

**UNIT- 1 FINANCIAL ACCOUNTING**

Introduction to Financial, Cost and Management Accounting- Generally accepted accounting principles, Conventions and Concepts-Balance sheet and related concepts-Profit and Loss account and related concepts - Introduction to inflation accounting-Introduction to human resources accounting.

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**UNIT I**  
**FINANCIAL ACCOUNTING**

### **1.1 INTRODUCTION**

In all activities (whether business activities or non-business activities) and in all organizations (whether business organizations like a manufacturing entity or trading entity or non-business organizations like schools, colleges, hospitals, libraries, clubs, temples, political parties) which require money and other economic resources, accounting is required to account for these resources.

### **1.2 Meaning of Accounting:**

Accounting is nothing but a means of communicating the result of business operations to various parties interested in or connected with the business, which is the owner, creditors, investors, government, financial institution and other agencies.

### **Definition of Accounting:**

According to **American Institute of Certified Public Accountants (AICPA)**, accounting is "The art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part, at least, of a financial character and interpreting the results thereof".

### **OBJECTIVES OF ACCOUNTING**

Objective of accounting may differ from business to business depending upon their specific requirements. However, the following are the general objectives of accounting.

- **To keeping systematic record:** It is very difficult to remember all the business transactions that take place. Accounting serves this purpose of record keeping by promptly recording all the business transactions in the books of account.
- **To ascertain the results of the operation:** Accounting helps in ascertaining result i.e., profit earned or loss suffered in business during a particular period. For this purpose, a business entity prepares either a Trading and Profit and Loss account or an Income and Expenditure account which shows the profit or loss of the business by matching the items of revenue and expenditure of the some period.
- **To ascertain the financial position of the business:** In addition to profit, a businessman must know his financial position i.e., availability of cash, position of assets and liabilities etc.
- This helps the businessman to know his financial strength. Financial statements are barometers of health of a business entity.
- **To portray the liquidity position:** Financial reporting should provide information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, about its capital transactions, cash dividends and other distributions of

resources by the enterprise to owners and about other factors that may affect an enterprise's liquidity and solvency.

- **To protect business properties:** Accounting provides upto date information about the various assets that the firm possesses and the liabilities the firm owes, so that nobody can claim a payment which is not due to him.
- a. **To facilitate rational decision – making:** Accounting records and financial statements provide financial information which help the business in making rational decisions about the steps to be taken in respect of various aspects of business.
- b. **To satisfy the requirements of law:** Entities such as companies, societies, public trusts are compulsorily required to maintain accounts as per the law governing their operations such as the Companies Act, Societies Act, and Public Trust Act etc. Maintenance of accounts is also compulsory under the Sales Tax Act and Income Tax Act.

### 1.3 FUNCTIONS OF ACCOUNTING

#### **Recording:**

It is the basic function of accounting.

Record all transactions that are financial character in an chronological order.

#### **Classifying:**

Concerned with systematic analysis of recorded facts done in the book called "Ledger", Ledger contains different pages for individual accounts.

#### **Summarizing:**

Involves presenting the classified data in a manner, which is understandable and useful to the internal and external end-users i.e. trial balance, income statement, balance sheet

#### **Analyzing:**

It establishes the relationship between the items of P&L account and Balance sheet. The Purpose of analyzing is to identify the financial strength and weakness of the business

#### **Interpreting:**

The recorded financial data is interpreted in a manner that the end- users can make a meaningful judgement about financial condition and profitability of the business operations.

**Difference between Accounting and Finance:**

	<b>Accounting</b>	<b>Finance</b>
Definition	Preparation of accounting records	Efficient and productive management of assets and liabilities based on existing information
Purpose	Measuring, preparation, analyzing, and interpretation of financial statements. To collect and present financial information.	Decision making regarding working capital issues such as level of inventory, cash holding, credit levels, financial strategy, managing and controlling cash flow.
Goal	To see how the company is performing, to monitor day to day accounting operations, and for taxing.	To forecast the future performance of the business.
Tools	Balance sheets, profit and loss ledgers, positional declarations, and cash flow statements.	Performance reports, ratio analysis, risk analysis, estimating break evens, returns on investment, etc.
Determination of funds	Revenue is acknowledged at the point of sale and not when it was collected. Expenses are acknowledged when they are incurred than when they are paid.	Revenues are acknowledged during the actual receipt in cash as in cash flow and the expenses are acknowledged when the actual payment is made as in cash outflow.

**1.4 Branches of Accounting:**

It can be classified as follows:

- a. Financial Accounting
- b. Cost Accounting
- c. Management Accounting

**Financial Accounting:**

It is the original form of accounting. It is mainly confined to the preparation of financial statements for the use of outsiders like shareholders, debenture holders, creditors, banks and financial institutions. The financial statements, i.e. the profit and loss account and the balance sheet, show them the manner in which operations of the business have been conducted during a specified period.

