the amount field of the voucher.

When the total of debit and credit amount are equal, voucher entry part would be treated as complete, and the cursor would move to the narration field.

4. **Narration:** Details of the transaction are written in this field. You can write long sentences. However, the letters would be crumbled to fit the limited space and text become illegible to read.

11.7 CONVERSION OF VOUCHER ON TYPE TO ANOTHER

For example, you entered a rate difference entry in Journal voucher, now you wish to convert it to credit note voucher

The steps are:

- Select the voucher in alteration mode.
- Click the appropriate voucher type button on the button bar and select the voucher type, if multiple vouchers are listed.
- If some entries offend the selected voucher type, you would be prompted to select appropriate ledger from list of ledger accounts.

In our illustration the entries will be different vouchers in the following manner:

While entering the transaction, specify the date by clicking on the date button on the right-hand side of Gateway of Tally.

Purchases Voucher

By Purchases Account	250.00	
To Samuel & Co Account (Sundry Creditor)		250.00

Narration

On 2 April 2018 goods were purchased from Samuel & Co. on credit.

By Purchase Account	250.00	
To Jacob Bros. Ltd. Account (Sundry Creditor)		250.00

Narration

On 13 April 2018, goods were purchased from Jacob Bros. Ltd on credit.

Sales Voucher

By Narain Bros. Account (Sundry Debtors)	250.00	
To Sales Account (Sales Account)		250.00

Narration

On 4 April 2018, goods sold to Narain Bros, on credit for ₹ 250.

By Cash account	100.00	
To Sales Account (Sales Account)		100.00

Narration

On 3 April 2018, goods sold for cash worth 100 to Dhiraj & Co.

By Narain Bros. Account (Sundry Debtors)	237.50	
To Discount Allowed		12.50
To Sales Account (Sales Account)		250.00

Narration

On 25 April 2018, goods sold to Narain Bros. on credit for 250 and discount allowed to them 12.50.

Contra Voucher

By Bank Account	125.00	
To Cash Account		125.00

Narration

On 21 April 2018, cash sent to bank.

Payment Voucher

By Jacob Bros. Ltd. Account (Sundry Creditor)	250.00	
To Bank Account (Bank Account)		243.75
To Discount Received Account (Indirect Income)		6.25

Narration

On 6 April 2018 payment made to Jacob Bros. Ltd, by cheque of 243.75 and discount allowed by them for 6.25.

By Purchases Account (Purchases Account)	187.50	
To Cash Account (Cash-in-hand)		187.50

Narration		
On 10 April 2018, purchases of goods for cash worth 187.75.		
By Repairs Account (Indirect Expenses)	25.00	
To Bank Account		25.00
Narration		
On 12 April 2018, amount paid for repairs 25.00.		
By Cartage Account (Direct Expenses)	12.50	
To Cash Account		12.50
Narration		
On 13 April 2018, amount paid for cartage on goods bought from Jacob Bros. Ltd		
By Municipal Taxes Account (Indirect Expenses)	25.00	
To Cash Account		25.00
Narration		
On 24 April 2018, amount paid as tax.		
By Advertisement Account (Indirect Expense)	25.00	
To Cash Account		25.00
Narration		
On 28 April 2018, amount paid for advertisement.		
By Rent Account (Indirect Expense)	37.50	
To Bank Account		37.50
Narration		
On 30 April 2018, amount paid for rent.		
By Salaries Account (Indirect Expense)	75.00	
To Cash Account		75.00
Narration		
On 30 April 2018, amount paid for salaries.		
By Capital Account (Capital Account)	62.50	
To Bank Account		62.50

Narration

On 30 April 2018, amount drawn out of bank by proprietor for private use.

By Cash Account	362.50	
By Discount Allowed Account (Indirect Expense)	12.50	
To Narain Bros. Account (Sundry Debtor)		375.00

Narration

On 5 April 2018, amount of 362.50 received in payment for a debt of 375; hence discount allowed if 12.50.

By Cash Account	25.00	
To Furniture Account (Fixed Asset)		25.00

Narration

On 9 April 2018, sale of old furniture made, and payment received in cash.

By Bank Account	875.00	
To B.K. Bros. Account (Sundry Debtors)		625.00

Narration

On 11 April 2018, cheque for 625 received from B. K. Bros, and deposited in the bank

By Jacob Bros. Account (Sundry Debtors)	250.00	
To Bank Account		250.00

Narration

On 17 April 2018, amount paid by cheque to Jacob Bros. Ltd.

By Narain Bros. Account	250.00	
To Bank Account		237.50
To Discount Allowed Account		12.50

Narration

On 18 April 2018, cheque received from Narain Bros, dishonored. They are debited with full amount due to us; Bank credited with 237.50 because previous debit has to be cancelled; Discount Account credited because discount allowed previously will be written back.

By Cash Account	150.00	
To Sales Account		150.00

Narration

On 19 August 2019, goods sold in cash.

By Bank Account	2,500.00	
To Loan Account Loans (Liability)		2,500.00

Narration

On 25 August 2019, amount borrowed from Urania investment Co. Ltd.

By Bank Account	237.50	
By Discount Allowed Account (Indirect Income)	12.50	
To Narain Bros. Account		250.00

Narration

On 16 April 2018, cheque received from Narain Bros, and deposited in the bank; discount allowed
₹ 12.50.

By Cash Account	5.00	
To Sundry Receipts Account (Indirect Income)		5.00

Narration

On 26 April 2018, income derived from sale of old newspapers,

Cash Account	125.00	
By Bad Debts Account (Indirect Expense)	125.00	
To Narain Bros Account		250.00

Narration

On 30 April 2018, half the sum due from Narain Bros. received in cash and the other half written off as being irrecoverable

---

By Cash Account	37.50	
To Bad Debt Recovered Account (Indirect Income)		37.50

Narration

On 30 April 2018, sum previously treated as lost, now recovered it is a gain.

In the above entries, the bracketed words are the Group names under which the Ledger accounts have been prepared. These ledger accounts are then available at the time of entering transactions in the vouchers i.e., you need not create the ledger accounts again.

IN-TEXT QUESTIONS

9. In manual accounting, the transactions are recorded through the _________ & in computerized accounting, it is done through __________
10. Details of the transaction are written in ________ field
11. A credit note is generally issued when a buyer _______some goods that you sold him
12. All inflow of money (in cash or through Bank) are recorded through _________

11.8 SUMMARY

In this chapter we have briefly covered Ledger creation this is the actual account head under which the transactions are identified. It is advised that one should first jot down all the accounts that one wish to create on the paper and then start placing them under appropriate group, else you may not be able to enter transactions properly in vouchers. You should create all the ledgers appearing in the Balance Sheet as at the previous date with opening balance. Groups formation, Types of groups and group formation under inventory information, voucher creation and Conversion of voucher one type to another.

11.9 GLOSSARY

Financial Year: A Period of usually 12 months for which organisations either government or private maintain books of accounts. In India it starts from 1 April to 31 March.

Ledger: A ledger is a part of accounting process and bookkeeping in which accounts of different parties or heads maintain separately.

11.10 ANSWER TO IN-TEXT QUESTIONS

Answer to In-Text Questions

1. Assets 2. Single 3. Indirect Expenses Group	9. Journal Entries, Voucher Entry 10. Narration 11. Return

4. Multiple Groups 5. Ledger 6. Inventory Info---Stock Group 7. Subgroups, Ledger A/C 8. 34	12.Reciept Voucher

11.11 SELF-ASSESSMENT QUESTIONS

1. Options under Ledger Creations are

1. State
2. Pin Code
3. Provide Bank Details
4. Income Tax No
5. All of them

2. Configuration of Numbers are

1. Decimal Separator to Use
2. Thousand Separator to Use
3. Put Signs before Currency/Unit Symbols
4. Show Numbers in Millions (and not lakhs)
5. All of them

3. Account master not allowed following entries:

1. Allow Advanced Entries in Masters
2. No Use Addresses for Ledger Accounts
3. Use Contact Details
4. Add Notes for Ledger Accounts

4. Inventory Master allow following entries:

1. Allow advanced entries in Masters
2. Use Part Numbers for Stock Items
3. Use Description for Stock Items
4. All of them

5. The general concept of accounts divides the accounting heads into four entities namely

1. Liabilities,
2. Assets,
3. Income
4. All of them

6. Liabilities includes following items:

1. Capital Account
2. Reserves and Surplus (Retained Earning)
3. Loans (Liability)
4. Bank OD Accounts
5. All of them

7. Assets does not Includes following items:

1. Fixed Assets
2. Investments
3. Bank Account
4. Debtors

8. Reserved Income groups that not go into Profit & Loss Account:

1. Building
2. Sales Account
3. Direct Income
4. Indirect Income

9. Expenses that not go into Profit & Loss Account:

1. Purchase Account
2. Machine
3. Direct Expenses
4. Indirect Expenses

10. Groups sub-option, options for

1. Creation,
2. Display and

3. Alteration of groups
4. All of them

11. You can create additional cash account:

1. Petty cash account,
2. Cash-at-branch,
3. Cash-in-transit
4. All of them

Ans. 1(5), 2(5), 3(2), 4(4), 5(4), 6(5), 7(1), 8(1), 9(2), 10(4), 11(4)

Exercise 2: Fill in the Blanks

1. Select the parent group for the ledger from List of Groups. If the group is ……………… you can create new groups by pressing Alt + C.
2. This will bring group creation screen as explained under group creation step. Upon creation of the group, cursor will ……………… to the ledger creation screen picking the newly created group.
3. Sundry Creditor group has been selected from the ………………...
4. This option will appear when you are creating a Bank ledger account. It asks for a date when you would like to reconcile the Cash Book and the …………………… when they differ.

1. Non-existent 2. Return 3. List 4. Passbook

Exercise 3: Mix and Match

Effective date for	Option will come for creditors' ledger and debtors' ledger accounts only. When we have created a creditor's account, therefore we are getting this option. Say yes if you want to see the records bill wise.
Maintain Bill by Bill	This option will appear when you are creating a Bank ledger account. It asks for a date when you would like to reconcile the Cash Book and the Passbook when they differ.
Name	This will appear in all types of ledger accounts. It prompts you to enter an amount, which will be reflected at the top right corner of the screen. The amount so entered will be recorded for the date at which the books are beginning from (displayed for instant reference). When you enter the amount. Also enter D (for Dr) or C (for Cr). Tally also inserts the sign according to the primary group

	under which the ledger has been selected. If you press enter at this prompt, no amount will be recorded.
Opening Balance	This and the rest of the labels below will appear on the right side of ledger creation screen. It promotes one to enter the mailing name. Tally ERP 9 displays the ledger account name by default with a cursor, meaning that changes are possible. This name appears in all external documents (e.g., invoice, reminder letter, confirmation statement, cheque etc.)

Ans. 1(2), 2(1), 3(4), 4(3)

Exercise 4: Short Questions Answer:

Q.1 Write the items under Liabilities?

Q.2 What are the benefits of Journal Voucher?

Q.3 Name the reserved groups that go into profit & loss account?

Q.4 Write the steps for creation of single or multiple groups.

Q.5 What do you understand by Receipt Voucher? Explain with example.

