# Unit I

# Forms of Business orgarnisations

## TRADE

The term 'trade' is used to denote buying and selling. Therefore, one who buys and sells is a trader. A trader is a middleman between the producer and the consumer. Trade may be wholesale trade or retail trade. A wholesale trader purchases in large quantities from the producers, and sells in small quantities to the retail traders. A retail trader is one who purchases from the wholesale trader or sometimes directly from the producer, and sells in smaller quantities to the ultimate consumers.

## AIDS TO TRADE (AUXILIARIES TO TRADE)

All activities that facilitate smooth flow of goods from manufacturing centres to the consumption centres are called aids or auxiliaries to trade. Aids to trade may be classified into five categories: (i) transportation, (ii) warehousing, (iii) insurance, (iv) advertising, and (v) banking.

### Commerce

Commerce is the process of distribution of goods and services produced by industrial sector. It represents only the demand side of goods and services. Commerce creates place and time utility by moving goods from one place to another. It has wider scope than trade. It includes Trade and aids to trade

Commerce = Trade + Aids to trade

## MEANING OF BUSINESS

Business refers to any human activity undertaken on a regular basis with the object to earn profit through production, distribution, sale or purchase of goods and services. Business may be defined as "an activity. involving regular production or purchase of goods and services for sale, transfer and exchange with an object of earning profit".

## CHARACTERISTICS OF BUSINESS

The essential characteristics of business are as follows:

**(i) Deals in goods and services:** People in business are engaged in production and distribution of goods and services. The goods may be consumer goods like bread, burter, milk, tea. etc. or capital goods like plant, machinery, equipments, etc. The services may be in the form of transpottation, banking, insurance, warehousing, advettising and so on.

**(ii) Sale or exchange of goods and services:** If a person produces or buys a product for self-consumption or for gifting it to another, he is not engaged in business. But when he produces or buys goods to sell it to somebody. he is engaged in business. Thus, in business the goods and services produced or purchased must be exchanged for money or for goods (under barter system) between the buyers and sellers. Without sale or exchange of goods the activities cannot be treated as business.

**(iii) Regular exchange of goods and services:** The production or buying and selling activities must be called out on a regular basis.

**(iv) Requires investment:** Every business activity requires some amount of investment in terms of land, labour or capital. These resources are utilised to produce a variety of goods and services for distribution and consumption. .

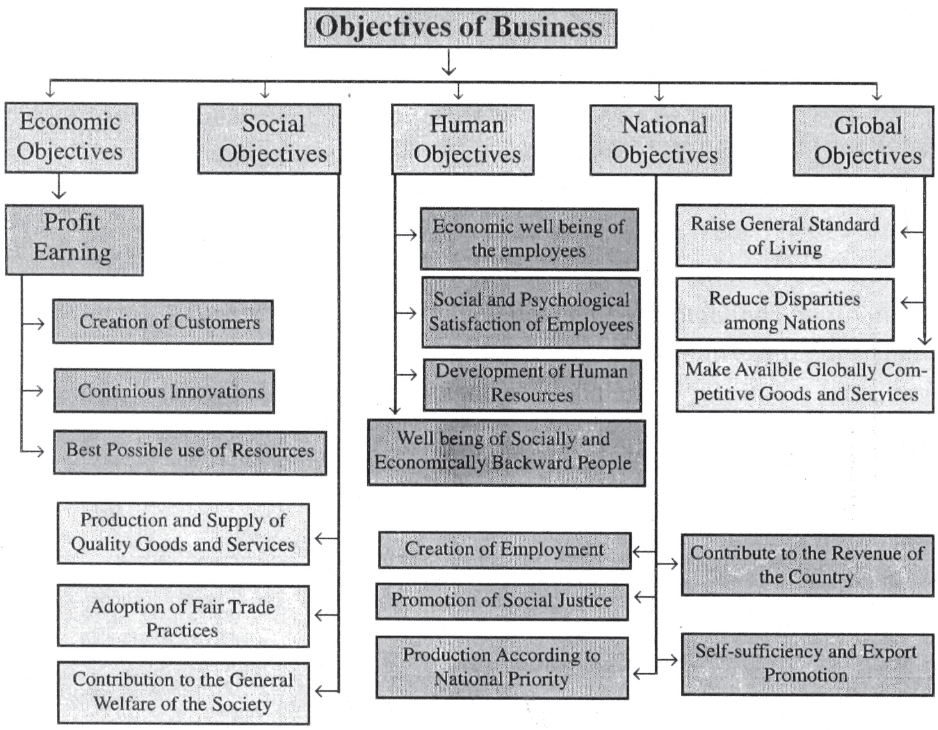
**(v) Aims at earning profit:** Business activities are performed with the primary objective of earning income by way of profit. Without profit it is not possible to survive for a long period. Earning of profit is also required to grow and expand the business.

**(vi) Involves risk and uncertainty of income:** Sometimes he/she enjoys profits and also times may come when he suffers heavy losses. This happens because the future is unpredictable and businessperson has practically no control over certain factors that affects his/her earnings.

## Objectives of Business:

## 1.6 CLASSIFICATION OF OBJECTIVES OF BUSINESS

All the business activities are performed with some objectives. The objectives of business may be classified as -



### 1.6.1 ECONOMIC OBJECTIVES

Economic objectives of business refer to the objective of earning profit and also bther objectives that are necessary to be pursued to achieve the profit objective. which includes creation of customers, regular innovations and best possible use of available resources.

### Profit Earning

Profit is the lifeblood of business, without which no business can survive in a competitive market. Thus. profit making is the primary objective for which a business unit is brought into existence. Profits help businessmen not only to earn their living but also to expand their business activities by reinvesting a part of the profits.

In order to achieve this primary objective, certain other objectives are also necessary to be pursued by business, which are as follows:

**i) Creation of customers**

A business unit cannot survive unless there are customers to buy the products and services. Again a businessman can earn profits only when he/she provides quality goods and services at a reasonable price. For this it needs to attract more customers for its existing as well as new products. This is achieved with the help of various marketing activities.

**ii) Continuous innovations**

Business is highly dynamic and an enterprise can continue to be successful only by adopting itself to change in its environment. Innovation means changes, which bring about improvement in products. process of production and distribution of goods. Reduction in cost and increase in sales gives more profit to the businessman. Use of power-looms in place of handlooms, use of tractors in place of hand implements in farms etc. are the results of innovation.

**iii) Best possible use of resources**

As you know, to run any business you must have sufficient capital or funds. The amount of capital may be used to buy machinery and raw materials, to employ men and have cash to meet day-to-day expenses. Thus, business. activities require various resources like men, materials, money and machines. This objective can be achieved by employing efficient workers, making full use of machines and minimizing wastage of raw mateIials.

### 1.6.2 SOCIAL OBJECTIVES

Social objectives are those objectives of business, which are desired to be achieved for the benefit of the society. No activity of the business should be aimed at giving any kind of trouble to the society. Sociar objectives of business include production and supply of quality goods and services, adoption of fair tracle practices and contribution to the general welfare of society and provision of welfare amenities.

**(i) Production and supply of quality goods and services**

Since the business utilizes the various resources of the society, the society expects to get quality goods and services from the business. The objective of business should be to produce better quality goods and supply them at the right time and at a right price. They should charge the price according to the quality of the goods and services provided to the society.

**(ii) Adoption of fair trade practices**

In every society, activities such as hoarding, black-marketing and over-charging are considered undesirable. Besides, misleading advertisements often give a false impression about the quality of products. The business unit must not create artificial scarcity of essential goods or raise prices for the sake of earning more profits. All these activities earn a bad name and sometimes make the businessmen liable for penalty and even imprisonment under the law. Therefore. the objective of business should be to adopt fair trade practices for the welfare of the consumers as well as the society.