**Cost Accounting:**

It is the process of accounting and controlling the cost of a product, operation or function. The purpose of this branch of accounting is to ascertain the cost, to control the cost and to communicate information for decision making.

### **Managerial Accounting:**

Management accounting is comprised of two words 'Management' and 'accounting'. It is the study of managerial aspect of accounting. The emphasis of management accounting is to redesign accounting in such a way that is helpful to the management information of policy, control of execution and appreciation of effectiveness.

Management accounting covers various areas such as cost accounting, budgetary control, inventory control, statistical methods, internal auditing, etc.

### **1.5 Accounting Cycle:**

The purpose of accounting cycle is to measure business activities in the form of transaction and to transfer these transactions into financial statements will communicate useful information to decision makes.

- Business Transactions are created
- Analyze and Record the transactions
- Post the information from the journal to the ledger
- Prepare a trial balance
- Journalize adjusting Entries
- Post adjustments from the journal to the ledger
- Prepare and adjusted trial balance
- Journalize closing entries
- Post closing entries from the journal to the ledger
- Prepare a post closing trial balance
- Prepare the financial statements

### **Definition of Management Accounting:**

According to the **American Accounting Association**, "Management Accounting includes the method and concepts necessary for effective planning, for choosing among alternative business actions and for control through the evaluation and interpretation of performance".

### **Journal:**

The word '**journal**' has been derived from the **French** word '**Jour**' meaning **daily records**. The journal records all daily transactions of a business in the order in which they occur. A journal is a **book of original entry/books of prime entry**. The recording of a transaction in the journal is called **journalizing**. The record of a business transaction in journal is called a **journal entry**.

### **Rules of Debit and Credit:**

Every accounting transaction has got two sides, the debit and a credit. These are the two signs used in accounting to present and report the financial effect of every transaction. All the **business transactions must have debit and its corresponding credit of the same amount**.

### **Ledger:**

When the transactions are recorded from the primary books of accounts on permanent basis under double entry system in a summarized and classified form in different accounts and the same is posted in separate pages, it is called a **Ledger**.

A ledger is a book which contains all the accounts whether personal, real or nominal, which are first entered in journal or special purpose subsidiary books.

### **Trial Balance:**

Trial balance is a statement, prepared with the debit and credit balances of ledger accounts to test the arithmetical accuracy of the books. If the totals of the debit and credit amount columns of the trial balance are equal, it is presumed that the posting to the ledger in terms of debit and credit amounts is accurate.

Preparing a trial balance for a company serves to detect any mathematical errors that have occurred in the double entry accounting system. Provided the total debts equal the total credits, the trial balance is considered to be balanced, and there should be no mathematical errors in the ledger.

### **Methods of Preparing Trial Balance:**

- i. Balance method
- ii. Total Method
- iii. Total and Balance method
- iv. Elimination of Equal Total Methods

### **1.6 RULES OF ACCOUNTING/ TYPES OF ACCOUNTS:-**

There are 3 golden rules or types of accounts. These are:-

**PERSONAL ACCOUNT** – These are accounts of parties with whom the business is a carried on. Personal accounts may be:

- i. Accounts of natural or physical persons. Ex: Rama Account, Krishna Account
- ii. Accounts of artificial or legal persons. Ex: ABC & Co.
- iii. Representative personal account. Ex: O/S Expenses Account, O/S income Account, Prepaid Expenses Account, Income Received in Advance.

### **Rules of Accounting:**

**Debit the Receiver**

**Credit the Giver**

**Real Account** – These are asset accounts that appear in the Balance Sheet. They are referred to as Real Account (or Permanent Accounts) as these are owned by businesses and the balances in these accounts at the end of an accounting period will be carried over to the next period. Ex: Cash Account, Land Account, Building Account etc.

**Rules of Accounting:**

**Debit what comes in**

**Credit what goes out**

**Nominal Account** – These are accounts of expenses and losses which a business incurs and income & gains which a business earn in the course of business. Ex: Rent Account, Interest Account.

**Rules of Accounting:**

**Debit all expenses and losses**

**Credit all income and gains**

**1.7 ACCOUNTING PRINCIPLES (GAAP-GENERALLY ACCEPTED ACCOUNTING PRINCIPLES)**

Accounting principles, rules of conduct and action are described by various terms such as concepts, conventions, tenets, assumptions, axioms, postulates, etc.