Exercise 5: Practice Session

Illustration: 1 Below is the Balance Sheet of Park & Sons (2017-2018). Create below ledgers with their opening balances for (2018-2019) The

Park & Sons
Balance Sheet
1 April 2017 to 31 March, 2018

Liabilities	**Amount**	**Assets**	**Amount**
Capital	6,00,000	Plant & Machinery	2,35,000
Loan from HDFC	1,45,000	Furniture	1,50,000
Outstanding Salary	30,000	Building	1,00,000
Sundry Creditors	65,000	Cash	1,45,000
Profit & Loss A/c	1,00,000	Kotak Mahindra Bank	1,30,000
		Sundry Debtors	118.70,000
		Closing Stock	1,10,000

Total	**9,40,000**	**Total**	**9,40,000**

➢ Create below Debtors in Park & Sons with their bill details:

Debtors Name	Bill No.	Bill Date	Amount
Raj Distributors	JPL-001	01-02-2018	30,000
Sharma Brothers	JPL-002	02-02-2018	40,000

➢ Create below Creditors in Park & Sons with their bill details:

Creditors Name	Bill No.	Bill Date	Amount
Surya Traders	ST-004	01-01-2018	55,000
Sudhir Enterprises	SE-005	02-02-2018	10,000

➢ Create below Inventory Master in Park & Sons:

Godown	Stock Item	UOM	Qty.	Rate	Amount
Shop-1	Samsung S6	Nos	4	12,000	48,000
Shop-2	RAM 4 GB	Nos	5	2,000	10,000
Shop-2	Motherboard	Nos	2	4,500	9,000
Shop-1	Keyboard	Nos	5	500	2,500
Shop-1	USB Mouse	Nos	2	250	500
Shop-2	Samsung J7	Nos	5	8,000	40,000

➢ Find out the below Opening Reports for Park & Sons in Tally. ERP 9

1. Balance Sheet, 2. Outstanding Report, 3. Stock Summery, 4. Godown wise report

Illustration :2

➢ Create below Accounting Ledger in Park & Sons

➢ Pass below Accounting Transaction in Park & Sons

Date	Transaction Details
01-04-2018	Withdraw cash 25,000 from Kotak Bank for office expenses
01-04-2018	Paid Outstanding salary cheque No. 112233 (Ram 12,500, Shyam 12,500
01-04-2018	Paid advertisement expenses 10,000 to Rajkumar Cheque No. 112234
03-04-2018	Received 29,500 from Raj Distributors full and final settlement through Ch. No. 123456 of HDFC Bank

03-04-2018	Purchase printing and stationery 4,500 by cash
04-04-2018	Paid 54,000 to Surya Traders full and final settlement Ch. No. 112235
05-04-2018	Paid Office Rent 15,000 for Mohali Shop and 20,000 for Chandigarh Shop to Anand Kumar through Cheque No. 112236
06-04-2018	Mr. Jindal owner of Park & Sons deposited own cash in company bank account 70,000
07-04-2018	Mr. Jindal brought household furniture in his business of 1,25,000.
08-04-2018	Company paid LIC premium of Mr. Jindal 2,500 by cash
09-04-2018	Mr. Jindal withdraw 10,000 for personal expenses
10-04-2018	Mr. Jindal purchased 1 HP Laptop @ 25,500 for business purpose by his Kotak Bank Credit Card.
11-04-2018	Mr. Jindal purchase 2 nos. Mobile 1 is for business use and 2nd one for personal use @ 27,500 each.
12-04-2018	Company purchase Printing & Stationery of 5,500 by cash
14-04-2018	Paid Electricity bill of 5,600 by cash.
15-04-2018	Paid Telephone Bill of 4,500 by cash
16-04-2018	Paid advance 10,500 by Kotak bank Ch. No. 112238 to Mr. Ram Office staff.
17-04-2018	Rent Received from Sudhir Kumar & Associate of 25,500 by Axis Bank Ch. No. 223311.

➢ Find out the below Reports for Park & Sons in Tally. ERP 9.

1. Balance Sheet, 2. Profit & Loss Accounts, 3. Cash & Bank Book, 4. Day Book, 5. Cash & Fund Flow

➢ Pass below Inventory Transaction in the book of Park & Sons

Purchase Transaction

Date	Party Details (Creditors)	Bill No.	Godown	Stock Item	UOM	Qty.	Rate
01-05-2018	Surya Traders	ST-001	Shop-1	RAM 4 GB	Nos	10	2,000
02-05-2018	Sudhir Enterprises	SE-011	Shop-1	USB Mouse	Nos	10	750

03-05-2018	Sridhar Enterprises	SEP-998	Shop-1	Samsung S6	Nos	10	11,500
04-05-2018	Sen & Sen Co.	SS-776	Shop-1	Keyboard	Nos	20	500
				32 GB Pen drive	Nos	20	650
05-05-2018	Maharaj & Sons	MS-667	Shop-1	500 GB HDD	Nos	10	2,500

Sales Transaction

Date	Party Details (Creditors)	Bill No.	Godown	Stock Item	UOM	Qty.	Rate
06-05-2018	Raj Distributors	JPL-011	Shop-1	RAM 4 GB	Nos	4	2,500
07-05-2018	Sharma Brothers	JPL-012	Shop-1	USB Mouse	Nos	6	850
08-05-2018	Rajat & Co.	JPL-013	Shop-1	Samsung S6	Nos	6	12,500
09-05-2018	Disha Trading Co.	JPL-014	Shop-1	Keyboard	Nos	15	650
				32 GB Pen drive	Nos	15	800
10-05-2018	Radhika Enterprises	JPL-015	Shop-1	500 GB HDD	Nos	6	3,500
11-05-2018	Cash	JPL-C-01	Shop-1	Samsung S6	Nos	1	13,000
12-05-2018	Cash	JPL-C-02	Shop-1	32 GB Pen drive	Nos	1	850
13-05-2018	Cash	JPL-C-03	Shop-1	Keyboard	Nos	1	750

Illustration :3

Journal

Date Particulars Dr. Cr.

Apr. 1 Cash in hand /ac Dr. 200

Cash at Bank a/c Dr. 6,800

Stock a/cDr. 4,000

Machinery a/c Dr. 10,000

Furniture a/c		Dr.	1,000	
M/s Narain Bros.		Dr.	1,500	
To Loan a/c				5,000
(To Capital a/c)				21,000
Apr. 2	Purchase a/c	Dr.	1,000	
(To Samuees Company)				1,000
Apr. 3	Cash a/c	Dr.	400	
(To Sales a/c)				400
Apr. 4	Narain Bros.	Dr.	1,000	
(To Sales a/c)				1,000
Apr. 5	Cash a/c	Dr.	1,450	
Discount allowed a/c		Dr.	50	
(To Narain Bros.)				1,500
Apr. 6	Jacob Bros Ltd.	Dr.	1,000	
To Bank a/c				975
(To Discount received a/c)				25
Apr. 9	Cash a/c	Dr.	100	
(To Furniture)				100
Apr. 10	Purchases a/c	Dr.	750	
(To cash a/c)				750
Apr. 11	Bank a/c	Dr.	2,500	
(To B.K. Bros.)				2,500
Apr. 12	Repairs a/c	Dr.	100	
(To Cash a/c)				100
Apr. 13	Purchases a/c	Dr.	1,000	
(To Jacob Bros Ltd.)				1,000
Apr. 13	Carriage inwards	Dr.	50	
	To Cash			50
Apr. 16	Bank a/c	Dr.	950	
	Discount allowed a/c	Dr.	50	
	(To Narain Bros.)			1,000
Apr. 17	Jacob Bros. Ltd.	Dr.	1,000	
	(To Bank a/c)			1,000
Apr. 18	Narain Bros.	Dr.	950	
	(To bank a/c)			950
Apr. 19	Cash a/c	Dr.	600	
	(To Sales a/c)			600
Arp. 21	Bank A/c	Dr.	500	

	(To cash a/c)			500
Apr. 24	Municipal Corporation a/c	Dr.	100	
	(To Cash a/c)			100
Apr. 25	Bank a/c	Dr.	10,000	
	(To Urania Investment. Cott.)			10,000
Apr. 25	Narain Bros.	Dr.	950	
	Discount allowed a/c	Dr.	50	
	(To Sales a/c)			1,000
Apr. 28	Add. a/c	Dr.	100	
	(To Cash a/c)			100
Apr. 30	Salary a/c		300	
	Rent a/c		150	
	(To Bank a/c)			450
Apr. 30	Drawings a/c	Dr.	250	
	(To Bank a/c)			250
Apr. 30	Cash a/c	Dr.	950	
	Bad Debts	Dr.	950	
	(To Narain Bros.)			1,900
Apr. 30	Cash a/c	Dr.	150	
	(To Bad Debtors received)			150

Ques. You are given B/S as on 1/3/04.

Liabilities		Assets	
Capital	2,20,000	Furniture	10,000
Loan	40,000	Cash	25,000
S/ Cr.		Bank	75,000
X 15,000 Y 45,000	60,000	Stock	40,000
		A: 20,000 B: 50,000	70,000
		Building	1,00,000
	3,20,000		3,20,000

Transactions during Match

1. Goods of L.P. of 10,000 purchased from Z at 10% t.d. on 2/3/04.
2. 5/3/04 Issued a cheque of 14,000 in favor of X in final settlement.
3. 8/3/04 received 10,000 cash and cheque of 35,000 from B in final statement.

10/3/04 a declared insolvent & a final demand of 60% received from their estate.

12/3/04

Sold goods on Cr. to C for 25,000

13. Return goods to Z 1,000
15. Creature good 2,500
19. Deposited 3,000 in Bank
20. Purchased Investment. 1,00,000 by cheque
25 Paid I.O.L. 1,000 & Salaries 5,000
31 Cheque Dep. on from 500, Building 5000 C/L Stock 30,000
Prepare final Accounts

Journals

2/3	Purchase a/c	Dr.	9,000	
	(To Z a/c)			9,000
5/3	X	Dr.	15,000	
	To Bank a/c			14,000
	(To Discount Received Indirect Inc.) 1,000			
9/3	Cash a/c	Dr.	10,000	
	Bank a/c	Dr.	35,000	
	Discount allowed	Dr.	5,000	
	to B			50,000
10/3	Cash a/c	Dr.	12,000	
	Bad Debtors	Dr.	8,000	
	To A			20,000
12/7	C	Dr.	25,000	
	(To Sales)			25,000
13/3	2	Dr.	1,000	
	(To Purchase Ret.)			1,000
15/3	Sales Ret.	Dr.	2,500	
	TO C			2,500
19/3	Bank	Dr.	30,000	
	To Cash a/c			30,000
20/3	Investment	Dr.	1,00,000	
	To Bank			1,00,000
25/3	IOL	Dr.	1,000	
	Salaries	Dr.	5,000	

	To Cash			600
31	Deprecation on Building	Dr.	50,05,000	
	To fuel.			500
	Building			5,000

11.12 SUGGESTED READINGS

- *Monga, J R. Financial Accounting: Concept and Applications. Mayur Paper Backs, New Delhi*
- *Goyal, Bhushan Kumar and H.N. Tiwari, Financial Accounting, Taxmann*

LESSON 12

TRIAL BALANCE, CASH FLOW STATEMENT AND REPORTS

Sumita Jain

STRUCTURE

12.1 LEARNING OBJECTIVES

- To check all the transactions in the respective accounts like cash book, Profit and Loss Account, Ledger Accounts, Trail Balance, Funds Flow statements and Cash Flow statements and Balance Sheet.
- To understand the procedure of selecting, shutting a company, backup and restore of data of a company.

12.2 INTRODUCTION

Transactions entered in the respective vouchers, the cash Book, Ledger Accounts, Trial Balance, Profit and Loss Account and Balance Sheet for the respective company is automatically created both in condensed and detailed form.

12.3 GENERATING REPORTS

Cash Book

The Cash Book of a company records all the transactions that affect cash, and hence Tally.ERP 9 brings all the cash transactions under the group Cash Book. To open/view cash book:

Go to Gateway of Tally → Click Display → Accounts Book → Cash/Bank Book(s)

Following the above steps, as per our illustration the Cash Book of ABC Pvt. Ltd. (in condensed form) is given in the Fig. 12.1 in condensed form and to view in detailed press F1 for detailed view

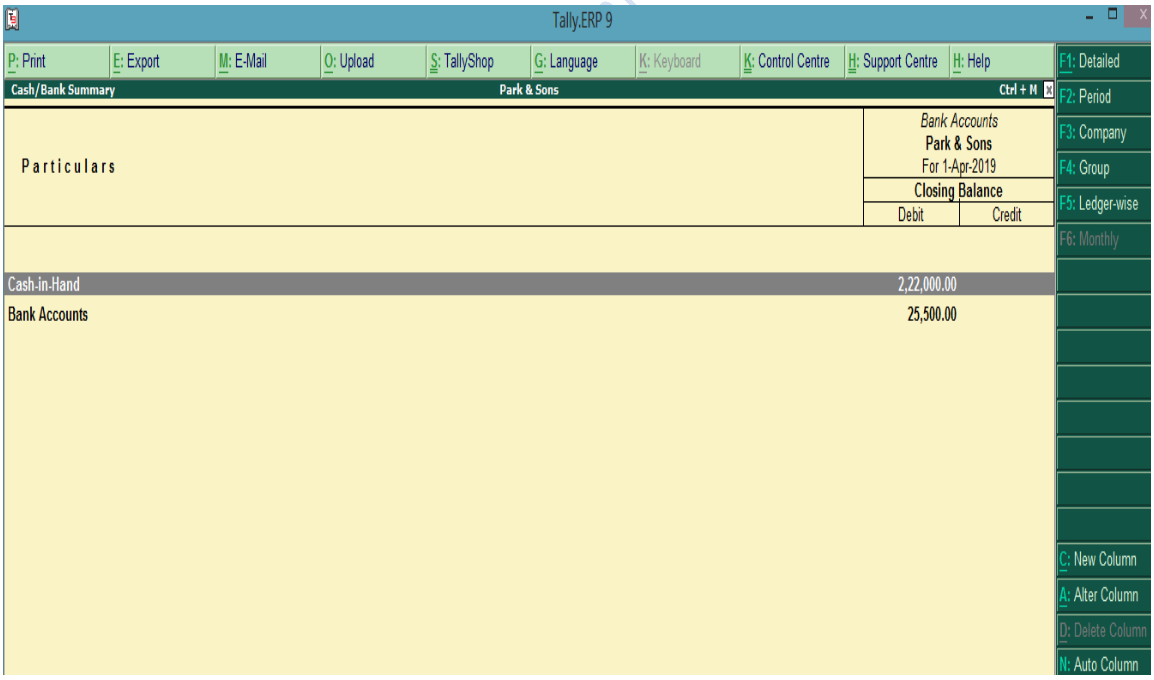


Fig. 12.1: Cash Book

In order to view the detailed form of the cash book, Highlight the Cash in hand (shown in Fig. 13.2) and press Enter, this will take you to screen as shown below. You can also use F1 key.