**(iii) Contribution to the general welfare of the society**

Business units should work for the general welfare and upliftment of the society. This is possible through running of schools and colleges for better education, opening of vocational training centres to train the people to earn their livelihood, establishing hospitals for medical facilities and providing recreational facilities for the general public like parks, sports complexes etc.

### 1.6.3 HUMAN OBJECTIVES

Human objectives refer to the objectives aimed at the well-being as well as fulfillment of expectations of employees as also of people who are disabled, handicapped and deprived of proper education and training. The human objectives of business may fuus include economic well-being of the employees, social and psychological satisfaction of employees and development of human resources.

**(i) Economic well being of the employees**

In business employees must be provided with fair remuneration and incentives for performance, benefits of provident fund, pension and other aJ11eniti~s like medical facilities, housing facilities etc. By this they feel more satisfied at work and contribute more for the business.

**(ii) Social and psychological satisfaction of employees**

It is the duty of business units to provide social and psychological satisfaction to their employees. This is possible by making the job interesting and challenging, putting the right person in the right job and reducing the monotony of work. Further, grievances of employees should be given prompt attention and their suggestions should be considered seriously when decisions are made. If employees are happy and satisfied they can put their best efforts in work.

**(iii) Development of human resources**

Employees as human beings always want to grow professionally. Their growth requires proper training as well as development. Business can prosper if the people employed can improve their sldlls and develop their abilities and competencies in course of time. Thus, it is important that business should arrange training and development programmes for its employees.

**(iv) Well being of socially and economically backward people**

Business units being inseparable parts of society should help backward classes and also people those are physically and mentally challenged. This can be done in many ways. For instance, vocational training programme may be arranged to improve the earning capacity of backward people in the community. Business units can also help and encourage meritorious students by awarding scholarships for higher studies.

## 1.6.4 NATIONAL OBJECTIVES

Being an important part of the national economy, every business must have the objective of fulfilling national goals and aspirations. The following are the national objectives of business.

**(i) Creation of employment**

One of the important national objectives of business is to create opportunities for gainful employment of people. This can be achieved by establishing new business units, expanding markets, widening distribution channels, etc.

**(ii) Promotion of social justice**

As a responsible citizen, a businessman is expected to provide equal opportunities to all persons with whom he/she deals. She/he is also expected to provide equal oppOltunities to all the employees to work and progress. Towards this objective special attention must be paid to weaker and backward sections of the society.

**(iii) Production according to national priority**

Business units should produce and supply goods in accordance with the priorities laid down in the plans and policies of the Govemment. One of the national objectives of business in our country should be to increase the production and supply of essential goods at reasonable pnces.

**(iv) Contribute to the revenue of the country**

The business owners should pay their taxes and dues honestly and regularly. This will increase the revenue of the government, which can be used for the development of the nation.

**(v) Self-sufficiency and Export Promotion**

To help the country to become self-reliant, business units have the added responsibility of restricting import of goods. Besides, every business unit should aim at increasing expOlts and adding to the foreign exchange reserves of the country.

## 1.6.5 GLOBAL OBJECTIVES

Earlier India had a very restricted business relationship with other nations. There was a very rigid policy for import and export of goods and services. But, now-a-days due to liberal economic and expOit-import policy, restlictions on foreign investments have been largely abolished and duties on imported goods have been substantially reduced. This change has brought about increased competition in the market. Today because of globalisation the entire world has become a big market. Goods produced in one country are readily available in other countries. So, to face the competition in the global market every business has celtain objectives in mind, which may be called the global objective . Let us learn about them.

**(i) Raise general standard of living**

Growth of business activities across national borders makes available quality goods at reasonable prices all over the world. The people of one country get to use similar types of goods that people in other countries are using. This improves the standard of living of people.

**(ii) Reduce disparities among nations**

Business should help to reduce disparities among the rich and poor nations of the world by expanding its operation. By way of capital investment in developing as well as underdeveloped countries. It can foster their industrial and economic growth.

**(iii) Make available globally competitive goods and services**

Business should produce goods and services which are globally competitive and have huge demand in foreign markets. This will improve the image of the exporting country and also earn more foreign exchange for the country.

## MEANING OF SOLE PROPRIETORSHIP

'Sole' means single and 'proprietorship' means ownership. It means only one person or an individual is the owner of the business. Thus, the business organization in which a single person owns, manages and controls all the activities of the business is known as sole proprietorship form of business organisation. The individual who owns and runs the sole proprietorship business is called a 'sole proprietor' or 'sole trader'. A sole proprietor pools and organises the resources in a systematic way and controls the activities with the sole objective of earning profit.

## CHARACTERISTICS OF SOLE PROPRIETORSHIP

Sole proprietorship has the following characteristics:

i. **Ease of formation:** An ideal form of ownership should be easy to form. Ease of formation implies minimum of legal and other formalities. Sole proprietorship is easy to form.

ii. **Single Ownership:** A single individual always owns sole proprietorship foml of business organization. That individual owns all assets and properties of the business. Hence, he alone bears all the risk of the business. Thus, the business of the sole proprietor comes to an end at the will of the owner or upon his death.

iii. **No sharing of Profit and Loss:** The entire profit arising out of sole proprietorship business goes to the sole proprietor. If there is any loss it is also to be borne by the sole proprietor alone. Nobody else shares the profit and loss of the business with the sole proprietor.

iv. **One man's Capital:** The capital required by a sole proprietorship form of busin"ess organisation is totally arranged by the sole proprietor. He provides it either from his personal resources or by borrowing from friends, relatives, banks or other financial institutions.

v. **One-man Control:** The controlling power in a sole proprietorship business always remains with the owner. The owner or proprietor alone takes all the decisions to run the business.

vi. **Unlimited Liability:** The liability of the sole proprietor is unlimited. This implies that, in case of loss the business assets along with the personal properties of the proprietor shall be used to pay the business liabilities.

## 3.3 ADVANTAGES OF SOLE PROPRIETORSHIP

The sole proprietorship form of business is the most simple and common in our country. It has the following advantages:

i. **Easy to Form and Wind up**

ii. **Direct Motivation:**

iii. **Quick Decision and Prompt Action:**

iv. **Better Control :**

v. **Maintenancc of Busincss Secrets:**

vi. **Close Personal Relation:**

vii. **Provides Self-employment:**

## LIMITATIONS OF SOLE PROPRIETORSIDP

One-man business is the best form of business organisation because of the above-discussed advantages. However. all types of ownership have some limitations and the sole proprietorship is no exception. Let us learn those limitations.

i. **Limited Capital:**

ii. **Lack of Continuity :**

iii. **Limited Size:**

iv. **Lack of Managerial Expertise:**

## MEANING OF PARTNERSIDP

In order to overcome drawbacks of sole proprietorship pattnership form of business has come into existence .. It is basically a relation between two or more persons who join hands to form a business organisation with the objective of earning profit. The persons who join hands are individually known as 'Partner' and collectively a 'Firm'. A partnership firm is governed by the provisions of the Indian Partnership Act, 1932,. Section 4 of the Indian Partnership Act. 1932, defines partnership as "a relation betvveen persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

## CHARACTERISTICS OF PARTNERSIDP FORM OF BUSINESS ORGANISATION

After having a brief idea about partnership, let us identify the various features of this form of business organisation.

i. **Two or more Members :** At least two members are required to start a pmtnership business. But the number of members should not exceed 10 in case of banking business and 20 in case of other business.