**Accounting concepts**

The term 'Concept' is used to mean necessary assumptions and ideas which are fundamental to accounting practice. The various accounting concepts are as follows:

- i. **Business Entity concept:** For accounting purposes, the proprietor of an enterprise is always considered to be separate and distinct from the business which he/she controls.
- ii. **Dual aspect concept:** Every business transaction involves two aspects – a receipt and a payment. In other words, every debit has an equal and corresponding credit. The dual aspect concept is expressed as:  $\text{Capital} + \text{Liabilities} = \text{Assets}$ . This is known as 'the accounting equation'.
- iii. **Going concern concept:** Under this assumption, the enterprise is normally viewed as a going concern. It is assumed that the enterprise has neither the intension nor the necessity of liquidation of curtailing materially the scale of its operations. That is why assets are valued on the basis of going concern concept and are depreciated on the basis of expected life rather than on the basis of market value.
- iv. **Accounting period concept:** 'Accounting year' is the period of 12 months for which accounts are to be prepared under the Companies Act and Banking Regulation Act.
- v. **Money measurement concept:** In accounting, every event or transaction which can be expressed in terms of money is recorded in the books of accounts. This concept does not record any fact or happening, even though it is important to the business, in the books of accounts if it cannot be expressed in terms of money. And as per this concept, a transaction is recorded at its money value on the date of occurrence and the subsequent changes in the money value are convenient ignored.

- vi. **Historical Cost concept:** The underlying idea of cost concept is
  - asset is recorded at the price paid to acquire it, that is, at cost and
  - this cost is the basis for all subsequent accounting for the asset. Fixed assets are shown in the books of accounts at cost less depreciation. Current assets are periodically valued at cost price or market price whichever is less.
  
- vii. **Revenue recognition concept:** In accounting, 'revenue' is the gross inflow of cash, receivables or other considerations arising in the course of an enterprise from the sale of goods, from the rendering of services and from the holding of assets. In the case of revenue, the important question is at what stage, the transaction should be recognized and recorded.
  
- viii. **Periodic matching of cost and revenue concept:** After the revenue recognition, all costs, incurred in earning that revenue should be charged against that revenue in order to determine the net income of the business.
  
- ix. **Verifiable objective evidence concept:** As per this concept, all accounting must be based on objective evidence. In other words, the transactions should be supported by verifiable documents.
  
- x. **Accrual concept:** Under this concept, revenue recognition and costs for the relevant period, depends on their realization and not on actual receipt or payment. In relation to revenue, the accounts should exclude amounts relating to subsequent period and provide for revenue recognized, but not received in cash. Like wise, in relation to costs, provide for costs incurred but not paid and exclude costs paid for subsequent period.

### Accounting conventions

The term 'convention' is used to signify customs or traditions as a guide to the preparation of accounting statements. The various accounting conventions are as follows.

- ii. **Convention of disclosure:** This convention implies that accounts must be honestly prepared and all material information must be disclosed therein. The term 'disclosure' implies that there should be a sufficient disclosure of information which is of material interest to proprietors, potential creditors and investors. This concept also applies to events occurring after the balance sheet date and the date likely to have a substantial influence on the earning and financial position of the enterprise. Their non – disclosure would affect the ability of the users of such statements to make proper evaluations and decisions.
  
- iii. **Convention of materiality:** As per this convention, financial statements should disclose all items which are material enough to effect evolutions or decisions. The American Accounting Association (AAA) defines '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". Unimportant items can be either left out or merged

with other items. Sometimes, items are shown as footnotes or in parentheses according to their relative importance.

- iv. **Convenient of consistency:** Consistency, as used in accounting means that persistent application of the same accounting procedures or method by a given firm from one time period to the next so that the financial statements of different period can be compared meaningfully. This convention thus implies that in order to enable the management to draw important and meaningful conclusion of performance over.
- v. **Convention of conservatism:** According to this convention, the accountant should be conservative in his / her approach in his opinions and selection of procedure. in accounting, conservatism refers to the early recognition of unfavourable events. For instance, all possible and expected losses must be provided for. On the other hand, gains and other financial benefits should not be provided for unless they are realized. In other words, 'anticipate no profit and provide for all possible losses'.

#### **Definition of Financial Statement:**

**According to John N.Myer,** "The financial statements provide a summary of the accounts of a business enterprise, the balance sheet reflecting the assets, liabilities and capital as on a certain data and the income statement showing the results of operations during a certain period".

#### **Objectives of Financial Statements:**

- Financial Position
- Financial Performance
- Changes in Financial Position of an Enterprise

#### **1.8 Preparation of Financial Statements:**

There are three stages of preparing financial statements of a trading concern:

- Trading account
- Profit and loss account
- Balance sheet

#### **Meaning of trading account:**

The trading account is an account, which shows the result of buying and selling of goods/services. Therefore, it contains, in a summarized form, all the transactions occurring during a trading period which have a direct relation to the goods in which a business deals.

Excess of sales and closing stock over opening stock, purchases and direct expenses is known as the gross profit. Gross loss is the excess of opening stock, purchases and direct expenses over sales and closing stock.