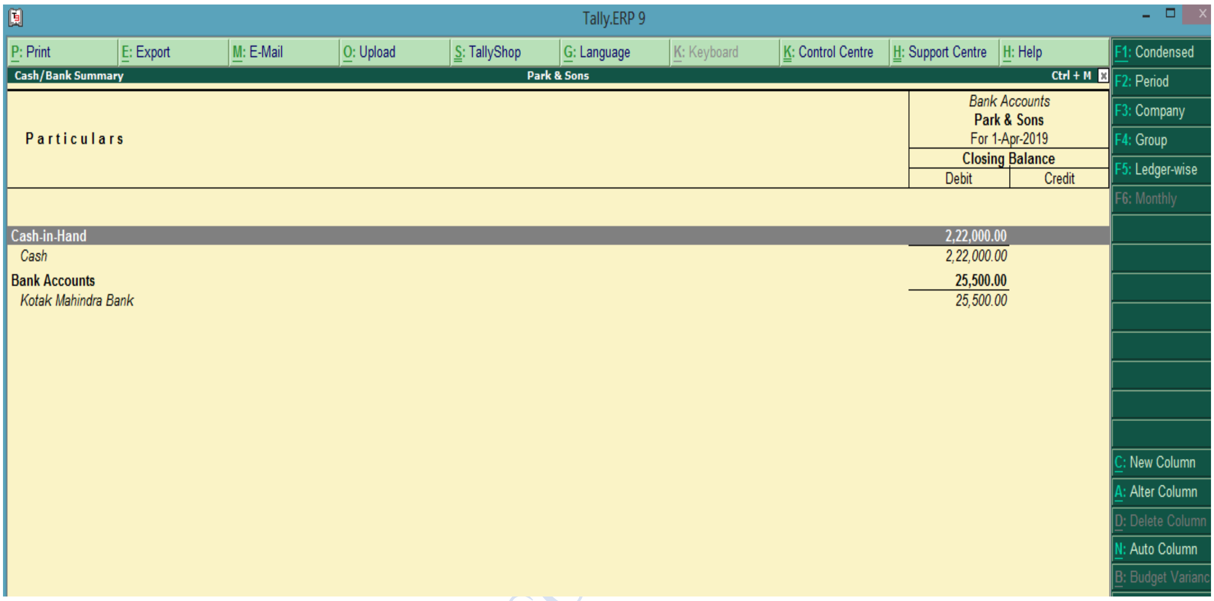


Fig. 12.2: Cash Book in Detailed Form

As per our illustration fig 12.2 we have taken transactions only for the month of April, the above screen shows the detailed cash book for the company ABC Pvt. Ltd. for month of April.

Ledger Accounts

Ledger means a book where the various accounts of a company are kept. To open/view Ledger Account:

Go to Gateway of Tally → Click Display → Accounts Book → Ledger and select the ledger you want to view (we have selected Jacob Bro, as per our illustration). Following screen will appear as shown in Fig. 12.3.

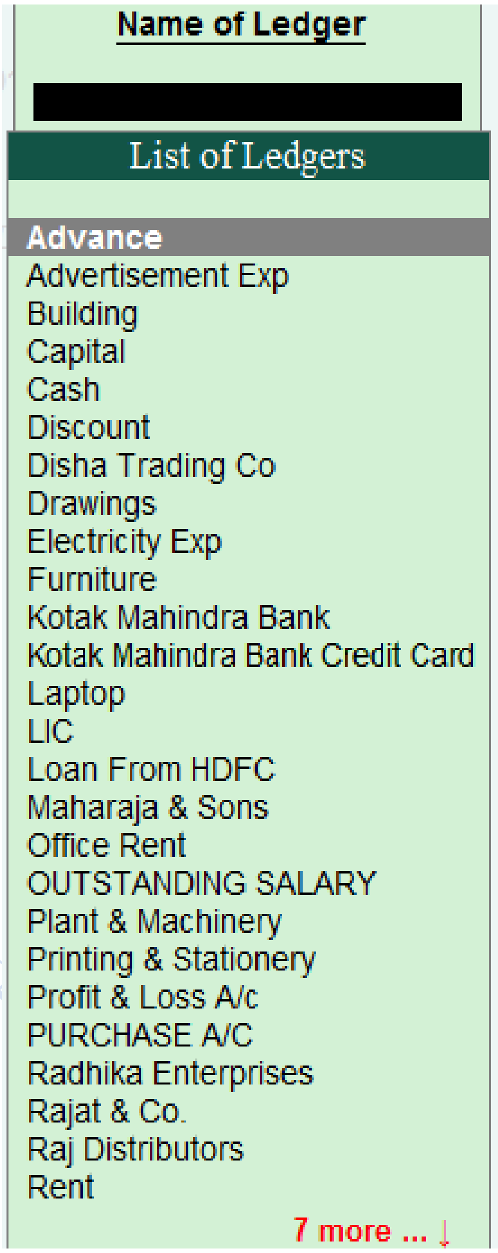


Fig.12.3: Opening a Ledger

Press Enter and we will be taken to the screen which will show the detailed ledger account of Jacob Bro. as shown in Fig. 12.4

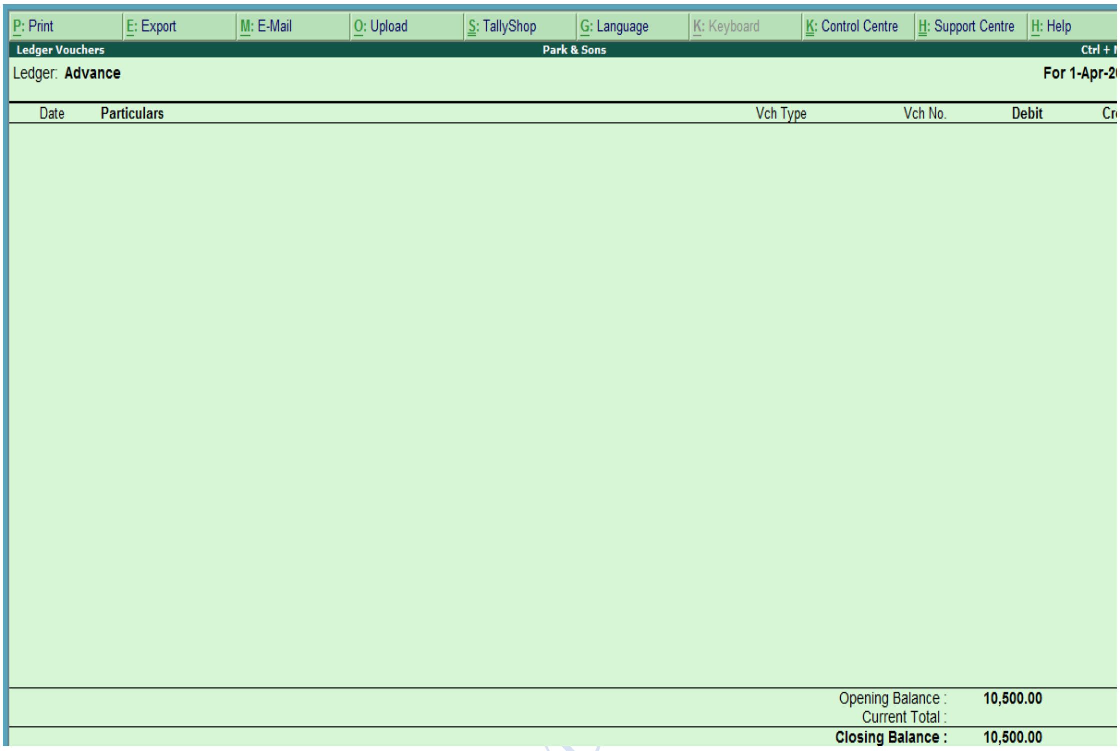


Fig. 12.4: Detailed Ledger Account

12.4 TRIAL BALANCE

A Trial Balance of a company shows summary of all ledger balances to check whether the figures are correct and balanced. In Trail Balance the total of debit balances should be equal to total of credit balances.

To open/view Trial Balance fig 12.5:

Go to Gateway of Tally → Click Display → Trial Balance

As per our illustration the Trial Balance of ABC Pvt. Ltd. (in condensed form) is given in the Fig. 12.5 in condensed format using F1 Key.

Tally.ERP 9

P: Print | E: Export | M: E-Mail | O: Upload | S: TallyShop | G: Language | K: Keyboard | K: Control Centre | H: Support Centre | H: Help

Trial Balance — Park & Sons — Ctrl + M

Particulars	Park & Sons For 1-Apr-2019 Closing Balance Debit	Credit
Capital Account	12,500.00	8,20,500.00
Loans (Liability)		1,45,000.00
Current Liabilities		2,06,500.00
Fixed Assets	6,35,500.00	
Current Assets	6,04,950.00	
Profit & Loss A/c		80,950.00
Grand Total	12,52,950.00	12,52,950.00

Fig. 12.5: Trail Balance

When you click on the "Details" (F1) button (right hand side), the details of all the items of Trial Balance are shown. The details do not lie on the same page and scroll to the next page Fig. 43. To view the contents of the next page, keep pressing the down or up arrow key and the items will scroll up or down one by one.