ii. **Agreement :** Whenever you think of joining hands with others to start a paltnership business, first of all, there must be an agreement between all of you. This agreement contains-

   - the amount of capital contributed by each pattner,
   - profit or loss sharing ratio;
   - salary or commission payable to the partners. if any;
   - duration of business, if any;
   - name and address of the pattners and the firm;
   - duties and powers of each partner;
   - nature and place of business; and
   - any other terms and conditions to run the business:

iii. **Lawful Business :** The paltners should always join hands to carryon any kind oflawful business. To indulge in smuggling, black marketing etc, can not be called partnership business in the eye of the law.

iv. **Sharing of Profit :** The main objective of every partnership firm is sharing of profits of the business amongst the partners in the agreed proportion. In the absence of any agreement for the profit sharing, it should be shared equally among the pmtners.

v. **Unlimited Liability :** Just like the sole proprietor the liability of partners is also unlimited. That means, if the assets of the firm are insufficient to meet the liabilities, the personal properties of the partners, if any. can also be utilised to meet the firm's liabilities.

vi. **Voluntary Registration :** It is not compulsory that you register your paltnership firm. However, if you don't get your firm registered, you will be deprived of certain benefits. therefore, it is desirable. The effects of non-registration are:

- ❑ Your firm cannot take any action in a court of law against any other party for settlement of claims.
- ❑ In case there is any dispute among partners, it is not possible to settle the settlement of claims, through a court of law.
- ❑ Your firm cannot claim adjustments for amount payable to or receivable from any other palty through a Comt of law.

vii. **Principal Agent Relationship :** All the partners of a firm are the joint owners of the business. They all have an equal right to actively participate in its management. Every partner has a right to act on behalf of the tirm. When a partner deals with other parties in business transactions, he/she acts as an agent of the others and at the same time the others become the principal. So there always exists a principal agent relationship in every partnership tirm.

viii. **Continuity of Business :** A partnership firm comes to an end in the event of death. lunacy or bankruptcy of any partner. Even otherwise, it can discontinue its business at the will of the paltners. At any time, they may take a decision to end their relationship.

## ADVANTAGES OF PARTNERSHIP FORM OF BUSINESS ORGANISATION

Partnership form of business organisation has certain advantages, which are as follows:

i. **Easy to form -** Like sole proprietorship, the partnership business can be formed easily without any legal formalities. It is not necessary to get the fim1 registered. A simple agreement, either oral or in writing. is sufficient to create a partnership firm.

ii. **Availability of large resources -** Since two or more pattners join hands to start paltnership business it may be possible to pool more resources as compared to sole proprietorship. The partners can contribute more resources as compared to sole proprietorship. The partners can contribute more capital, more efforts and also more time for the business.

iii. **Balanced decisions -** The partners are the owners of the business. Each of them has equal right to participate in the management of the business. In case of any conflict they can sit together to solve the problems. since all partners participate in decision-making, there is less scope for reckless and hasty decisions.

iv. **Sharing of losses -** In a partnership firm all the partners share the business risks. For example, if there are three paltners and the firm suffers a loss of Rs. 12,000 during a particular period, then all partners may share it and the individual burden will be Rs. 4,000 only.

## LIMITATIONS OF PARTNERSHIP FORM OF BUSINESS ORGANISATION

Inspite of all these advantages as discussed above, a partnership firm also suffers from celtain limitations, some of them are as follows:

i. **Unlimited Liability :** All the partners are jointly as well as individually liable for the debts of the firm to an unlimited extent. Thus, they can share the liability among themselves or anyone can be asked to pay all the debts even from his personal properties.

ii. **Uncertain Life** : The pattnership firm has no legal entity separate from its paltners. It comes to an end with the death, insolvency, incapacity or the retirement of any partner. Further, any dissenting member can also give notice at any time for dissolution of partnership.

iii. **Limited Capital :** Since the total number of partners cannot exceed 20,the capital to be raised is always limited. It may not be possible to start a very large business in partnership form.

iv. **Non transfera bility of share:** If you are a partner in a firm you cannot transfer your share of interest to outsiders without the consent of other This creates inconvenience for the partner who wants to leave the firm or sell part of his share to others.

## 1.8 Types of Partners :

According to the Indian Partnership-Act, all the partners are expected to contribute capital, share profits and losses of business, participate in the management, etc. But, in actual practice, it may not be so. In practice, partners are classified according to their contribution to the business. Some of the partners are discussed below:

(a) **Active or Working Partner:** The partner who takes an active interest in the day-to-day work and management of the business is known as a 'working partner'. Jrle has a voice in the management of the firm. He also carries out the work on behalf of non-working partners. Generally, the active partner gets an additional salary or remuneration or commission for the managerial work. The active partner contributes capital, shares profits and losses of the business, and has an unlimited liability.

(b) **Dormant or Sleeping Partner:** A dormant partner is one, who does not take an active part in the day-to-day business and management of the firm. The working partner carries on the business of a partnership firm on behalf of the dormant partners. A sleeping partner contributes capital, shares the profits and losses of the business and has an unlimited liability. He voluntarily surrenders his rights of management. A sleeping partner is fully liable for the debts of the company.

(c) **Secret Partner:** A secret partner is a person who does not want to be known as a partner to the outsiders, although in reality.he is a partner of the firm. He contributes capital, shares the profits and losses of the firm and has an unlimited liability. The only difference betWeen a dormant partner and a secret partner is that, in the former case, outsiders are aware of his being a pa~ner, only he does not take an active part in the business, while in the latter case, outsiders are not aware of his being a partner.

(d) **Nominal Partner:** A nominal partner is one who lends his name and credit to the firm. Such a person is admitted as a partner in order to fetch more business, since he may be a reputed or well known person in the market. His name can bring or build goodwill for the firm. A nominal partner does not contribute any capital, nor does he take an active part in the business. He does not bear the losses of the business, but he is held responsible for all the debts of the firm, i.e., his liability is unlimited.

(e) **Quasi Partner:** Quasi partner is a person who has actually retired from the firm, but has been permitted to use his name in connection with the firm. He does not take an active part in the management of the firm. He may have even withdrawn his capital from the business. He may not be even sharing the profits and losses of the firm. But the liability of a quasi partner is unlimited. If he does not want to keep his name attached to the firm, then he has to issue a public notice declaring that he is no more a partner of the firm.

(f) **Minor Partner:** According to the Indian Contract Act, a minor is not competent to enter into any contract. Therefore, a minor cannot become a partner of the firm. But, with the consent of all the partners, the minor may be admitted to the benefits of a partnership firm. A minor has a limited liability up to his capital contribution and is entitled to get a share already agreed upon, in the profits and property of the firm. A minor also has right to inspect the books of accounts.

**(g) Partner by Estoppel:** Partner by estoppel is not a partner of the firm as per agreement of the firm. He is a person who behaves or positively expresses himself as a partner. He does not contribute capital to the firm and does not participate in the management of the firm. A partner by estoppel does not share the profits and losse of the firm and is not liable for the debts of the firm. However, he is fully responsible for the liabilities or the loss arising due to his behaviour.

**(h) Partner by Holding Out:** A partner by holding out is a person who is declared by others as a partner of the firm or is mistaken to be a partner of a particular firm and he does not contradict it even after having a knowledge of the truth. He becomes liable to those third parties who have entered into a contract with the firm in the belief that he is a partner. Such a person is known as a 'partner by holding-out'. He neither contributes capital nor does share the profits or losses of the firm.