#### **Items Appearing on Debit side of Trading account:**

- Purchases
- Purchases Returns
- Opening stock
- Wages

- Carriage Inwards/ Freight-in
- Customs and Import duty
- Royalty
- Gas, Electricity, water and Fuel etc
- Packing Material

**Items Appearing on Credit Side of Trading account:**

- ✓ Sales
- ✓ Sales Returns
- ✓ Closing Stock

**Contents of Profit and Loss Account:**

- Salaries
- Rent
- Discount--- Trade Discount and Cash Discount
- Bad Debts
- Carriage Outwards or Freight Outwards
- Drawings
- Income tax
- Loss by Fire, Theft, etc
- Loss or Gain on sale of Fixed Assets

**Items of Balance Sheet:**

Items to be shown on the Assets Side of a Balance Sheet:

1. Current Assets:
  - a. Cash at bank
  - b. Bills Receivable
  - c. Sundry Debtors
  - d. Prepaid Expenses
  - e. Accrued Income
2. Fixed Assets:
  - a. Tangible Fixed Assets
  - b. Intangible Fixed Assets
3. Investments

Items to be shown on the Liabilities Side of a Balance Sheet:

1. Current Liabilities
  - a. Bank Overdraft
  - b. Outstanding Expenses
  - c. Bills Payable
  - d. Sundry Creditors
2. Long term Liability
3. Capital
4. Drawings

### **Adjustments Entries:**

The adjustments that are usually necessary, in the light of accrual basis of accounting, at the end of the accounting period for the preparation of the trading and profit and loss account are generally as follows:

- Closing stock
- Outstanding expenses
- Prepaid expenses
- Income earned but not received (Accrued Income)
- Income received in advance
- Depreciation
- Bad debts
- Provision for bad debts
- Provision for discount on debtors
- Provision for discount on creditors
- Interest on drawings
- Interest on Capital

### **1.9 Inflation Accounting:**

Accounting for price level is that accounting technique by which transactions are recorded at current prices and the effect of changes in price level on accounting items is neutralized or such effects are made clear along with transactions recorded at historical costs.

**According to J Batty**, “The term revaluation accounting is used to denote the methods used for overcoming the problems connected with fixed assets replacement in a period of rising prices”

### Impact of Inflation on Corporate Financial Statements:

1. Profit Overstated (Illusory Figure of Profit)
2. Understatement of Assets
3. Inadequate Funds for Replacement
4. Capital is Not Intact
5. Valuation of Stock

### Advantages of Inflation Accounting:

1. Accurate picture of profitability
2. Keeps the capital of the enterprise intact
3. Depicts the true and fair view
4. Profitability comparative study
5. Helps the enterprises to replace the assets
6. Satisfy the social obligation
7. Helps the company to have realistic price
8. Positive indication of efficiency
9. Indicate the profits at realistic figures
10. Help to establish a realistic price

Disadvantages of Inflation Accounting:

1. Complicated, confusing and time consuming
2. Fails to understand, analyze and interpret
3. Information disclosed by financial statements more inaccurate
4. Not suitable for income tax purposes
5. Involves constant adjustments
6. Profits are overstated.

**1.10 Techniques of Inflation Accounting**

- a) Current Purchasing Power Method (CPP Method)
- b) Replacement Cost Accounting Method (RCA Method)
- c) Current Value Accounting method (CVA Method)
- d) Current Cost Accounting method (CCA Method)

**Current Purchasing Power Method (CPP)**

In this method the increase or decrease of price level in a period should be adjusted with the items in the Profit and Loss account and Balance Sheet.

- Also called as Constant rupee method
- The method is based on General Price Index.
- Accounting to the Price Index the items should be adjusted to know the real values.

**Procedure for inflation accounting under CPP method**

1. Calculation of conversion factor

$$\text{Conversion factor} = \frac{\text{Current Price Index (consumer Price Index)}}{\text{Previous Price Index}}$$

2. Calculation of converted value

$$\text{Converted value} = \text{Historical value} \times \text{Conversion Factor}$$

**Consumer Price Index:** The Consumers Price Index (CPI) is a measure of the price change of goods and services purchased by private Indian households

**Current Cost Accounting Method**

CCA was introduced during 1975 by the British Government through a committee known as Sandilands Committee, headed by Francis C.P. Sandilands.

**Hybrid Method:**

The Combination of the Current Purchasing Power Method (CPP) and Current Cost Accounting Method (CCA) is called as hybrid method.

### 1.11 Human Resource Accounting (HRA):

Human resource accounting may be considered as such an accounting system which recognizes the human resources as an asset and records it in the books of account after measuring its value in the same way as other physical resources.