Tally.ERP 9

P: Print | E: Export | M: E-Mail | O: Upload | S: TallyShop | G: Language | K: Keyboard | K: Control Centre | H: Support Centre | H: Help

Trial Balance — Park & Sons — Ctrl + M

Particulars	Park & Sons For 1-Apr-2019 Closing Balance Debit	Credit
Capital Account	12,500.00	8,20,500.00
Capital		*7,95,000.00*
Drawings	*10,000.00*	
Kotak Mahindra Bank Credit Card		*25,500.00*
LIC	*2,500.00*	
Loans (Liability)		**1,45,000.00**
Secured Loans		1,45,000.00
Current Liabilities		**2,06,500.00**
Sundry Creditors		2,01,500.00
OUTSTANDING SALARY		*5,000.00*
Fixed Assets	**6,35,500.00**	
Building	*1,00,000.00*	
Furniture	*2,75,000.00*	
Laptop	*25,500.00*	
Plant & Machinery	*2,35,000.00*	
Current Assets	**6,04,950.00**	
Opening Stock	*1,73,600.00*	
Sundry Debtors	1,73,350.00	
Cash-in-Hand	2,22,000.00	
Bank Accounts	25,500.00	
Advance	*10,500.00*	
Profit & Loss A/c		80,950.00
Grand Total	12,52,950.00	12,52,950.00

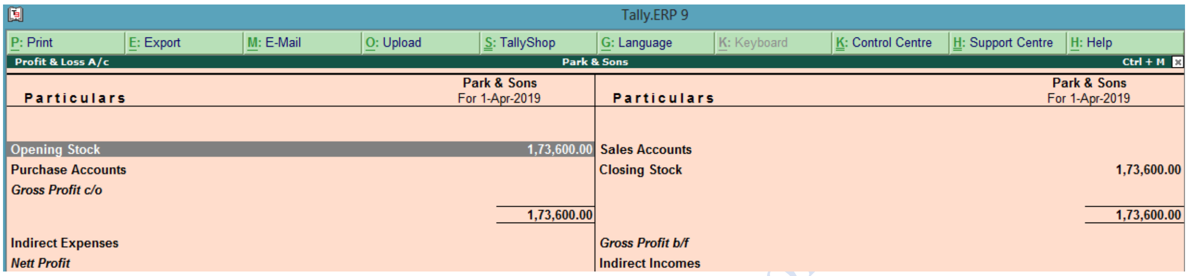
Fig. 12.5: Trail Balance in Detailed Form

Profit & Loss Account

To open/view the Profit & Loss Account

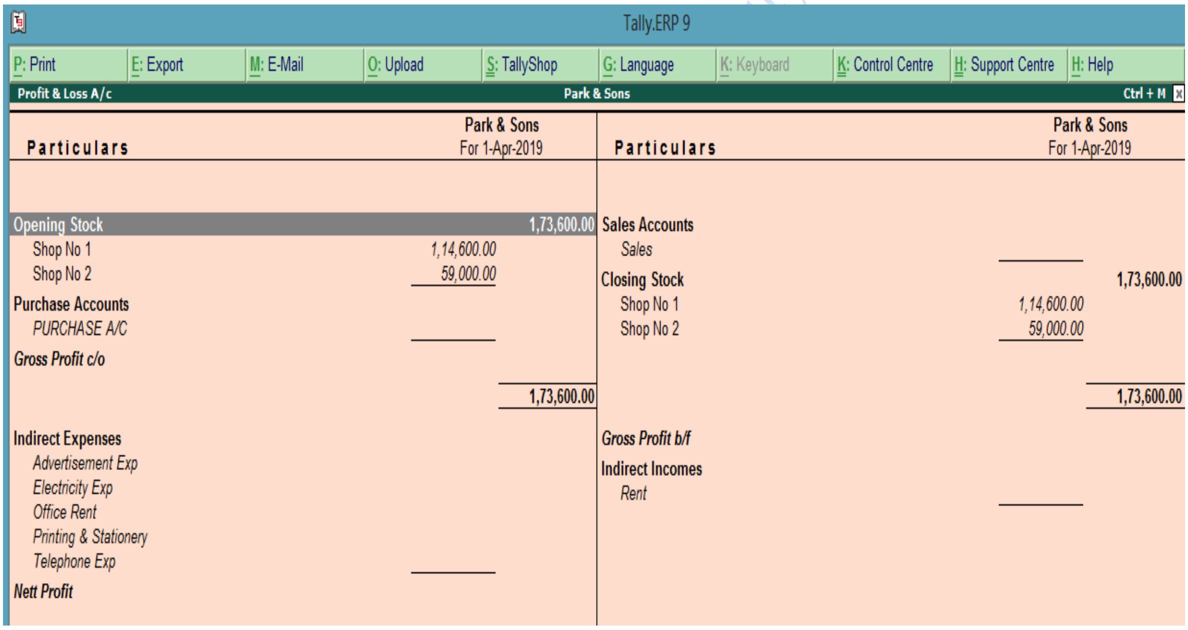
Go to Gateway of Tally → Profit & Loss Account

As per our illustration the Profit & Loss Account of ABC Pvt. Ltd. (in condensed and detailed form) is shown in Fig. 12.6 and Fig. 37.



Particulars	Park & Sons For 1-Apr-2019	Particulars	Park & Sons For 1-Apr-2019
Opening Stock	1,73,600.00	Sales Accounts	
Purchase Accounts		Closing Stock	1,73,600.00
Gross Profit c/o			
	1,73,600.00		1,73,600.00
Indirect Expenses		*Gross Profit b/f*	
Nett Profit		Indirect Incomes	

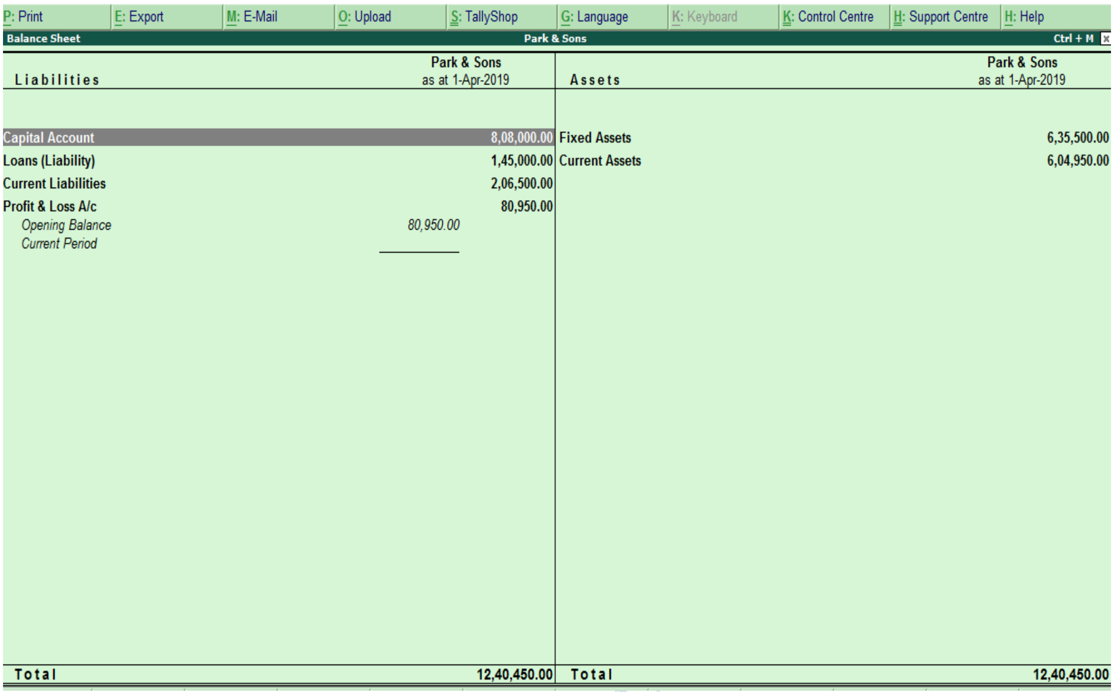
Fig. 12.6: Profit and Loss Account in Condensed Form



Particulars		Park & Sons For 1-Apr-2019	Particulars		Park & Sons For 1-Apr-2019
Opening Stock		1,73,600.00	Sales Accounts		
Shop No 1	*1,14,600.00*		*Sales*		
Shop No 2	*59,000.00*		Closing Stock		1,73,600.00
Purchase Accounts			Shop No 1	*1,14,600.00*	
PURCHASE A/C			Shop No 2	*59,000.00*	
Gross Profit c/o					
		1,73,600.00			1,73,600.00
Indirect Expenses			*Gross Profit b/f*		
Advertisement Exp			Indirect Incomes		
Electricity Exp			*Rent*		
Office Rent					
Printing & Stationery					
Telephone Exp					
Nett Profit					

Fig. 12.7: Profit and Loss Account in Detailed Form

Similarly, the balance sheet (condensed form, Fig. 12.8) and details form (Fig. 12.9) of ABC Pvt. Ltd. are also automatically created. However, to make changes, you can select the items and press enter.



Liabilities		Park & Sons as at 1-Apr-2019	Assets	Park & Sons as at 1-Apr-2019
Capital Account		8,08,000.00	Fixed Assets	6,35,500.00
Loans (Liability)		1,45,000.00	Current Assets	6,04,950.00
Current Liabilities		2,06,500.00		
Profit & Loss A/c		80,950.00		
Opening Balance	*80,950.00*			
Current Period				
Total		12,40,450.00	**Total**	12,40,450.00

Fig. 12.8: Balance Sheet in Condensed Form

When you click on the button on the right-hand side "Details", you get the following screen.

Fig. 12.9: Balance Sheet of ABC Pvt. Ltd. in Detail Form

If any alterations are to be done in the final accounts, the same steps have to taken in reverse order. This is how the final accounts and trial balance are automatically created by Tally. The user only needs to enter the transaction in the voucher and rest of the work is done by Tally.

12. 5 CASH FLOW STATEMENT

Cash Flow is the inflow and outflow of cash during an accounting period.

A cash flow statement concentrates on the transactions that have a direct impact on cash. It deals with the inflow and outflow of cash between two Balance Sheet dates. That is, it explains the changes in cash position between the two periods. Here the term cash stands for cash and bank balances.

Cash flow statements can also be used as receipts and payments statement. This is particularly useful for businesses such as Non-Profit Organizations where receipts and payments statements need to be generated.

Basically, Cash flow is the movement of money in or out of your company, project or finance department. It is measured based on a specific time or duration. Cash flow statement helps determining particular projects return on investment (ROI). It also helps determining problem of business liquidity, risk evaluation and fulfill reinvestment request.

It is very well known in the finance industry, having a proper cash flow statement is crucial for every modern business, to take the business to a new height with analysing financial data and taking business decision based on it.

A Cash flow statement provides the detailed transaction of money ins and outs of the business, and these all required information is provided on a single screen on Cash flow statement. It also shows the current balance of your company that helps you taking important business decision as well. After all, it makes easier to management financial health of a company.

You can prepare your Cash Flow statement manually taking the data from journals, however, it's huge time-consuming process and it's recommended to make it automate for many reasons.

IN-TEXT QUESTIONS

1. Go to Gateway of Tally → ____________ → Trial Balance
2. The ________ of a company records all the transactions that affect cash
3. A ______ of a company shows summary of all ledger balances
4. A cash flow statement concentrates on the transactions that have a _____impact on cash
5. Cash flow statements can also be used as _____________statement.

12.6 CASH FLOW ERP.9

Imagine running a business and not being sure how much cash is owed and when payments are due. Or never being able to predict what your cash position is going to be 6 months down the road. The Cash Flow Projection statement in Tally ERP 9 ends all the uncertainty. This powerful tool helps you manage cash flow and understand the future impact of transactions, for the success of your business.

Every enterprise has to prepare a Cash Flow Statement to report cash flows during the period classified by Operating Investing and Financing Activities in a manner which is most appropriate to its business.

Now make confident decisions on Bank loans, credit limits, capital investments and much more. Use Cash Flow statements to ensure the financial health of your business.

Highlights of the Cash Flow statement include:

- Ageing of payments
- Ageing of receipts
- Cash balance
- Committed payments
- Day-wise cash position
- Exception reports
- Interest calculation on over-dues

Benefits:

- Predicting cash flow
- Financial planning/forecasting
- Financial health of business
- Show cash position to Financial Institutions
- Capital investment requirements/judgement
- Setting credit limits for parties
- Bank loans
- Optimising cost of finance

An enterprise can report cash flows using either:

1. Direct method
2. Indirect method

While reporting the cash flows of Operating, Investing and Financing activities, enterprise has to disclose the details:

- Foreign Currency Cash Flows
- Extraordinary Items

- Interest & Dividends
- Taxes on Income
- Investments in Subsidiaries, Associates and Joint Ventures
- Non-cash Transactions
- Components of Cash and Cash Equivalents
- Other Disclosures

Cash Flow Statement is being explained below with the help of following illustration.

Income statement of XYZ Ltd. for the year ended June 2018

Revenue from sales					
Sale				285,480	
Less: Sales Return and Allowances				6,480	
Net Sales				**279**	
Cost of Good Sold:					
Merchandiser Inventory					
July 1, 2014,			81,600		
Purchase		186,360			
Less: Purchase turns and Allowances	3,180				
Purchases Discounts	2,760		(5,940)		
Net Purchases			1,80,420		
Add: Freight in			9,180		
Delivered Cost of Purchase				**1,89,200**	
Cost of Goods Available for Sale				2,71,200	
Less Merchandise Inventory					
June 30, 2015				(85,200)	
Cost of Good Sold					**18,600**
Gross Profit					**93,000**
Operating Expenses:					
Salary Expense				44,100	

Payroll Tax Expense	4,890	
Advertising Expense	2,130	
Depreciation Expense Building	7,200	
Depreciation Expense, Equipment	4,200	
Supplies Expense	960	
Insurance Expense	630	
Miscellaneous Expense	420	
Total Operating Expenses		(6,453)
Income from Operations		**28,470**
Other Income:		
Interest Income	420	
Other Expenses:		
Interest Expense	(6,000)	(5,580)
Income Before Income Taxes		**22,890**
Income Tax Expenses		(5,940)
Income After Tax		**16,950**

Following transactions were also recorded by the Yatin Ltd.