**(i) Partner in Profits Only:** A person can become a partner of the firm with t understanding that he will only share the profits of the firm but will not share any losses sustained by it. Generally, such a partner contributes a large amount of capital or the entire amount of capital of the partnership firm. In other words, he contributes an extra capital in the organisation. Therefore, he can dictate his terms and conditions on th firm. However, his liability for the firm's debts continues to remain unlimited.

**( j) Sub-partner:** A sub-partner can be defined as *"the transferee of a share of a partner's interest in the firm"*. In other words, if a partner transfers a part of the share of his profit in a partnership firm to the outsider, then such an outsider is known as a 'sub-partner'. The rights and liabilities of the sub-partner are limited. He does not contribute an capital. In short, he is a co-partner, who shares a part of the profits of the main partner. He is not liable for any debts of the firm. He is only liable to the main partner.

## 8.5 DUITES AND LIABILITIES OF PARNTERS

As per Section 11 of the Indian Partnership Act, 1932, the mutual rights and duties of partners of a firm may be determined by a contract between the partners, and such a ct may be expressed or may be implied by a course of dealing.

The Indian Partnership Act, 1932, prescribes the following duties and liabilities of partners firm:

(a) **General Duties of Partners:** The three fundamental duties of partners are:

- To carry on the business of the firm to the greatest common advantage;
- To be just and faithful to each other; and
- To render true accounts and full information of all things affecting the firm to any partner or his legal representative.

(b) **A duty to indemnify the firm for any loss, caused by fraud:** It is the duty of every partner to indemnify the firm for any loss, caused to it by fraudulent act in the conduct of the business of the firm.

(c) **A duty of a partner to attend his duties diligently:** Every partner is bound to attend diligently to his duties in the conduct of business. He must use his knowledge and skill and take care of the common advantage of all partners of the firm.

(d) **A duty of a partner to account for private profits:** It is the duty of a partner to surrender to the firm any profit derived by him from any transaction of the firm, from the use of the property of the firm or business connection of the firm or the firm's name.

(e) **A duty of a partner to indemnify the firm for any loss, caused by his wilful neglect:** A partner must attend to his duties and responsibilities diligently. It is the duty of a partner to indemnify the firm for any loss caused to it by his wilful neglect.

(f) **A duty of a partner to account for profits in competing business:** If a partner carries on any business of the same nature and competing with that of the firm, shall account for and pay the firm all the profits made by him in that business.

(g) **No remuneration to partners:** It is the duty of every partner to take active part in 1 affairs of the business. Thus, a partner is not entitled to receive any remuneration' taking a part in the conduct of the business.

However, all of the qbove duties and liabilities are subject to the agreement between It partners.

**Rights, Duties and liabilities of Partners**

## 8.6 RIGHTS OF PARNTERS

Subject to the contract between the partners, the Indian Partnership Act confers the following rights upon the partners:

(a) **Right to take part in the business of the firm:** Every partner has the right to participate in the day-to-day management of the firm.

(b) **Right to be consulted in all matters of the firm:** No major decision of the firm can be taken without the consent of all partners of the firm.

(c) **Right to access books of the firm:** Every partner has an access to and the right to inspect and copy any books of the firm.

(d) **Right to share equally in the profits, earned by the firm:** In the absence of any contract, all partners are entitled to share equally in the profits of the firm.

(e) **Right to claim interest on capital, subscribed by partners:** A partner is entitled to receive interest on his share of capital only if the firm makes profit.

(f) **Right to claim interest on advances made by the partners:** A partner is entitled to receive interest at 6% p.a., on additional capital contributed by him in the joint business.

(g) **Right of a partner to be indemnified:** The firm indemnifies the partner in case of an emergency, if he incurs any expense or liability in the course of business.

## MEANING OF JOINT HINDU FAMILY BUSINESS

The Joint Hindu family business refers to a business which is owned by the members of a joint Hindu family. It is also known as Hindu Undivided Family Business. This form of organisation exists under Hindu law and is governed by the law of succession. The joint Hindu family form is a form of business organisation in which the family possesses some inherited property. The inheritance of the property is among the male members. The share of ancestral propelty is inherited by a member from his father, grandfather and great grandfather. Thus, three successive generations can simultaneously inherit the ancestral property. For purposes of running oOoint Hindu family business, only male members are entitled who are referred to as co-parceners. The oldest member is known as the *Karla.*

## MEANING OF CO-OPERATIVE SOCIETY

Co-operation means working togetheLIt means those who want to work together with some common economic objective can form a society which is termed as "co-operative society". It is a voluntary association of persons who work together to promote their economic interest. It works on the principle of self-help as well as mutual help. Nobody joins a cooperative society to earn profit.

People come forward as a group, pool their individual resources, utilize them in the best possible manner, and derive some common benefit out of it. “Cooperation is a form of organization wherein persons voluntarily associate together as human beings, on a basis of equality, for the promotion of economic interests of themselves”.

## CHARACTERISTICS OF CO-OPERATIVE SOCIETIES

A co-operative society is a special type of business organization different from other forms of business organization you have learnt earlier. Let us discuss its characteristics.

1. ***Voluntary Association:*** A Cooperative Society is a voluntary association of persons. A member can join the society as and when he likes, continue for as long as he likes, and leave the society at will.
2. ***Open Membership:*** The membership of a Co-operative Society is open to all those who have a common interest. Membership is not restricted on the basis of caste, sex, colour or religion, but may be limited to the employees of a particular organisation.
3. ***Separate Legal Entity :*** A cooperative undertaking must seek registration under the Cooperative Societies Act, 1912, or under the relevantCooperative Societies Act of the State Government. A cooperative society, has a separate legal existence, distinct from its members.
4. ***Source of Finance:*** The capital of a cooperative society is raised from among its members in the form of share capital. However, it can easily raise loans and secure grants from government after its registration.
5. ***Service Motive:*** The primary aim of a cooperative society is service to its members, though it may also in the process happen to earn reasonable profits for itself
6. ***Voting Power:*** Each member has only one vote, irrespective of the number of shares held by him or her.

## 4.3 TYPES OF CO-OPERATIVE SOCIETIES

Co-operatives socities may be classified on the basis of the nature of services rendered by them. The following are the main types of cooperatives societies.

1. Consumer’s Co-operative Societies
2. Producers Co-operath’e Societies
3. Marketing Cooperative Societies
4. Thrift and Credit Cooperative Societies
5. Cooperative Group Housing Societies

## 4.4 ADVANTAGES OF CO-OPERATIVE SOCIETY

A Co-operative form of business organization has the following advantages:

I. Voluntary Organization

2. Democratic Control

3. Open Membership

4. Elimination of Middlemen's Profit

5. Limited Liability

6. Stable Life

## JOINT STOCK COMPANY

### Definition and Meaning:

Section 3(1) of Indian Companies Act, 1956

"Company means a company formed and registered under this Act or an existing company" & Existing company means a company formed and registered under any of the previous company laws".

### Meaning:

Thus a company is a voluntary association, an incorporated association, an artificial person created by law, having a common seal and perpetual succession Shareholder's are the owners of the company but management lies in the hands of Board of Directors. The company conducts its business under the provision of the Indian Companies act, 1956.

### Characteristics *I* Features of a Joint Stock Company:

The characteristics *I* features of a Joint Stock Company are:

1. **Compulsory Incorporation:** A company is a voluntary association of persons formed and incorporated under the existing Corinne law. Only when it gets certificate of incorporation it comes into existence as a body corporate.
2. **Artificial person:** A company is an artificial person created by law. It is created by legal process and not by natural birth. Even though it has no natural personality, it has legal personality. Therefore it can enter into contracts, sue and can be sued, own property, appoint employees and borrow money like any other natural person.
3. **Common Seal:** Since a company is an artificial person having no physical features like a natural person, it cannot sign. Hence every company by law must have a common seal on which its name

is engraved. The common seal can serve as its signature. The common seal is affixed on all important documents and contracts which is witnessed by signature of two directors and countersigned by secretary where ever required. The common seal is kept under the custody of directors.