**According to American Accounting Association Committee**, “Human resource accounting is the process of identification and measuring data about human resource, and communicating this information to interested parties”

#### Approaches of HRA:

1. Historical Cost Approach
2. Replacement Cost Approach
3. Opportunity Cost / Competitive Bidding Approach
4. Capitalization of Salary Approach
5. Economic Valuation Approach
6. Return on Efforts Employed Approach
7. Adjusted Discounted Future Wages Approach
8. Reward Valuation Approach

#### Advantages of HRA:

Improvement in Internal Management Decisions  
Motivation of Employees for Production Purposes  
Savings of Time in Meetings of the Executive  
Impact on Investors' Decisions  
Knowledge of Value of Employees on the Basis of Training etc  
Knowledge about Economic Value of the Personnel  
Improvement in Decision-Making Process  
Decision About Further Recruitment

#### Disadvantages of HRA:

Non Availability of Standard  
Opposition of Trade Unions  
Expenditure on HRA  
Objection about Treating Employees as Assets  
Variety of Methods  
Category of Asset  
Uncertainty about Continuance of Employee's  
Lack of Perfect Knowledge about Future Earnings of HR.

### 1.12 Methods of HR Accounting

#### Historical cost method

This approach was developed by **William C. Pyle** and R.G. Barry corporation, Ohio (USA) in 1967.

According to this method, the cost of human resources is measured on the basis of actual cost incurred for it.

It is the cost for recruitment, training and developing the human resources of the organization. The present cost for recruitment and training of human resources who are already employed will not be considered by this method.

### **Replacement Method**

In this method, the cost of HR is ascertained on the basis of the **cost required to replace the entire employees** of a concern.

This cost will be definitely high when compared to the actual cost of recruitment, training and development. This method was suggested by **Rensis Likert**.

According to him, there may be situation where all employees may leave the and only chairman of the concern may exist. In such a situation there is a need for the concern to recruit all new employees.

**Opportunity cost method:** Also known as **Market value method**.

**Hekimian and Jones** suggested the concept of opportunity cost for valuing human resources in a company. Opportunity cost means the most profitable opportunity cost that was foregone due to the adoption of this method. Or the next probable alternative with low cost.

Opportunity cost for valuing human resources is based on the chance for the **selection of the employees** in other departments of the same organisations or in other organizations. If the employees have the chance of being selected in other places, the remuneration of that better place has been foregone by them due to the present employment. According to this method the value of the employees are assessed on the basis of the foregone better remuneration.

The opportunity cost method is possible only when there is **scarcity of qualified people**. **This method is not a popular one** for valuing the human resources of a company.

### **Human Resource Value Accounting**

This method of accounting of HR is based on the Discounting factor of cost and revenue related to HR in future. The value of HR depends upon the excess of revenue generated due to it, over the cost incurred for it.

i.e. the cost and the revenue aspects include the present and future cost and revenue.

**Cost = cost of recruitment, training and development**

For calculating the cost, the present cost should be taken as it is, and The future expected cost should be converted into **present cost by discounting factor**.

### **Present value of future earnings model**

**Lev and Schwartz (1971)** proposed an economic valuation of employees based on the **present value of future earnings**.

According to this model, like any other investment of capital the capital invested in **human resource will give return in future**.

The basis of ascertainment of the human value is the **remuneration given** to them. The **present value** of it should be determined through **discounting factor** of the revenue (remuneration) for the employees. This concept of valuation should be adopted for **each individual (employees)** of the organisation

### **Flamholtz Stochastic Rewards Valuation Model**

This model states that the **individual's value** in an organisation is the **expected realizable** value. i.e. Present value of the expected service provided by the individual to the organisation during his employment. Based on the **revenue** aspect of the concern.

### **Prof. S.K.Chakraborty's Model**

According to this model the value of human resources is Determined **on Aggregate basis and** not on individual basis.

In this method, the cost involved for recruitment, replacement, training and development should be shown separately in **Deferred Revenue Expenditure Account**.

**1.13 Illustration Sums:**

1. The following is the Trial Balance of M/s Kasturi Agencies as on 31<sup>st</sup> March, 2010. Prepare Trading and Profit and Loss Account for the year ended 31<sup>st</sup> March, 2010 and a Balance Sheet on that date.

	Rs.	Rs.
Capital		1,00,000
Buildings	15,000	
Drawings	18,000	
Furniture & Fittings	7,500	
Motor Van	25,000	
Loan from Hari @ 12% Interest		15,000
Interest paid on above	900	
Sales		1,00,000
Purchases	75,000	
Opening Stock	25,000	
Establishment Expenses	15,000	
Wages	2,000	
Insurance	1,000	
Commission received		7,500
Sundry Debtors	28,100	
Bank Balance	20,000	
Sundry Creditors		10,000
	2,32,500	2,32,500

Adjustments: (a) The value of closing stock on 31-3-2010 was Rs.32,000 (b) Outstanding Wages Rs.500. (c) Prepaid Insurance Rs.300. (d) Commission received in advance Rs.800. (e) Allow interest on capital @ 10%. (f) Depreciation Building 2.5%, Furniture & Fittings 10%, Motor Van 10%. (g) Charge interest on drawings Rs.500.