1. Paid 7,200 on mortgage.
2. Collected note receivables of 10,800 plus 840 interests
3. Declared a dividend of 15600.
4. Received 5,940 from subscriber of common stock, having a par value of stock 5,400 and issued the stock.

Comparative Balance Sheet of Farheen Ltd. for the year 2018 and 2017.

Assets		**2018**	**2017**	
Cash	14,910	11,010	3,900	
Notes Receivable		-	5,400	(5,400)
Accounts Receivable (net)		28,350	18,720	9,630
Subscription Receivable, Common Stock		14,430	-	14,430

Merchandise Inventory		85,200	81,600	3,600
Supplies		180	120	60
Prepaid Insurance		90	210	(120)
Land	18,600	18,600	-	-
Building		132,000	132,000	-
Less Accumulated Depreciation		(64,800)	(57,600)	(4,200)
Equipment		22,200	22,200	-
Less Accumulated Depreciation		(12,600)	(8,400)	(4,200)
Total Assets		**2,38,560**	**2,23,860**	**14,700**
Liabilities				
Accounts Payable		17,610	25,680	(8,070)
Salaries Payable		1260	1470	(210)
Income Tax Payable		570	420	150
Interest Payable		660	780	(120)
Mortgage Payable		64800	136800	(3,600)
Total Liabilities		**84,900**	**96,750**	**(11,850)**
Stockholder's Equity				
Common Stock		86,100	83,400	2,700
Common Stock Subscribed		12,930	-	12,930
Paid-in Capital in Excess of Par Value		15,660	13,890	1,770
Unappropriated Retained Earnings		23,970		
Retained Earnings Appropriated for Plant Expansion		15,000	12,000	3,000
Total stockholders' Equity		153,660	127,110	26,550
Total Liabilities and Stockholders' Equity		**238,560**	**223,860**	**14,700**

Prepare a cash flow statement.

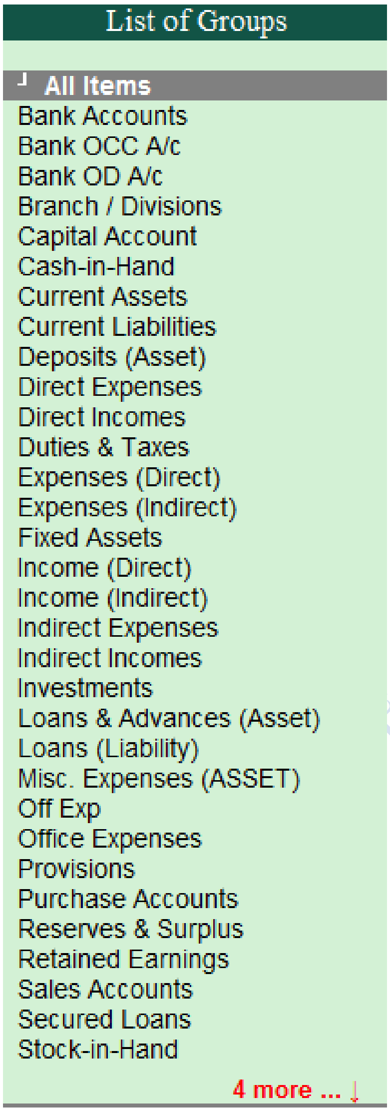
Solution:

Given this illustration,

Step 1: First create the company named Y Ltd with Accounts only transactions.

Step 2: At the second step create the ledger accounts. The ledger accounts can be created using STEP 3 of Tally as already discussed. We create the following ledger accounts using the path:

Gateway of Tally → Masters → Accounts Info. → Ledger → Multiple Ledgers → Create Under Group - All Items (as shown in Figure below)



Note:

Ledger accounts should be prepared with a single name otherwise related transaction will not be recognized. For example: Accounts payable is an account related to purchases on credit.

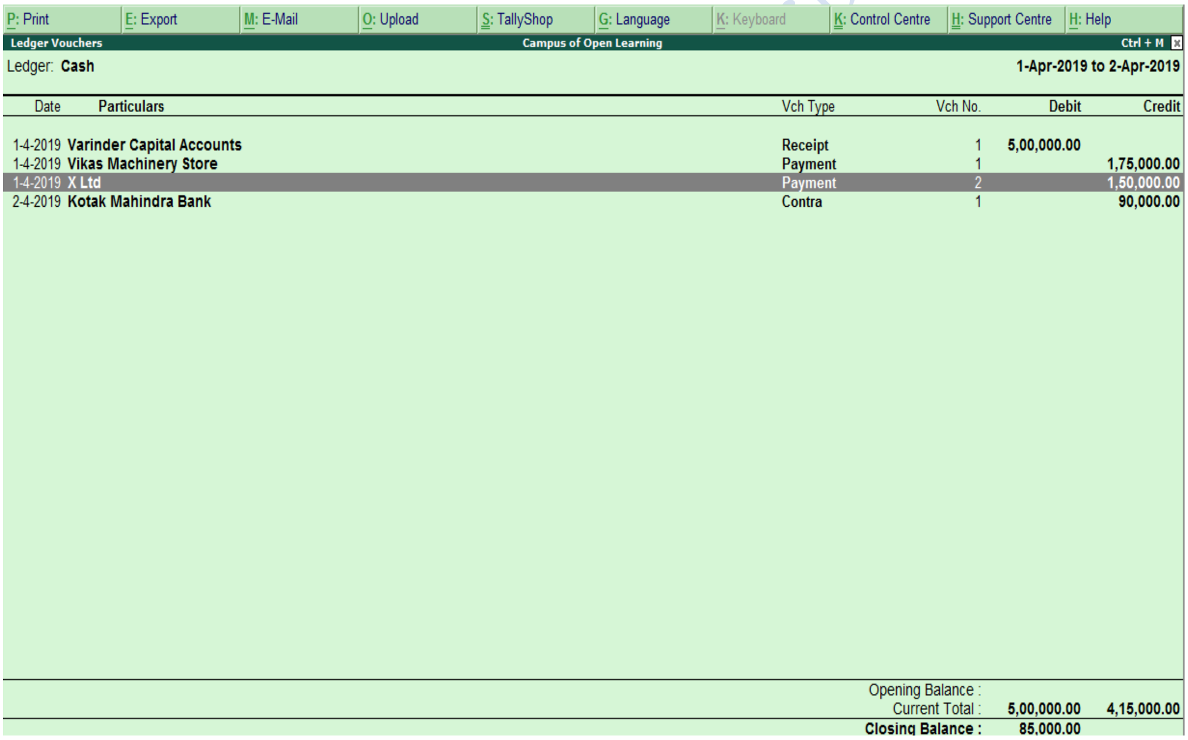
If you create accounts payable and merchandise purchases as two accounts, the transactions related to each other will not give the required effect. Hence, we have created Merchandise Purchases Payable account for accounts payable and merchandise purchases.

As can be seen the opening balance is the 2014 balance sheet figure and closing balance is 2015 balance sheet figure and sorting position has not been set for any ledger account.

Step 3: In this step, pass the entries relating to cash transaction i.e., the payments and the receipts as and when they occur during the course of business using this path:

Gateway of Tally → Display → Account Books → ledger Cash

When you do so, a cash ledger is prepared by Tally ERP9 (as shown in Figure below) showing the cash receipts and the cash payments The balance is the net increase in cash flow.



P: Print | E: Export | M: E-Mail | O: Upload | S: TallyShop | G: Language | K: Keyboard | K: Control Centre | H: Support Centre | H: Help

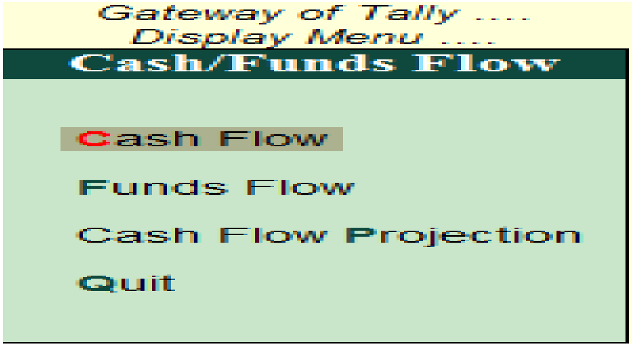
Ledger Vouchers — Campus of Open Learning — Ctrl + M

Ledger: Cash — 1-Apr-2019 to 2-Apr-2019

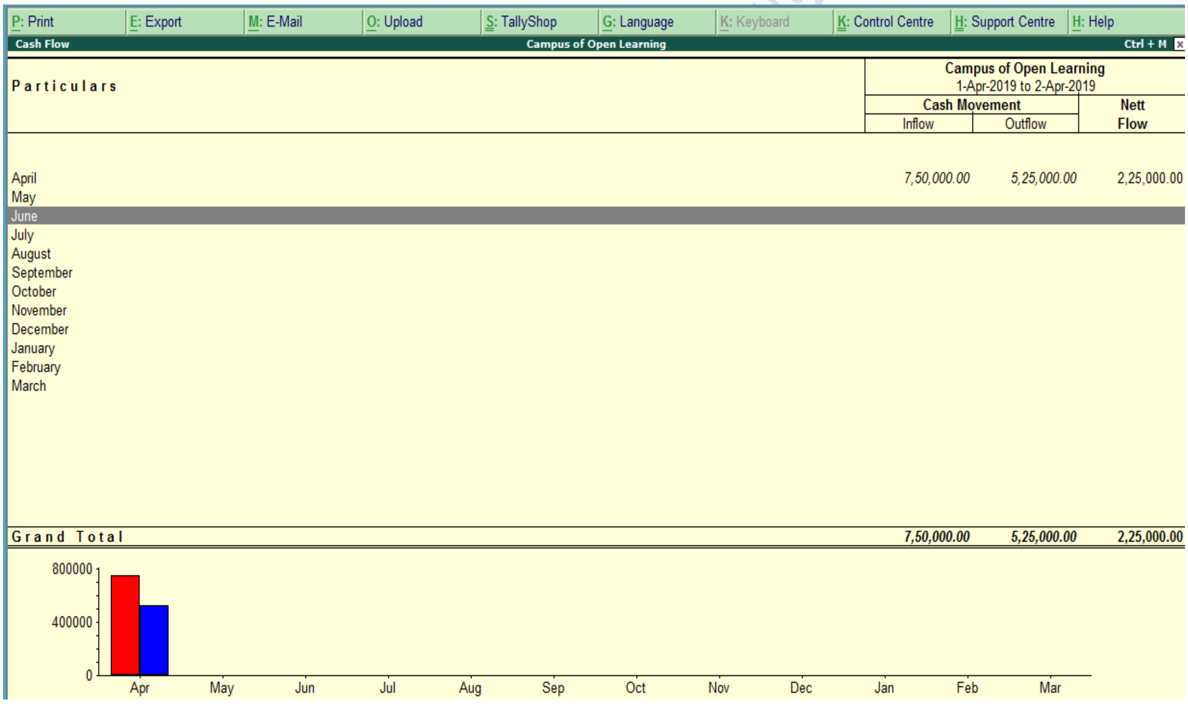
Date	Particulars	Vch Type	Vch No.	Debit	Credit
1-4-2019	Varinder Capital Accounts	Receipt	1	5,00,000.00	
1-4-2019	Vikas Machinery Store	Payment	1		1,75,000.00
1-4-2019	X Ltd	Payment	2		1,50,000.00
2-4-2019	Kotak Mahindra Bank	Contra	1		90,000.00
		Opening Balance :			
		Current Total :		5,00,000.00	4,15,000.00
		Closing Balance :		85,000.00	

This can also be seen from the Cash flow statement (which was our basic task) after following the path:

Gateway of Tally → Display → Cash/Funds Flow → Cash Flow



We can see that the cash flow statement (a summary) is confined to July month as the transactions are taking place in this month. Every month when the similar transactions occur, they will affect the cash flow statement and a comprehensive picture will be displayed. Here, since this is just the introduction, the data has been confined to one month. The bottom portion of cash flow statement shows the bars of inflow as red colour and outflows as blue colour. This helps the decision maker by just having a glance on the chart (see Figure given below).