4. **Perpetual succession:** Since the company has a separate existence from its members, directors and employees, their death, insolvency or insanity will not affect its life and existence men may come and men may go but a company remains forever. It can be wound up only under the provisions of the act.

5. **Limited liability:** Usually the liability of members of a company is limited to the extent of uncalled or unpaid value of shares held by them. Their personal property cannot be seized to meet the company's liability beyond the above mentioned liability.

6. **Share capital:** The capital required by the company is raised by issues shares. A share is a share in the share capital of the company. The member who holds the shares of a company can transfer its ownership any other person, without the company's permission.

7. **Separation of ownership and management:** In company organisation the ownership and management are separated. The shareholders who are the owners do not take active part in the everyday affairs of the company. Instead, they elect their representatives known as Directors, who with the help of managers and employees manage the company. Thus, there is division of labour and specialisation.

8. **Legal Entity:** Since the company is created by law it has separate legal existence compared to its members. Therefore the members cannot be personally held responsible for the acts of the company.

9. **Large membership:** The company is owned by a larger number of members - maximum of 50 in the case of private limited company and unlimited number of members in the case of a public limited company.

## Advantages / Merits of a Joint Stock Company:

The advantages / Merits of a Joint Stock Company are:

1. **Large Capital:** A company can collect huge capital for the business through shares and debentures, public deposits, loans etc. due to huge capital the company can conduct business on a large scale.

2. **Limited liability:** Shareholder's liability is limited to the face value of the shares held by them. The members are liable only to the extent of unpaid value of share. If the shares are fully paid up then the member is not liable for any debts of the company.

3. **Continuity and Stability:** A company has a long and stable life. its existence is not affected by death, insolvency or insanity of its members.
4. **Professional Management:** The company appoints experienced, competent and experts to manage the business. Their services lead to llJanagerial and administrative efficiency and accuracy.
5. **Economies of scale:** As the company operates on a large scale it enjoys economies in production. distribution, management and financing.
6. **Bargaining Power:** Compared to other forms of commercial organization a joint stock company has strong bargaining power in buying as well as in selling of goods because of its large scale production.
7. **Legal Status:** The company enjoys a distinct legal entity separate from its members. Being a legal creation it enjoys permanent existence.
8. **Large Membership:** A joint stock company (especially a public company) has large number of members. Large membership brings in large amount of funds which can be invested in companies expansion and diversification.
9. **Transferability of shares:** Shares of a Joint Stock Company (especially public companies) are freely transferable A member who wants to sell his shares can easily do so in the stock market. This encourages the public and other to invest in shares.
10. **Employment:** Joint stock company provides employment to a large number of people directly and indirectly. This leads to higher national income for the country and higher standard of living for the people.
11. **Government Revenue:** Joint Stock Companies provides revenue to the government in the form of taxes charged directly and indirectly.
12. **Research and Development:** Joint Stock Companies undertake R & D continuously thus bringing about new and improved products which benefits people.
13. **Economic Development:** Because of Joint Stock Companies there is all round development of trade, commerce and industry. The society in general gains the benefit of the industrial development. Large capital, government revenue, economic development etc. are the advantages of a Joint Stock Company.

## Disadvantages *I* Demerits of a Joint Stock Company:

The disadvantages / demerits of a Joint Stock Company are:

1. Difficult Formation

2. Lacks Flexibility
3. No Business secrecy
4. Excessive government regulation
5. Delay in Decision Making
6. Lack of contact with customers
7. Lack of contact with employees
8. Conflicts of Interest
9. Not suitable for all types of business
10. Exploitation of shareholders

## Types of Companies:

The companies can be classified on the basis of the following: (A) On the basis of Incorporation:

1. **Chartered Companies:** Such companies are incorporated under a Royal Character (order) issued by the King or Queen or Head of the State.

   Example: East India Company, Bank of England.

2. **Statutory Companies:** Such companies are formed under the special act passed by the Parliament or State Legislature.

   Example: Reserve Bank of India, State Bank of India, Life Insurance Corporation.

3. **Registered Companies:** A company incorporated under the Indian Companies Act, 1956 is called Registered Company.

   Example: registered company can be a Private Ltd. Company or a Public Ltd. Company.

## (B) On the basis of liability of its members:

1. **Companies Limited by Shares:**

   **Members liability limited:** In such companies the liability of the members is limited to the extent of the unpaid value on shares. In the event of winding up of the company the members need to pay the unpaid value of the shares.

   Such companies may be a Public limited company or a Private limited company.

2. **Companies Limited by Guarantee:**

   Every member promises or guarantees to pay a fixed sum of money (specified in the memorandum) at the time of liquidation of the company for payment of companies liabilities.

Such companies are formed without a share capital for non - trading (non - profit) purpose to promote culture, art, science, religion, charity, sports etc.

Such companies depend upon their existence on entrance and subscription fees as they do not have share capital.

3. **Unlimited Companies:**

   In such companies the liability of the members is unlimited. In the event of winding up of the company the private property of the member can be used to pay the debts of the firm.

## (C) On the basis of Membership:

1. **Private Limited Company:** A private limited company is the one which by its articles

   (a) **Minimum, Maximum:** Limits the maximum number of its members to 50, minimum being

   (b) **Transfer of shares:** Places some restriction on the transfer of its shares.

   (c) **Prohibits any invitation:** Prohibits any invitation by prospectus or otherwise to the general public to subscribe to any of its shares or debentures.

   (d) **Word 'Private Limited':** A private company must used the word 'Private Limited' after its name

2. **Public Limited Company:**

   (a) **Not a private company:** According to Companies Act, a public limited company is a company which is not a private company.

## (D) On the basis of Ownership:

1. **Government Company:** A government company means any company in which not less than 51 % of the paid -up share capital is held by the Central Government and / or by any State Government(s) or partly by the Central Government and partly by one or more State Government.

   Such companies have to follow all provisions of the Indian Companies Act, 1956. It has to be registered under the Indian Companies Act, 1956.

   Examples: Hindustan Machine Tools, Oil and Natural Gas Commission etc.

2. **Foreign Companies:** It is a company which is registered in one country but carries out its operations in India.

## (E) On the basis of Shareholding:

1. **Holding Companies:** It is a company which controls another company by holding a minimum 51 % of shares and thereby controlling the composition of the board of the company.

2. **Subsidiary Companies:** A company which another company holds a minimum of 51 % of share capital i.e. holding company is known as subsidiary company. Thus the above given are the various types of companies.