**Solution**

**Trading & Profit & Loss Account of  
M/s. Kasturi Agencies for the year ending 31<sup>st</sup> March, 2010**

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To opening Stock		25,000	By Sales		1,00,000
To purchases		75,000	By Closing Stock		32,000
To Wages	2,000				
Add: Outstanding	500				
		2,500			
To Gross Profit c/d		29,500			
		1,32,000			1,32,500
To Insurance	1,000		By Gross Profit b/d		29,500
Less: Prepaid	300		By Commission	7,500	
		700	Less: Received in advance	800	
To Interest on Loan	900				6,700
Add: Outstanding	900		By Interest on Drawings		500
		1,800			
To Establishment Expenses		15,000			
To Depreciation					
Buildings	375				
Furniture and Fittings	750				
Motor Van	2,500				
		3,625			
To Interest on Capital		10,000			
To Net Profit transferred to Capital Account		5,575			
		36,700			36,700

**Balance Sheet as on 31<sup>st</sup> March, 2010**

Liabilities	Rs.	Rs.	Asset	Rs.	Rs.
Outstanding Wages		500	Cash at Bank		20,000
Commission received in Advance		800	Sundry Debtors		28,100
Sundry Creditors		10,000	Closing Stock		32,000
Loan from Hari	15,000		Prepaid Insurance		300
Add: Outstanding Interest	900		Buildings	15,000	
		15,900	Less:	375	
Capital	1,00,000		Depreciation		14,625
Add: Net Profit	5,575		Furniture & Fittings	7,500	
Add: Interest on Capital	10,000		Less:	750	
	1,15,575		Depreciation		6,750
Less: Drawings	18,000		Motor Van	25,000	
Interest on Drawings	500		Less :	2,500	
	18,500		Depreciation		22,500
		97,075			
		1,24,275			1,24,275



**Solution**

**MANUFACTURING, TRADING & PROFIT & LOSS ACCOUNT OF MR. SURESH**  
**for the year ending 31<sup>st</sup> March, 2009**

	Rs.	Rs.		Rs.
To Raw Materials used			By Cost of Goods manufactured transferred to Trading A/c.	5,45,090
Opening Stock	1,24,400			
Add: Purchases	3,49,800			
	4,74,200			
Less: Closing Stock	46,900			
		4,27,300		
To Carriage Inwards		10,200		
To Factory Wages		59,700		
To Fuel and Coal		11,200		
To Factory Power		25,000		
(Rs.22,900 + 2,100)				
To Depreciation on Plant and Machinery		11,690		
		5,45,090		5,45,090
To Opening Stock of Finished Goods		63,800	By Sales	5,60,000
To Cost of Goods manufactured		5,45,090	By Closing Stock of finished goods	1,52,300
To Gross Profit c/d		1,03,410		
		7,12,300		7,12,300
To Carriage outwards		12,400	By Gross Profit b/d	1,03,410
To Advertisement		12,000		
To Discount		2,500		
To Rent, Rates & Taxes		13,300		
(Rs.12,400 + 900)				
To Printing & Stationery		2,600		
To Bad Debts		6,080		
To Misc. Expenses		3,300		
To Interest		10,792		
To Insurance		1,760		

**KV INSTITUTE OF MANAGEMENT AND INFORMATION STUDIES  
BA5103-ACCOUNTING FOR MANAGEMENT**

To Staff Salaries (Rs.12,700 + 1,100)	13,800	
To Electricity (Rs.2,300 + 200)	2,500	
To Dep. on Furniture & Fittings	2,860	
To Net Profit transferred to Capital Account	19,518	
	1,03,410	1,03,410

**3. From the following balances extracted from the books of Mr. Rati Ram Saboo and the subjoined information you are required to prepare the Profit and Loss Account for the year ended on 31<sup>st</sup> December, 2009 and also the Balance Sheet as on that date:**

	Dr. Rs.	Cr. Rs.
Stock on January 1, 1989	60,500	
Purchases and Sales	90,500	1,37,200
Returns	2,200	1,300
Capital Account		30,000
Drawings Account	4,500	
Land and Buildings	30,000	
Furniture and Fittings	8,000	
Sundry Debtors and Creditors	25,000	45,000
Cash in hand	3,500	
Investments	10,000	
Interest		500
Commission		3,000
Total Direct Expenditure	7,500	
Postage, Stationery and Phones	2,500	
Fire Insurance Premium	2,000	
Salaries	11,000	
Bank Overdraft		40,000
	2,57,000	2,57,000

- (a) Closing Stock on 31<sup>st</sup> December, 1989 was valued at Rs.65,000. Goods worth Rs.500 are reported to have been taken away by the proprietor for his personal use at home during 1989. (b) Interest on investments Rs.500 is yet to be received while Rs.1,000 of the commission received is yet to be earned in 1990. (c) Rs.500 of the fire insurance premium paid is in respect of the quarter ending 31<sup>st</sup> March, 1990. (d) Salaries Rs.1,000/- for December, 1989 and Bank Overdraft interest estimated at Rs.2,000 have to be recorded as outstanding charges. (e) Depreciation is to be provided on Land Buildings @ 5% and on Furniture and Fittings @ 10%. (f) Provide provision for doubtful debts @ 5% of Sundry Debtors.