The cash payments and cash receipts for the cash flow statement have been computed as under:

Particulars	Amount (₹)
Cash Receipts - Account Receivable	
Net Sales	27,900
Account Receivable (2014)	18,720
	297,720
Account Receivable (2015)	28,350
	269,370
Cash Payments for Merchandise Purchases	
Cost of Purchases	189,600
Merchandise Purchases Payable (2014)	25,680
	215,280
Merchandise Purchases Payable (2015)	17,610
	197,670

Cash Payments – Salaries	
Salary Expense	44,100
Salaries Payable (2014)	1,470
	45,570
Series Payable (2015)	1,260
	44,310
Cash Payment Supplies Exp	
Supplies Expertise	960
Supplies (2015)	180
	1,140
Salaries Payable (2015)	120
	1,020
Cash Payment - Insurance in Advance	
Insurance Exp	630

Adv. Insurance (2015)	90
	720
Adv. Insurance (2014)	210
	510
Cash Payment Interest Payable	!
Interest Expense	6,000
Interest Payable (2014)	780
	6,780
Interest Payable (2015)	660
	6,120
Cash Payment – Income Tax Payable	
Income Tax Expense	5,940
Income Tax Payable (2014)	420
	6,360
Income Tax Payable (2015)	570
	5,790

Besides this cash payment of 7200 has been made towards mortgage and 12,000 towards interest expense. Cash has been received in respect to Notes Receivable as 10,800, interest income as 840 and subscription receivable as 5,940.

The cash flow statement under manual accounting for verification is provided below.

Particulars	**Detailed Amount ()**	**Amount ()**	**Final Amount ()**
Cash Receipts From (Used by) Operating Activities			
Cash Receipts From:			
Customers		269,370	
Interest		420	
Total Cash Receipts			269,790
Cash Payments For:			197,670

Merchandise Purchases			
Operating Expenses:			
Salaries Payable	44,310		
Payroll Tax	4,890		
Advertising Exp	2,130		
Supplies Exp	1,020		
Insurance Payable	510		
Misc. Exp.	420	53,280	
Interest Exp	6,120		
Income Tax Payable	5,790	14,410	**262,860**
Net Cash Flow from Operating Activity			6,930
Cash Flow from Investing Activity			
Notes Receivable			5,400
			12,330
Cash Flow from Financing Activity			
Mortgage Payable		(3,600)	
Common Stock Issue		2,970	
Divided Declared		(7,800)	
			(8,400)
Net Increase in Cash Flow			**3,900**

12.7 FUND FLOW STATEMENT

A Fund Flow statement is a report, which explains the movement of funds during an accounting period.

This statement consists of two parts

- Sources of funds
- Application of funds

Note: The term Funds means working capital

The difference between the two shows the net change in the working capital during the period. Only those transactions that affect the net working capital of the firm, find place in this statement.

The Fund Flow statement is a supplement to the two principal financial statements. While supplementing the position statement, it describes the sources from which additional fund were derived and for which these funds were used. The transactions, which increase working capital, are sources of funds and the transactions, which decrease working capital, are application of funds.

Fund Flow Statement is being explained below with the help of following illustration.

From the following balance sheet of Agni Computers, you are required to prepare a funds flow statement using Tally ERP 9.

Balance Sheet

Liabilities	2014	2015	Assets	2014	2015
Capital	40,000	42,500	Cash in Hand	2,000	4,500
P/L. Account	7,250	12,250	S. Debtors	8,250	9,750
Sundry Creditors	4,500	2,500	Stock	4,500	3,500
Long Term Loans	-	2,500	Machinery	12,000	17,000
			Building	25,000	25,000
	51,750	59,750		51,750	59,750

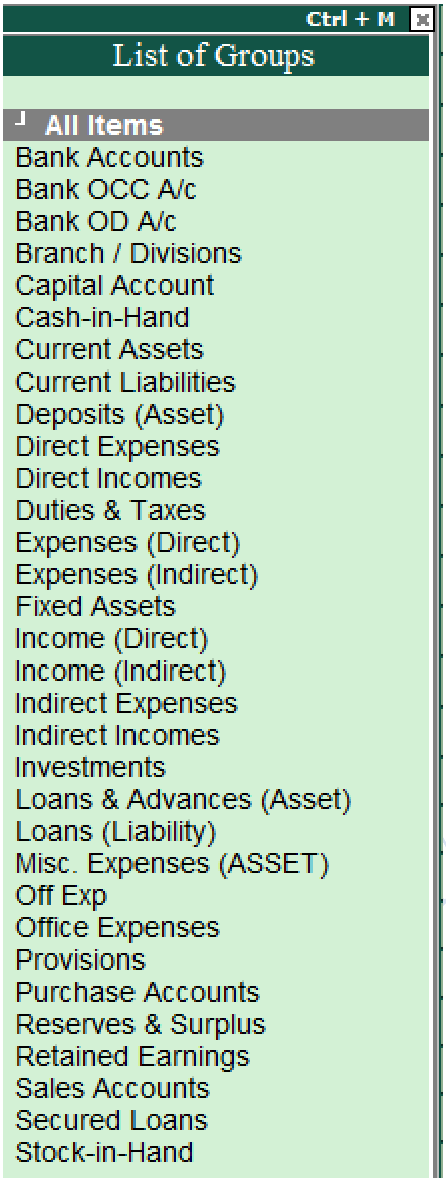
Solution:

We are using a very simple illustration (with no additional items) to understand how funds flow statement prepared. Given this illustration.

Step 1: First create the company named Agni Computers.

Step 2: In the second step create all the ledger accountant will be needed through the path: **Gateway of Tally → Masters Accounts Info. → Ledgers → Multiple Ledgers Create → Under Group All Items** (as shown in Figure below)

See Figure below for the ledger accounts created for the illustration. The amount in the year 2014 has been inserted in the opening balance column.

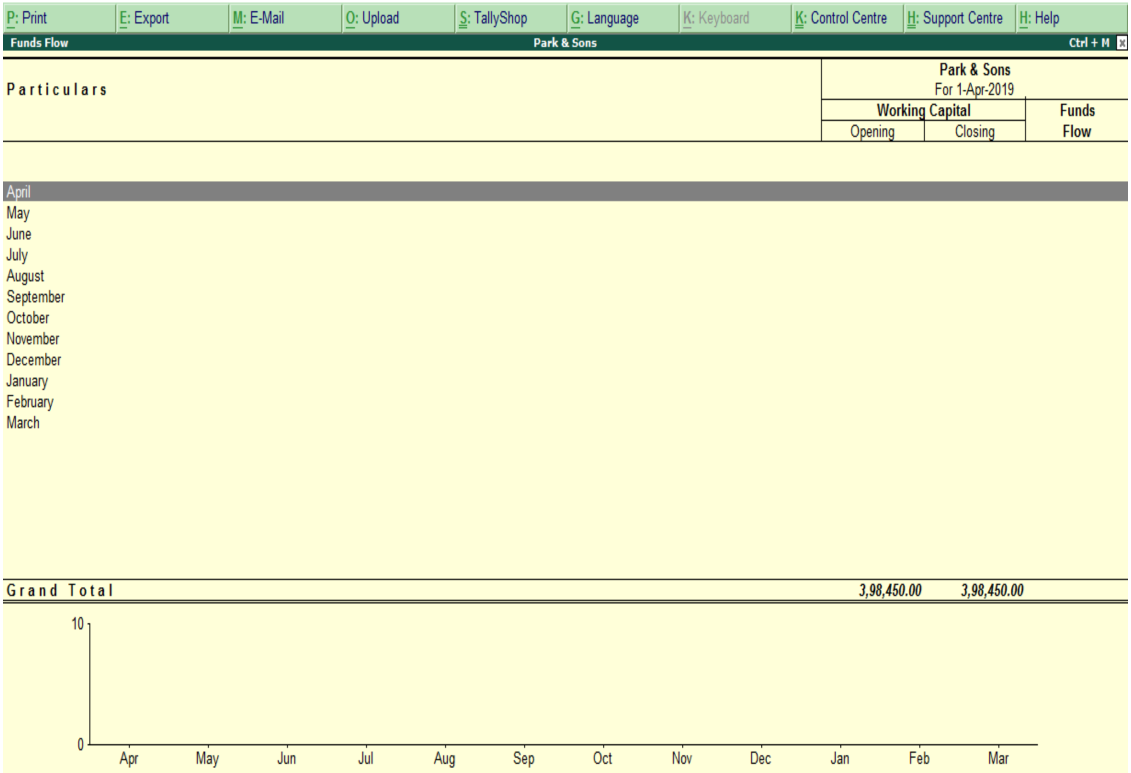


Step 3: In the third step, record all the increases or decreases from the 2019 to 2020 in primarily journal voucher.

In the middle of the period, if you want to view your funds' status, follow the path as shown below. To the funds flow statement open:

Gateway of Tally → Display Cash/funds flow → Funds Flow Statement

See below to view the funds flow statement as prepared for the illustration.



The button Auto Column in the button bar can change the view in the manner you want, whether it is company wise, 4 weeks wise, daily, fortnightly, yearly and so on, whichever way you choose to see it.

Fund flow statement in Tally ERP 9 displays a bar chart at the bottom, similar to cash flow statement. The difference is the positive funds flow is shown above x axis and negative is shown below as compared to two bars for inflow and outflow in cash flow statement. In cash flow statement, the inflow and outflow of cash are shown but here the opening and closing balances of funds is displayed.

12.8 SELECTING AND SHUTTING A COMPANY

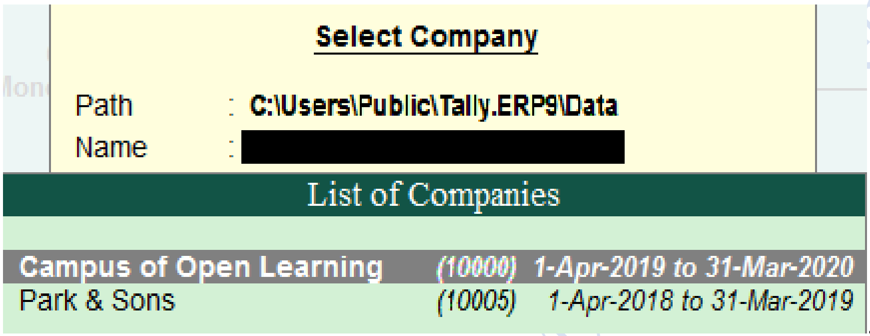
After having learned various aspects of computerized accounting with the help of TALLY ERP.9 like, creating a company, group formation, ledger creation, voucher creation, creation of final accounts, etc, let us learn the aspect of how to select a company and how to shut a company.

Selecting a Company (F1)

If you have created single company on tally then tally opens that company automatically once you open tally however, if you have created multiple companies on Tally, then tally gives you an option of selecting the company you want to work in. To select a company out of multiple companies:

Step 1: Open Tally

Step 2: Press Select Company or Press F1, new window opens showing multiple companies we have, select the company you want to open (in this case we have selected ABC Pvt. Ltd. as shown in Figure on the right) and press Enter



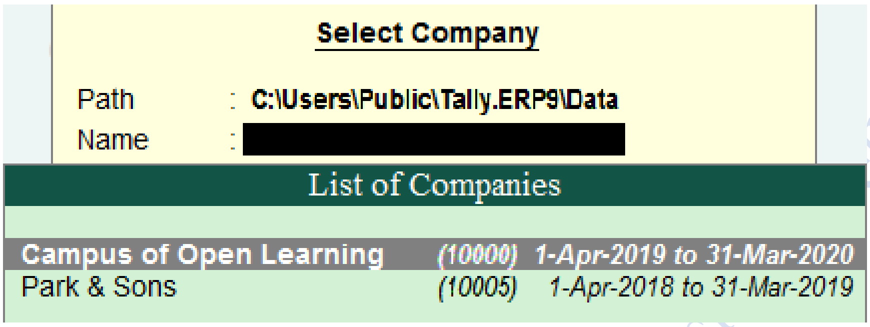
Once you press Enter the company ABC Pvt. Ltd. will open (see Figure below). Now you are ready to work in this company.

Shutting a Company (Alt + F1)

You can only use this option if you are working in multiple companies in tally. So, in case you our working in multiple companies in tally and you want to shut a company:

Step 1: Press Alt + F1

Step 1: Select the company you want to shut. Press Enter and that company will be shut down (In this case Scholar Tech Press, see Figure below).



Note:

However, if you again want to work in the company that you have shut down, you can always open it again by following the steps mentions under "Selecting a Company".