## Public and private company differences:

**6. Private Limited Company and Public Limited Company .**

| Private Limited Company | Public limited Company |
|---|---|
| 1. **Membership:**<br>Minimum membership 2,<br>Maximum membership 50 | Minimum membership 7,<br>Maximum membership unlimited |
| 2. **Formation**<br>Comparatively simple, certificate of incorporation is adequate | Comparatively, difficult as the procedure is lengthy. |
| 3. **Number of Directors:**<br>It must have at least two directors | It must have at least three directors |
| 4. **Transfer of Shares:**<br>The shares are not freely transferable | Shares are freely transferable. |
| 5. **Issue of Prospectus:**<br>It is allowed to issue prospectus | It can issue prospectus |
| 6. **Commencement of Business:**<br>It can start the business after the receipt of certificate of incorporation. | It requires trading certificate for starting business |
| 7. **Suitability:**<br>Suitable for business on a small scale | Suitable for large - scale business. |
| 8. **Invitation:**<br>It cannot invite public to subscribe for securities of the company | It invites public to purchase securities of the company. |
| 9. **Allotment:**<br>It can allot shares immediately after incorporation | Shares cannot be allotted unless minimum subscription is collected. |
| 10. **Qualification shares:**<br>The directors need not hold qualification shares | The directors have to purchase some qualification shares to become the director. |
| 11. **Directorship:**<br>There is no restriction on the number | A director cannot be a of director of more than 20 |

## Promotion & Meaning

**Formation of a Public Company:**

Formation of a public company can be divided into 4 stages

1. Promotion stage
2. Incorporation stage / Registration stage
3. Capital Subscription Stage
4. Trading Certificate Stage / Commencement of Business Stage 1. Promotion Stage:

1. **Discovery of an idea:** The work of a promoter starts when an idea strikes him regarding some business which can be profitably undertaken. When a person understands that there is a possibility of starting or expanding some business the idea is said to have been discovered.
2. **Detailed Investigation:** Commercial feasibility of the idea is checked with reference to:
   (a) Sources of supply of raw material.
   (b) Availability of funds and manpower
   (c) Extent of demand

   The investigation can be undertaken by the promoter themselves or by experts
3. **Verification of the idea:** In this stage the findings are verified so that there is a double guarantee regarding the validity of the report.

4 **Assembling:** In this stage activities like:

   (a) Selection of a site for the project
   (b) Purchase of land and building
   (c) Entering into technical, managerial contracts etc. is undertaken.

5. **Financial Plan:** In this stage the amount of funds required, sources of funds etc. is determined.
6. **Presenting the Proposition:** The promoter may ask some more persons to join venture. He presents the plan to them and they take the proposition. This is the promotion stage with its stages.

**(b) Incorporation Stage:**

The incorporation stage is also called as registration stage. The incorporation of a company gives birth to a new company. The promoters must obtain the registration or incorporation certificate from the Registrar of Companies. The following steps are to be followed:

1. **Name of the Company:** The promoters may give any name for the company but it should not resemble with the name of another existing company. The promoters should get the name allotted

or sanctioned. The application for the allotment of name must be forwarded to the Department of Company Law Administration, Government of India through the Registrar of Companies. The application form must consist of several alternate names, so that if one or the other name is rejected then the promoters can get at least one name allotted to their company.

2. **Preparation and Arrangement of Documents:**

   For getting a company incorporated, the following documents have to be prepared:

   (a) **Memorandum of Association:** It defines or states objectives and activities of the company.

   (b) **Articles of Association:** It is a set of rules and regulations regarding the internal affairs of the company.

   (c) **List of Directors:** It contains name, address, occupation and age of the directors.

   (d) **Written Consent of Directors:** Every director must give in his own handwriting - name, address, occupation, age and nationality and should put his signature declaring that he has given consent to act as director of the company. It is required in case of public companies only.

   (e) **Statutory Declaration:** That all the requirements or provisions of the Companies Act, 1956 with regard to registration have been complied with.

   (f) **Notice of Address:** At which the registered office of the company will be located.

   (g) **Declaration of Qualification Shares:** If the Articles provide for qualification shares, then the directors have to give a declaration stating that they have agreed to purchase and pay for qualification shares. Such declaration is required in case of public limited companies only.

3. **Filing of Documents:** All the required documents (as mentioned above) must be filed with the Registrar of Companies in order to get the company incorporated.

4. **Examination of Documents:** The Registrar of Companies will examine the documents. The Registrar will check:

   (a) Whether all documents are in order

   (b) Whether details in the documents are properly filled in

5. **Issue of Certificate of Incorporation:** If the Registrar is satisfied with the documents, he issues a Certificate of Incorporation. The issue of certificate is the conclusive evidence of the fact that the company is incorporated and that the requirements of the Companies Act have been complied with. The certificate of Incorporation is numbered, dated and signed by the Registrar of Companies.

## Memorandum of Association:

### Meaning:

Memorandum of Association is the most important document of a company. It is like the constitution of the company. Memorandum speaks about the aims and objects of the company. It defines the relationship of the company with the outsiders. Memorandum is treated as an unalterable charter or document of a company. Changes in the memorandum are possible but the procedure of bringing such changes in time - consuming, lengthy and requires the sanction from the government or, from the court. Memorandum is, therefore, treated as practically unalterable charter of the company. The purpose of this document is to inform the outsiders regarding the permitted range of activities of the company. The company must work within the limits of Memorandum of Association. Any act of company beyond the limits should be called ultra - virus and it will not be binding on the company. This document is prepared by promoters and filed with the registrar for incorporation certificate. It is divided into different paragraphs called Clauses. Each such clause deals with one aspect of company management.

**Following are the contents of Memorandum of Association:**

1. **The Name Clauses:** This clause mentions the name of the company followed by the words 'Limited' in case of a public company or 'Private Limited', in the case of a private company. The word 'Company' need not be included in the name of the company. The name should not be similar to that of any other existing company. It should not contain any word which may denote the governmel')t support or the patronage of the ruling power.
2. **The Domicile Clause:** This clause mentions the name of the State in which the registered office of the company is to be situated. This helps to determine domicile and nationality of the company and the jurisdiction of the court under which it comes. All communications and notices are to be addressed to the registered office. The company has to maintain all its statutory books at the registered office of the company.
3. **The Objects Clause:** This clause states the objects of the company. It contains the list of business activities which the company can undertake. The objects are classified as: (1) the main objects and (2) other objects. The list is usually exhaustive so as to include all those business activities which the company may undertake in future. While selecting the objects, the company has to see that they are not illegal or opposed to public policy or contradictory to the Companies Act or any other law. Any alteration in this clause requires the sanction of the Company Law Board.
4. **The Capital Clause:** This clause mentions the total share capital which the company is authorized to raise and its division into different types of shares of fixed denomination. The total capital mentioned in the Memorandum is called 'Authorised Capital' or 'Nominal Capital' or 'Registered Capital'. It also mentions whether the company is limited by shares or by guarantee. Any alteration

in this clause requires the sanction of the court. The MOA of a company must be printed and suitably divided into paragraphs which should be numbered serially. The Memorandum must be duly dated and stamped as required under the Indian Stamp Act.

5. **The Liability Clause:** This clauses states that the liability of the members of the company is limited to the face value of shares purchased by them. In the case of a company limited by guarantee, this clause states the amount which members undertake to contribute to the assets of the company in the event of its winding up. An unlimited company does not have this clause in the MOA.

6. **The Association or Subscription Clause:** This clause states that the persons who sign the Memorandum are desirous of forming themselves into a company to achieve the objects mentioned in the Memorandum and that they agree to subscribe for the number of shares of the company, mentioned against their names in the Memorandum. It is necessary to mention the name, description, occupation and address of each subscriber. The name, address, description and occupation of the witness are also required to be mentioned in this clause.

### Prospectus and Lieu of Prospectus:

1. **Prospectus Lieu Prospectus :** Prospectus is a document inviting the public to subscribe to the share capital of a company. Statement in Lieu of Prospectus is a document prepared for filing with the Registrar. It is an alternative to the prospectus.