**Solution**

**TRADING & PROFIT & LOSS ACCOUNT OF Mr. RATI RAM SABOO**  
**for the year ending 31<sup>st</sup> December, 2009**

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To opening Stock		60,500	By Sales	1,37,000	
To purchases	90,300		Less: Returns	2,200	
Less :				—————	
Returns	1,300	39,770			1,35,000
Goods for personal use	500		By Closing Stock		65,000
	—————	1,800			
		88,500			
To Direct Expenses		7,500			
To Gross Profit c/d		43,500			
		—————			
		2,00,000			2,00,000
		—————			
To Salaries	11,000		By Gross Profit b/d		43,500
Add: Outstanding	1,000		By Commission	3,000	
	—————	12,000	Less: Received in Advance	1,000	
				—————	
To Fire Insurance					2,000
Premium	2,000		By Interest	500	
Less: Prepaid	500		Add: Accrued	500	
	—————	1,500		—————	1,000

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To Postage, Stationery & Phones	2,500	
To Interest outstanding (for Bank overdraft)	2,000	
To Provision for Doubtful Debts on Debtors @ 5%	1,250	
To Depreciation on Land Buildings	1,500	
Furniture & Fitting	800	
To Net profit transferred to Capital Account	24,950	
	46,500	46,500

**BALANCE SHEET  
As on 31<sup>st</sup> December, 2009**

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Creditors		45,000	Cash in hand		3,500
Outstanding :			Sundry Debtors	25,000	
Salaries	1,000		Less: Provision for Doubtful Debts	1,250	
Interest on overdraft	2,000				23,750
		3,000	Investments	10,000	
Bank Overdraft		40,000	Add: Interest Accrued on Investments	500	
Commission received in advance		1,000			10,500
Capital Account	30,000		Stock		65,000
Add: Net Profit	24,950		Insurance (Prepaid)		500
	54,950		Land & Buildings	30,000	
Less:					
Drawing	4,500		Less: Depreciation	1,500	
s					
				46,500	

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Goods for personal use	500				28,500
		5,000		Furniture & Fitting	8,000
			49,950	Less: Depreciation	800
					7,200
			1,38,950		1,38,950

**4. The following balances were taken from the books of Shri Ram Prasad on 31<sup>st</sup> December, 2009:**

	Rs.			Rs.
Capital	1,00,000	Rent (Cr.)		2,100
Drawings	17,600	Railway Freight and other expenses on goods sold		16,940
Purchases	80,000	Carriage Inwards		2,310
Sales	1,40,370	Office Expenses		1,340
Purchases Returns	2,820	Printing and Stationery		660
Opening Stock	11,460	Postage & Telegrams		820
Bad Debts	1,400	Sundry Debtors		62,070
Bad Debts Provision (1.1.1989)	3,240	Sundry Creditors		18,920
Rates and Insurance	1,300	Cash at Bank		12,400
Discount (Cr.)	190	Cash in hand		2,210
Bills Receivable	1,240	Office Furniture		3,500
Sales Returns	4,240	Salaries and Commission		9,870
Wages	6,280	Additions to Buildings		7,000
Buildings	25,000			

Prepare Trading and Profit and Loss Account and Balance Sheet as on 31<sup>st</sup> December, 1989, after keeping in view the following adjustments:

(a) Depreciate old Buildings at 2.5% and new additions to Buildings at 2% and Office Furniture at 5%. (b) Write off further bad debts Rs.570. (c) Increase the Bad Debts Provision to 6% of Debtors. (d) On 31<sup>st</sup> December, 1989, Rs.570 are outstanding for salary. (e) Rent Receivable Rs.200. (f) Interest on Capital at 5%. (g) On 31<sup>st</sup> December, 1989, stock is valued at Rs.14,290. (h) Unexpired Insurance Rs.240.

**Solution:**

**TRADING & PROFIT & LOSS ACCOUNT OF**  
**SHRI RAM PRASAD**  
**for the year ending 31<sup>st</sup> December, 2009**

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To opening Stock		11,460	By Sales	1,40,370	
To Purchases	80,000		Less: Returns	4,240	
Less: Returns	<u>2,820</u>				1,36,130
		77,180	By Closing Stock		14,290
To Wages		6,280			
To Carriage Inwards		2,310			
To Gross Profit c/d		<u>53,190</u>			
		<u>1,50,420</u>			<u>1,50,420</u>
To salaries & Commission	9,870		By Gross Profit b/d		53,190
Add: Salary Outstanding	<u>570</u>		By Rent	2,100	
		10,440	Add: Rent Receivable	200	
To Rates and Insurance	1,300				2,300
Less: Unexpired Insurance	<u>240</u>		By Discount		190
		1,060			
To Railway Freight and other Expenses on		16,940			