Significance

12.9 BACKUP AND RESTORED DATA OF THE COMPANY

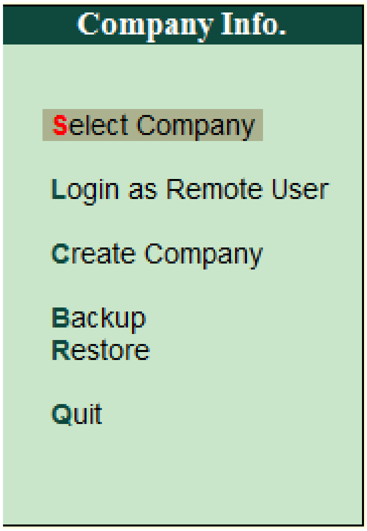
It is very important for a company maintaining accounts on Tally, that they regularly take backup of their data (on pen drive, external hard drive etc), since in case data becomes corrupt, or any other mishap, you will have the option of restoring the data from the backup you have saved.

Note: Data will be restored via backup only up to the date till the date backup has been taken.

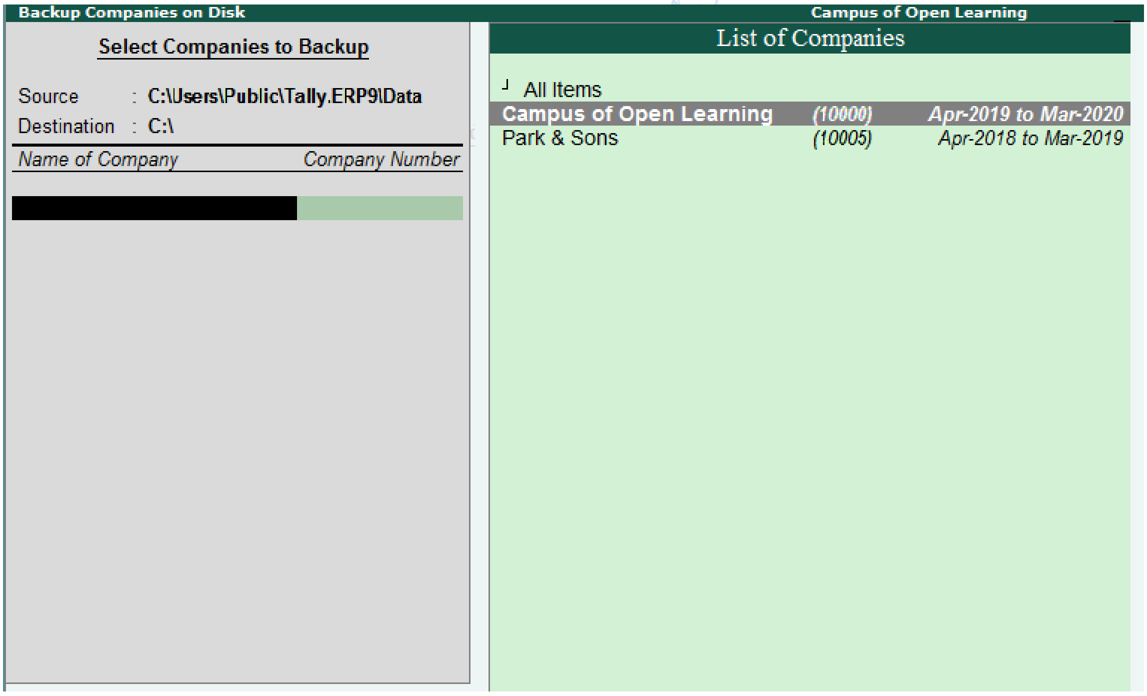
Taking Backup of Data

This option helps you to takes the backup of the Company Data on the same computer or on an external storage say a pen drive or a portable hard disk as shown in Fig. 11.

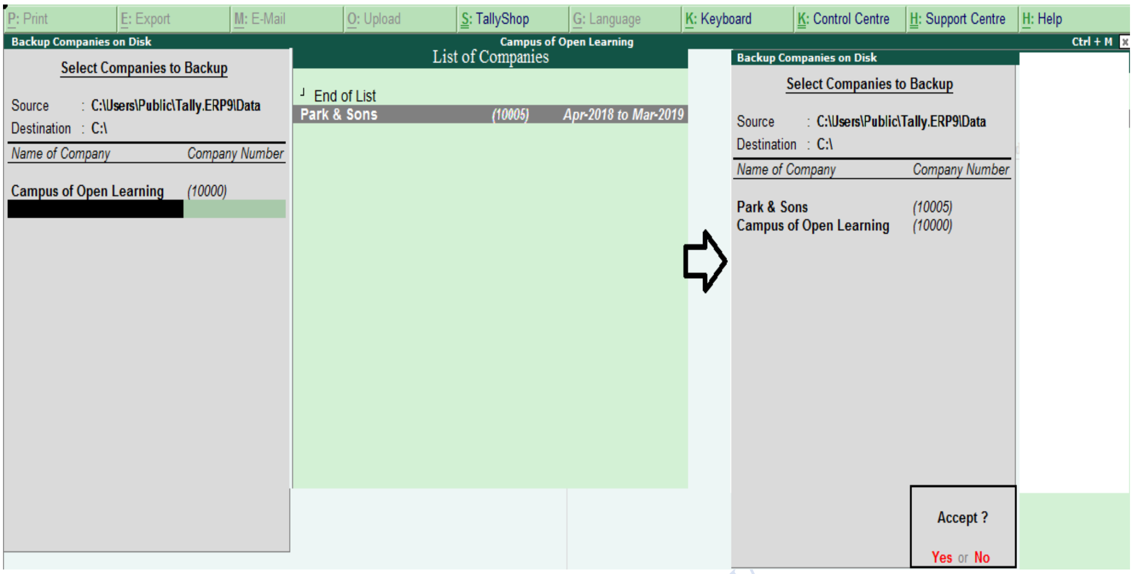
Step 1: Go to Company Info. Screen (Alt + F3) → Press Backup



After we Press Backup on the Company Info. Screen and we will be taken to the screen given below.



Step 2: Enter the Destination where you want to store backup. Select the Company for which you want to take backup (we have selected ABC Pvt. Ltd., see Figure above), and Press End of the List and it will ask you to Accept: **Yes/No** for backup (see Figure below). Press **Yes** to take backup.

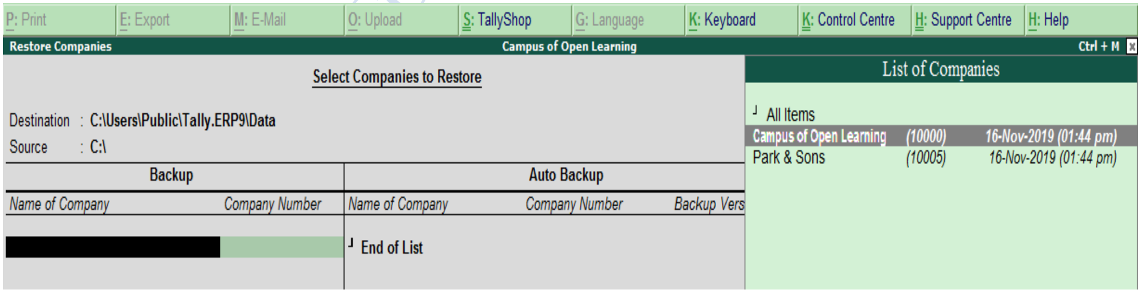


Restoring Data

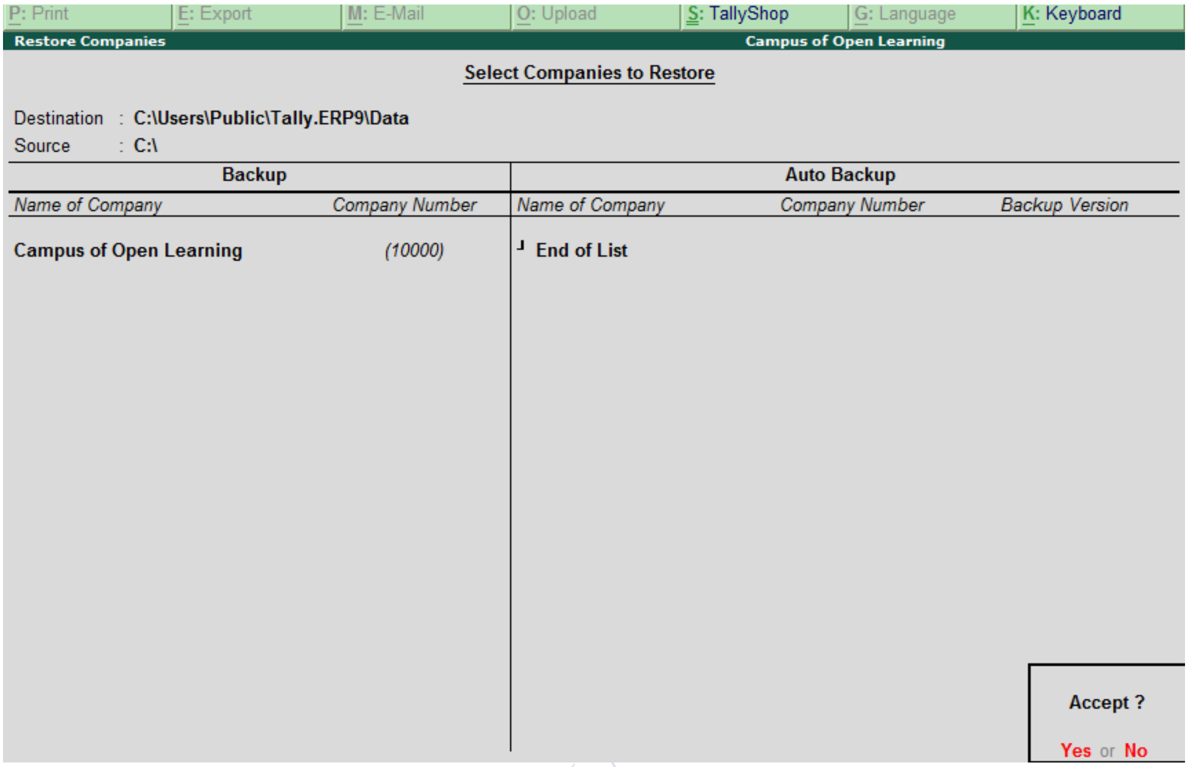
In case your data is corrupted, or any other mishap, this option helps you to restore or retrieve the saved data of the company from its respective folder created at the time of taking the backup.

Step 1: Go to Company Info. screen (Alt + F3) → Press Restore.

Following screen will open



Step 3: Enter the source where you have kept backup. Select the company for which you want to **Restore the data** (we have selected ABC Pvt. Ltd, see Figure above), and Press End of the List and it will ask you to Accept: **Yes/No** to restore data (see Figure below). Press **Yes** to restore.



IN-TEXT QUESTIONS

6. Cash Flow Statement can be prepared in _____ ways
7. Gateway of Tally → ________ → Account Books → ledger Cash
8. A ___________ is a report, which explains the movement of funds during an accounting period
9. What is the short cut key for Shutting a Company
10. The term Funds means _________

12.10 SUMMARY

In this lesson we have coved how to check all the transactions in the respective accounts like cash book, Profit and Loss Account, Ledger Accounts, Trail Balance, Funds Flow statements and Cash Flow statements and Balance Sheet.

Transactions entered in the respective vouchers, the cash Book, Ledger Accounts, Trial Balance, Profit and Loss Account and Balance Sheet for the respective company is automatically created both in condensed and detailed form. How data can be used for selecting, shutting a company, backup and restore of data of a company.

12.11 GLOSSARY

Ledger: It means a book where the various accounts of a company are kept. To open/view Ledger Account.

Cash Flow: It is the inflow and outflow of cash during an accounting period.