Sales				
To Office Expenses		1,340		
To Printing & Stationery		660		
To Postage and Telegrams		820		
To Bad Debts	1,400			
Add: Further Bad Debts	570			
Add: Provision of Bad Debts	3,690			
	5,660			
Less: Old Provision	3,240			
	2,420			
To Interest on Capital		5,000		
To Depreciation:				
Buildings (625 + 140)	765			
Office Furniture	175			
	940			
To Net Profit transferred to Capital Account		16,060		
		55,680		55,680

**5. From the following Trial balances from the books of Mr. Sujan. Prepare Trading and Profit & Loss Account for the year ended on 31.03.2006.**

Particulars	Rs.	Particulars	Rs.
Capital	7,00,000	Sundry Creditors	1,25,000
Loan from bank	1,00,000	Bills payable	8,000
Bank over draft	20,000	Sales	8,12,000
Interest allowed	2,000	Sales return	11,000
Discount allowed	10,000	Purchases return	12,000

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Interest received	5,000	Rent	10,000
Bad debts	1,000	Rent received	3,000
Carriage outwards	6,000	Insurances paid	12,000
Carriage Inwards	3,000	Good will	25,000
Salaries	2,00,000	Land & Building	3,00,000
Furniture & Fitting	2,00,000	Plant & Machinery	2,00,000
Sundry Debtors	60,000	Purchases	3,00,000
Bills receivable	30,000	Opening stock	1,35,000
Wages	2,000	Drawings	10,000
Machinery tools	45,000	Cash in hand	30,000

**Additional information**

Closing stock Rs.25,000/-

Goods destroyed at Rs.10,000/- for which insurances admits the claim Rs.8,000/-

Outstanding expenses:-

    Salaries Rs.10,000/-

    Rent Rs.2,000/-

    Prepaid General expenses Rs.1,000/-

    Dep. Charges P & M @ 10% Furniture @ 5% Machine @ 10% L & B 5%

    Bad debts Rs.5,000/- @ Reserve for doubtful debts 5%.

    Interest on capital 5%

(vii)Interest on drawing @ 2%

**Solution:-**

**Trading and Profit and Loss of account Mr.Sujan as on 31<sup>st</sup> March 2006**

**Dr.**

**Cr.**

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To opening Stock		1,35,000	By Sales	8,12,000	
To purchases	3,00,000		(-) Sales return	11,000	
(-) Purchases return	12,000				8,01,000
		2,88,000	By Closing Stock		25,000
To Carriage Inwards		3,000	By Goods destroyed by fire		10,000
To wages		2,000			
To Gross Profit		4,08,000			
		8,36,000			8,36,000

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To Salaries	2,00,000		By Gross Profit		4,08,000
(+) Outstanding	10,000		By Interest received		5,000
		2,10,000	By discount received		10,000
To Rent	10,000		By Rent received		3,000
(+) Outstanding	2,000		By Interest on drawing		200
		12,000			
To Insurance paid	12,000				
(-) Prepaid	1,000				
		11,000			
To Interest allow		2,000			
To Carriage outwards		6,000			
To Discount allowed		5,000			
To Goods loss due to fire		2,000			
To Depreciation					
Plant & Machinery	20,000				
Furniture	10,000				
Machine	4,500				
Land & Building	15,000				
		49,500			
Bad debts	1,000				
(+) New bad debts	5,000				
		6,000			
(+) Reserve DD	2,750				
		8,750			
To Interest on Capital		35,000			
To Net Profit		84,950			
		9,26,200			9,26,200

**Balance Sheet of Mr. Sujan as on 31<sup>st</sup> March 2006**

Liabilities	Rs.	Rs.	Asset	Rs.	Rs.
Capital	7,00,000		Cash in hand		3,00,000
(+) Net Profit	84,950		Good destroyed		8,000
	7,84,950		Insurances prepaid		1,000
(-) Drawing	10,000		Bills receivable		30,000

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	7,74,950		Land & Building	3,00,000	
(-) Interest on drawing	200		(-) Depreciation	15,000	
	7,74,750				2,85,000
(+) Interest on capital	35,000		Plant & Machinery	2,00,000	
		8,09,750	(-) Depreciation	20,000	
Loan from bank	1,00,000				1,80,000
Bank over draft	10,000		Furniture	2,00,000	
Bills payable	80,000		(-) Depreciation	10,000	
Creditors	1,25,000				1,90,000
Salaries Outstanding	10,000		Machine	45,000	
Rent outstanding	2,000		(-) Depreciation	4,500	
					40,500
			Good will		25,000
			Sundry Debtors	60,000	
			(-) new bad debts	5,000	
				55,000	
			(-) Reserve	2,750	
					52,250
			Closing Stock		25,000
		11,36,750			11,36,750