Trial Balance: It shows summary of all ledger balances to check whether the figures are correct and balanced

12.12 ANSWERS TO IN-TEXT QUESTIONS

1. Click Display 2. Cashbook 3. Trial Balance 4. Direct 5. Receipt and Payment Account 6. Two 7. Display	8.Fund Flow Statement 9.Alt+F 10.Working Capital

12.13 SELF-ASSESSMENT QUESTIONS

Exercise:1 Multiple Choice Questions

1. After entering the transaction in the respective vouchers, we get

1. Cash Book,
2. Trial Balance,
3. Profit and Loss Account
4. Balance Sheet
5. All the above

2. Highlights of the Cash Flow statement include:

1. Ageing of payments

2. Ageing of receipts
3. Cash balance
4. All the above

3. Benefits of Cash flow statements are not mentioned :

1. Predicting cash flow
2. Financial planning/forecasting
3. Non-Financial health of business
4. Show cash position to Financial Institutions

4. Benefits of Cash flow statements

1. Capital investment requirements/judgment
2. Setting credit limits for parties
3. Bank loans
4. Optimising cost of finance
5. All the above

5. An enterprise can report cash flows using either:

1. Direct method
2. Indirect method
3. Temporary method
4. Both (1) and (2)

6. Which statement is not consisting of two parts of fund flow?

1. Sources of funds
2. Application of funds
3. Indirect method
4. Both (1) and (2)

7. Cash flow statements can also be used as:

1. Receipts statement
2. Both (1) and (4)
3. Online statement

4. Payment's statement

8. While reporting the cash flows of Operating, Investing and Financing activities, enterprise has to disclose the details are:

1. Foreign Currency Cash Flows
2. Extraordinary Items
3. Interest & Dividends
4. Taxes on Income
5. All the above

9. Which account should be prepared with a single name otherwise related transaction will not be recognized?

1. Manual Account
2. Joint Account
3. Ledger Account

10. Which statement is the inflow and outflow of cash during an accounting period?

1. Fund Flow Statement
2. Cash flow statement
3. Indirect method
4. None of the above

ANSWER: 1. (5), 2. (4), 3. (3), 4. (5), 5. (4), 6. (4), 7. (4), 8. (5), 9. (3), 10. (2)

Exercise:2 Fill in the blanks:

1. ……………. is the inflow and outflow of cash during an accounting period.
2. Cash flow statements can also be used as ………. and ………. statement.
3. The………………. is a supplement to the two principal financial statements
4. A ……………. of a company shows summary of all ledger balances to check whether the figures are correct and balanced.
5. …………. means a book where the various accounts of a company are kept.

Answer: 2 1. Cash flow

5. Receipt and payment

6. Fund flow statement
7. Trial Balance
8. Ledger

Exercise: 3 Mix & Match

1. Fund Flow statement — is the inflow and outflow of cash during an accounting period.
2. Cash Flow — is a supplement to the two principal financial statements.
3. Trail Balance — Bank loans
4. Cash flow statement — Fund flow statement
5. Source of fund — the total of debit balances should be equal to total of credit balances

Answer: 3 1(b), 2(a), 3(e), 4(c), 5(d)

Exercise:4 Short Question Answer

Q.1 Which account should be prepared with a single name otherwise related transaction will not be recognized?

Q.2 Which statement can also used as receipt and payment statement?

Q.3 Which statement is the inflow and outflow of cash during an accounting period?

Q.4 What is the meaning of Ledger account?

Q.5 What do you understand by fund flow statement?

Exercise: 5

Illustration: 1

JOURNAL ENTRIES

1.	Purchase a/c	Dr.	1,35,000	
	To Cash			1,35,000\
2.	Shweta	Dr.	2,50,000	
	To Sales			2,50,000
3.	Yash	Dr.	1,35,000	
	To Cash			1,00,000
	To Discount received.			35,000
4.	Cash	Dr.	2,10,000	
	Discount allowed	Dr.	40,000	
	To Smeta			2,50,000

5.	Furniture	Dr.	50,000	
	To Cash			50,000
6.	Outstanding Sal.	Dr.	5,000	
	To Cash			5,000

Practical:2 JOURNAL ENTRIES

1.	Purchase	Dr.	7,000	
	To Shalu			7,000
2.	Reena	Dr.	2,40,000	
	To Sales			2,40,000
3.	Pankaj	Dr.	2,50,000	
	To Sales			2,50,000
4.	Shalu	Dr.	7,000	
	To SBI			6,800
	To Discount received.			200
5.	SBI	Dr.	4,70,000	
	Discount Allowed	Dr.	20,800	
	To Reena			2,40,000
	To Pankaj			2,50,800
6.	Sapna	Dr.	10,000	
	To SBI			10,000
7.	Purchases	Dr.	16,000	
	To Sangeeta			16,000
8.	Purchases	Dr.	20,000	
	To Sapna			20,000
9.	Pooja	Dr.	1,35,000	
	To Sales			1,35,000
10.	Furniture	Dr.	25,000	
	To Cash			25,000
11.	Insurance premium	Dr.	15,600	
	To Cash			15,600
12.	Land & Building	Dr.	10,00,000	
	To Bank Loan			4,00,000
	To Debtors			6,00,000
13.	Investment in Cash	Dr.	2,00,000	
	To Instalment.			80,000
	To Profit			1,20,000
14.	Salaries	Dr.	50,000	
	To Outstanding Salary			50,000

15.	Rent	Dr.	50,000	
	To Rent Outstanding			50,000
16.	Tax	Dr.	2,40,000	
	Received for Tax			2,40,000
17.	Deprecation	Dr.	32,500	
	To Furniture			32,500
18.	Deprecation	Dr.	50,000	
	To Machine			50,000

Illustration :2

Create accounts of Italian cement Trading Company for year 2019-20.

PRACTICAL:1 JOURNALS

1/4/19	Cash received from AK Sharma as capital 10,00,000
1/4/19	Cash deposited in PNB 8,00,000
1/4/19	Purchased furniture & fixture from Ram wood works 1,75,000
1/4/19	Computer purchased from HP Ltd. 65,000
1/4/19	Add. Expenses (Cash) 10,000
1/4/	Rent paid (Cash) to Mr. Malhotra in cash 10,000
1/4/	Staff Salary paid in cash 6,000
1/4/	Cheque issued to HP Ltd. from PNB 65,000
1/4/	Tea expenses paid in cash 5,000
2/4/	Purchased grey cement from Acc Ltd. 5,75,000
	Purchased white cement from JK Ltd. 3,75,000
	Add. Expenses in cash 5,000
	Grey cement sold for cash 15,000
	White cement sold to Deepak Kr. 25,000

Illustration :3

JOURNALS & B/S

1/4/19	Cash a/c	Dr.	10,00,000	
	(To Capital a/c)			10,00,000
1/4/19	PNB Bank a/c	Dr.	8,00,000	
	(To Cash ac/)			8,00,000
1/4/19	Furniture & Fixture	Dr.	4,75,000	

	(To Ram wood works)			4,75,000
1/4/19	Computes A/c	Dr.	65,000	
	(To H.P. Ltd.			65,000
1/4/19	Add. Expenses	Dr.	10,000	
	(To Cash a/c)			10,000
1/4/19	Rent A/c	Dr.	10,000	
	(To Cash a/c)			10,000
1/4/19	Salary a/c	Dr.	6,000	
	(To Cash a/c)			6,000
1/4/19	Ram wood works	Dr.	1,25,000	
	(To PNB Bank)			1,25,000
1/4/19	HP Ltd.	Dr.	65,000	
	(To PNB Bank)			65,000
1/4/19	Tea Expenses	Dr.	5,000	
	(To Cash a/c)			5,000
2/4/19	Purchases a/c	Dr.	5,75,000	
	(To APP Ltd.)			5,75,000
2/4/19	Purchases a/c	Dr.	3,75,000	
	(To Jan Kishan Ltd.)			3,75,000
2/4/19	Add Expenses a/c	Dr.	5,000	
	(To Cash a/c)			5,000
2/4/19	Cash a/c	Dr.	15,000	
	(To Sales a/c)			15,000
2/4/19	Deepak Kr.	Dr.	25,000	
	(To Sales a/c)			25,000

Next Ques. (Picture)

Illustration :4

JOURNAL

1/4/5	Cash a/c	Dr.	1,25,000	
	(To Capital a/c)			1,25,000
1/4/05	Steel Table a/c	Dr.	18,000	
	(To Cash a/c)			18,000
14/5/05	Bank a/c	Dr.	50,000	
	(To Cash a/c)			50,000
30/5/05	Purchase a/c	Dr.	35,000	
	(To Cash a/c)			35,000
5/6/05	Cash A/c	Dr.	45,000	

	(To Sales a/c)			45,000
9/7/05	Stationary a/c	Dr.	3,500	
	(To cash a/c)			3,500
25/7/05	Cash a/c	Dr.	12,500	
	(To bank a/c)			12,500
31/7/05	Rent A/c	Dr.	5,000	
	(Prepaid Rent a/c)	Dr.	2,500	
	(To Cash a/c)			7,500
15/8/05	Purchases A/c	Dr.	40,000	
	(To Ramesh a/c)			40,000
*Entry in last				
**Entry in last				
20/1/05	Purchases a/c	Dr.	20,000	
	(To Shyam a/c)			20,000
11/11/05	Ramesh a/c	Dr.	14,000	
	(To Cash a/c)			14,000
10/12/05	Varun	Dr.	47,000	
	(To Sales a/c)			47,000
15/12/05	Ramesh	Dr.	26,000	
	To Bank a/c			25,000
	(To Discount received)			1,000
01/01/06	Bank a/c	Dr.	45,000	
	Discount allowed a/c	Dr.	2,000	
	(To Varun)			47,000
1/2/06	Ravi	Dr.	40,000	
	(To Sales a/c)			40,000
15/2/06	Purchases a/c	Dr.	26,000	
	(To Shyam)			26,000
28/02/06	Rent a/c	Dr.	6,250	
	(To Cash a/c)			6,250
1/3/06	Stationery a/c	Dr.	3,150	
	(To Cash a/c)			3,150
31/3/06	Deprecation a/c	Dr.	900	
	(To Steel Table)			900
31/3/06	Rent a/c	Dr.	1,250	
	(TO Outstanding Rental)			1,250
*31/8/05	Rent a/c	Dr.	1,250	
	(To Prepaid Rent)			1,250

**31/9/05	Rent a/c	Dr.	1,250	
	(To Repaid rent a/c)			1,250

Step-3. Opening Reports

1. Balance Sheet, 2. Outstanding Report, 3. Stock Summery, 4. Godown wise report

Step-4. Accounting Transaction

Date	Transaction Details
01-04-2019	Withdraw cash ₹ 025,000 from Kotak Bank for office expenses
01-04-2019	Paid Outstanding salary Cheque No. 112233 (Ram ₹ 12,500, Shyam ₹ 12,500)
02-04-2019	Paid advertisement expenses ₹ 10,000 to Rajkumar Cheque No. 112234
02-04-2019	Received ₹ 29,500 from Raj Distributors full and final settlement through Ch. No. 123456 of HDFC Bank
02-04-2019	Purchase printing and stationery ₹ 4,500 by cash
02-04-2019	Paid ₹ 54,000 to Surya Traders full and final settlement Ch. No. 112235.
02-04-2019	Paid Office Rent ₹ 15,000 for Mohali Shop and ₹ 20,000 for Chandigarh Shop to Anand kumar through Ch. No. 112236

Step-4. Accounting Reports

1. Balance Sheet, 2. Profit & Loss Accounts, 3. Cash & Bank Book, 4. Cheque Register, 5. Cost Centre, 6. Day Book

Step-5. Inventory Transaction

Create Godown- MG Road

Date	Transaction Details
01-05-2019	Placed purchase order to Surya Traders for 5 Pcs RAM 4 GB @ ₹ 2,000 each and 5 Pcs HDD 500 GB @ ₹ 4,500 each. (Order No. JPLP 001)
01-05-2019	Received all the goods as per the order through Challan No. STC-001 and stored it into Shop-1 godown
02-05-2019	Received Invoice from Surya Traders Inv. No. ST-006
02-05-2019	Returned 1 Pcs HDD 500 GB to Surya Traders against Inv. No. ST-006 (Ref. No. 001)
02-05-2019	Received sales order from Raj Distributors for 3 Pcs RAM 4 GB @ ₹ 3,500 each and 3 Pcs HDD 500 GB @ ₹ 6,500 each. (Order No. RDS 002)

02-05-2019	Sent all the goods as per the order no. (RDS-002) from Shop-1 godown through challn no. JPLS-009
02-05-2019	Sent invoice to Raj Distributors Inv. No. JPL-004
02-05-2019	Raj Distributors returned 1Pcs HDD 500 GB against invoice no. JPL 004 (Ref. No. 002)

12.14 SUGGESTED READINGS

- *Monga, J R. Financial Accounting: Concept and Applications. Mayur Paper Backs, New Delhi*
- *Goyal, Bhushan Kumar and H.N. Tiwari, Financial Accounting, Taxmann.*

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