2. **Purpose:** It gives wide publicity to the company and also provides share capital to the company It is prepared only for completing the legal formality and not for capital collection. Statement in lieu of prospectus:

It is not compulsory for a public company to issue a prospectus. If the promoters are confident of raising the required capital privately from their friends and relatives then they need not issue a prospectus. However, in such a case a statement in lieu of prospectus must be filed with the Registrar of Companies at least three days prior to allotment of shares.

1. **Meaning:** It is a document prepared as an alternative to prospectus when public subscription is not required.

2. **Purpose:** It is required to be filed with the Registrar within 3 days prior to allotment.

3. **Suitability:** This document is suitable for private limited companies where the directors can collect money from private sources such as friends and relatives.

4. **Use:** It helps the Registrar to know whether the capital issue is as per the provisions of the companies act. This document is mainly used for fulfilling the statutory requirements.

5. **Contents of statements in lieu of prospectus:** The statement in lieu of prospectus are more or less similar to the prospectus. It should clearly indicate:

- The date on which it was delivered to the Registrar for registration.
- Number and type of shares.
- Rights of the shareholders.
- Particulars regarding directors, managing directors etc.
- Details about preliminary expenses paid or payable.
- Details of contracts relating to purchase of property.
- Treatment of Reserves
- Names and addresses of auditors, bankers, legal advisers etc.
- Full name and address of the registered office
- Main object of the company and other details
- Date and signature of the directors.

## Commencement Certificate 1. Meaning:

It is a certificate issued to a joint stock company by the Registrar of companies signifying the birth of the company It is a certificate issued to a public company by the Registrar, giving a signal to commence the business.

## Share - Meaning

## Types of shares

The owned capital of a company is divided or split into a large number of equal parts or units. Each such part or unit having the same face value or nominal value is known as a 'share'. A\ person who purchases a share or shares of a company is called a shareholder.

Shares are classified into two types (a) Equity shares (b) Preference shares.

**(a) Equity Shares :** Equity shares are those shares which do not have a preferential right or priority claim in respect of the payment of dividend and repayment of capital at the time of the winding up of the company. The rate of dividend is not fixed on Equity shares. It depends upon the profits of the company during the year. The equity shareholders enjoy voting rights in the shareholders meeting.

**(b) Preference shares :** Preference shares are those shares, which enjoy certain preferences oner the equity shares, in respect of the payment of dividend and repayment at the time of the winding up of the company. The rate of dividend is fixed on the preference shares. The preference shares have a limited voting rights pertaining to their financial issues.

## Types of preference shares

1. Cummulative and Non-cummulative preference shares.
2. Connertible and Non-connertiable preference shares.
3. Participating and Non-participating preference shares.
4. Redeemable and Irredeemable preference shares.

## Debenture - Meaning

A debenture is a document issued by a company as an evidence of a debt due from the compnay with or without a charge on the assets of the company. The debentureholders as the creditors of the company. Thus ammount collected through the issue of debentures is called 'borrowed capital.

"A debenture is a document given by a company in acknowledgement of a debt, undertaking to repay the stated sum on or prefare a certain date and in the mean time to pay interest at a fixed rate

- J. Lenois Brown and L.K. Howard

## Types of Debentures

1. Registered Debentures
2. Bearer Debentures
3. Secured Debentures
4. Unsecured Debentures
5. Fully connertible Debenture

6 Partly Connertible Debentures

# Unit II

# Introduction

## I. INTRODUCTION:

The main objective of any business is 'earning profit'. For this purpose, a businessman conducts various economic activities. In business, there are various transactions like cash and credit, sale and purchase, expenditure and revenue transactions and exchange of money. It is difficult to remember all these transactions and it is also not easy to find out the profit or loss and financial status of a business at the end of the year by recollecting all those transactions of that year. Hence, these should be recorded in the books of accounts systematically. Then, it is possible to present the 'Accounting Information' to the management, partners in the business, creditors, government, workers and others.

## 1. BOOK-KEEPING:

Meaning: In business, transactions are so numerous that it is not possible to remember all. Therefore, the trader records these transactions in a set of books. The recording of transactions in a set of books is called Book keeping. It teaches us to maintain the books of accounts in a systematic manner.

**Objects:**

- To have permanent accurate and complete record of all business transactions
- To find out the net profit or net loss of a business for a given period.
- To know the position of assets and liabilities on a particular date.
- To know the names of debtors and creditors
- To keep, records up-to-date.
- To detect and minimize errors and frauds.
- To keep control on expenses with a view to minimize the same.
- To have important information for legal and tax purposes

**Advantages:**

1. A firm can know the exact profit or loss made by it in a particular period.
2. The reasons leading to profit or loss can also be ascertained.
3. At the end of the year Balance sheet can be prepared, which discloses the financial position of the business.
4. The firm can know the amount due by debtors and amount due to creditors.
5. Errors can be revealed by the preparation of trial balance.
6. The tax liability ofthe firm can be easily calculated.
7. It helps the traders and firms in planning, reviewing, controlling and decision-making.

## 2. ACCOUNATANCY:

### Definition:

Accounting is the' method of identifying, arranging and passmg on the required financial information to the decision makers in business'.

As per the American Institute of Certified Public Accountants" Accountancy is the art of classifying, analyzing, recording and summarizing the available financial information for the purpose of passing on the results of these exercises to the business managers and to the management.

It tells us why and how to maintain books of account and how to summarize and communicate accounting information. It is the actual process of doing it Le. actually maintaining the books of account, preparing and presenting the accounts.

### Advantages of Accounting:

1. The net profit / net loss of the business in a financial year can be known.
2. The efficiency / performance of the department/ section can be ascertained
3. The approximate cost of production of goods manufactured can be known
4. Based on the financial results, it can decide which products are to be manufactured, which activities should be continued and which should be dropped.
5. The financial position of the business concern can be assessed.
6. Accounting is useful in submitting the statutory returns like Income Tax, Sales Tax, Commercial Tax etc., to the government in time.

**DISTINCTION BETWEEN BOOK-KEEPING AND ACCOUNTING**

BooK-keeping differs from accounting in the following respects:

| Basis of Distinction | Book-keeping | Accounting |
|---|---|---|
| 1. Scope | Book-keeping involves-<br>(a) identifying the transactions,<br>(b) measuring the identified clasified transactions,<br>(c) recording the measured transactions and<br>(d) classifying the recorded transactions | Accounting in addition to Book-keeping involves-summarizing the transactions, ana lysing the summa-rized results, interpreting the analysed results and communicating the interpreted information to the interested parties. |
| 2. Stage | Book-keeping is primary stage. | Accounting is the secondary stage. It starts where book-keeping ends. |
| 3. Basic Objective | The basic objective of book-keeping is **to is to maintain systematic records** of financial transactions. | The basic objective of accounting **ascertain net results of opera-tions and financial position and to communicate** information to the interested parties. |
| 4. Who Performs | Book-keeping work is performed by junior staff. | Accounting work is performed by senior staff. |
| 5. Knowledge Level | The book-keeper is not required to have **higher** level of **knowledge** than that of an accountant. | The accountant is required to have higher level of knowledge than that of an accountant. |
| 6. Analytical Skill | The book-keeper **may** or **may not possess** analytical skill. | An accountant is **required** to **possess** analy1ical skill. |
| 7. Nature of Job | The job of a book-keeper is often routine and clerical in nature. | The job of an accountant is **analytical** is nature. |
| 8. Designing of Accounting System | It does **not cover** designing of accounts system. | It **covers** designing of accounting system. |
| 9. Supervision & Checking | The book-keeper **does not** supervise and check the work of an accountant. | An accountant **supervises** and checks the work of a book-keeper. |

## Concepts:

Accounting is a commercial language; to make this language more meaningful and useful and to make it uniform in practice certain concepts are adopted:

1. **Business Entity Concept:** While recording the business transactions in the books, it should be noted that the business and owners are separate entities. The activities of the concern and personal transactions of the owners should not be mixed. The final accounts are prepared to refl~ct the profit/loss of the business concern only.
2. **Money Measurement Concept:** accounting records only transactions that are expressed in terms of money. The transactions, which cannot be expressed in money, fall beyond the scope of accounting.
3. **Cost Concept:** Business activity is an exchange of money. The price paid at the time of purchase is called 'cost'. All fixed assets are recorded in the books at their original purchase price.
4. **Going Concern Concept:** accounts are recorded assuming that the business will continue for a long time. In absence of this view, there is no need to maintain books of account. This is useful to determine the value of fixed assets and intangible assets like' goodwill'.
5. **Realisation Concept:** As per this concept 'imaginary profits should not be recorded at all. All transactions should be recorded only after it actually takes place. Similarly profits should not be recorded unless it is actually realised.
6. **Dual Aspect concept:** As per this, every transaction should have two aspects. One is 'receiving aspect' and other is 'giving aspect'. The receiving aspect is called 'debit' and giving aspect is called 'credit'. Therefore, for every debit there is an equal corresponding credit.

**Conventions:** Accountancy is based on usages or customs. These are termed as 'conventions' in accounting. The following are some of the important conventions:

1. **Consistency:** It means that business concern should follow uniform accounting methods for all years. This is useful as and when the businessman wants to compare the present year performance with that of last year or with different firms.
2. **Disclosure:** The results of the business have to be disclosed from time to time to the shareholders and creditors, government, employees etc.; Care should be taken to disclose all material information.
3. **Relevance:** The firm should give relevant accounting information as and when required with documentary proof like invoices, vouchers and cash and credit memos.
4. **Feasibility:** The practice of comparing expenses incurred for the business transactions with that of the income received during the year by the firm is called feasibility. As per this convention the expenditure should be less than the income.
5. **Conservation:** As per this the accountant has to record the actual financial position, he should not give a different picture of the business either by inflating or deflating the value of transaction.

**TERMINOLOGY:**

1. **Business transactions:** Every business operation deals with exchange of cash, goods and services. This results in change in the financial position of the business.
2. Goods: Goods are those with which the business concern does business.
3. Debtor: a person owing money to the business firm is called 'Debtor'
4. Creditor: Creditor is a person who lent money or sell goods on credit to the firm.
5. **Account:** Account is a summarized statement of Debit and credit. There are two parts for every account. The left hand side is called 'Debit' and the right hand side is called' Credit'
6. Assets: Assets are those, which are essential and beneficial for running the business operations. Like Furniture, Machinery, land building etc.,
7. **Liabilities:** The debts owned by the firm to outsiders and also to the investors. For example, creditors/ Bank overdraft, bills payable and loans and capital.
8. **Capital:** the amount invested by the owner for running the business. It can be in the form of goods or cash. **It** the excess of liabilities over assets.
9. **Invoice:** Invoice is a statement sent by the seller to the purchaser, which contains the details of the quantity of goods sold, and price of the goods/ products, terms and conditions of payment particulars.
10. **Cheque:** A Cheque is an instrument, by means of which a depositor can order the bank to pay a certain sum of money only top the order of a person or to the bearer of the instrument.

## II. DOUBLE ENTRY SYSTEM:

A businessman records the business transactions in two ways. They are 1) Single Entry system and 2) Double Entry system.

1. Single Entry System: This method is incomplete and unscientific. It records only one aspect of the transaction (either debit or credit). So complete information is not available for the preparation of final accounts. It will not be possible to arrive at the accurate profit. The trader cannot obtain the total information as they maintain only cash and personal accounts leaving the nominal accounts aside. A businessman cannot take accurate and timely decisions due to this unscientific method.
2. Double Entry System: This system was invented by a trader called "Luci Paciolo" in Italy in the year 1434. According to him every transaction takes place between either two persons or two firms. When such a transaction takes places one person receives benefit and the other person gives benefit. These two are inseparable.

In accountancy, the Receiving benefit is called 'Debit' aspect and Giving Benefit is called' Credit' aspect. Thus, the procedure of recording both the receiving and giving aspects related to business transactions is called" Double Entry Book-keeping".

**The proforma of an Account:**

Dr Cr

| Date | Particulars | Ledger Folio No | Amount Rs. | Date | Particulars | Ledger Folio No | Amount Rs. |
|---|---|---|---|---|---|---|---|
| | To (Debit side) | | | | By (Credit side) | | |

## CLASSIFICATION OF ACCOUNTS:

**ACCOUNTS:**

Accounts can be broadly classified in to Personal Accounts and Impersonal Accounts.

Impersonal Accounts can be subdivided into two:

1. Real Accounts 2. Nominal accounts.

1. Personal Accounts: accounts opened in the names of individuals and institutions are called 'Personal accounts'. For example: Raju's Account, M/s. Ramesh & Co account.

Dr Cr

| Date | Particulars | Journal Folio No | Amount Rs. | Date | Particulars | Journal Folio No | Amount Rs. |
|---|---|---|---|---|---|---|---|
| | To (Debit side) | | | | By (Credit side) | | |

**Real Accounts:** All the accounts, which record transactions related to Assets is known as Real Account. A separate account will be opened for every asset in the business concern.

Ex. Machinery, furniture, stock, cash etc.,

**Nominal Account:** Account that gives information related to expenditure and income is known as Nominal account. Separate accounts will be opened to record expenditure, losses, income and profit of a business. These are also known as 'Fictitious Accounts'.

Ex. Salaries, Rent, Depreciation etc.,

## PRINCIPLES OF DOUBLE ENTRY SYSTEM:

**Personal Accounts:** *"Debit the receiver and Credit the Giver"*

**Real Accounts:** *"Debit what comes in and Credit what goes out'*

**Nominal Account:** *"Debit all Losses and expenses and Credit all Gains and Incomes"*

**Important factors to be considered while recording the transactions while implementing the principles of Double entry system:**

1. It should be noted that the business firm is different from the person who owns it. The firm has got its own entity and account; its transactions should be recorded in its own name but not in the name of the owner.
2. Identify those accounts which are being involved in the business transaction and classify them according to their nature Le., Personal Accounts, Real Accounts and Nominal Accounts.
3. After identifying /classifying the accounts, we should apply the principles of Debit and Credit and debit all the accounts which are to be debited and credit all the accounts which are to be credited.
4. The name of the proprietor should not be recorded in the books of the firm. Since he is the part of all the transactions, he should be treated as the representative of the business concern only.

## Advantages of Double Entry System:

Almost all the business concerns are practicing only the double Entry system, which is proven to be scientific method of recording the transactions. If this system is followed the business firm gets the following advantages:

1. It gets accurate, comprehensive and reliable record of all its business transactions.
2. Comprehensive information relating to assets, liabilities, and profit and loss of the business will be made available.
3. It facilitates to know the actual profit or loss of the business firm for a given period.
4. By preparing the Balance Sheet the financial position of the business and other related information can be known.
5. Errors and frauds can be easily identified and can be prevented.
6. Information regarding the total debtors and creditors can be ascertained easily.
7. It will help in comparing the financial position with that of previous years and also with the similar line business competitors.
8. It is helpful in preparing the trial balance from the closing balances of the ledger accounts and in turn can prepare the Balance Sheet to know the fixed and current assets as well as liabilities and capital of the business concern.
9. This scientific method of accountancy enables the management to take appropriate decision in business
10. By preparing the Trial Balance and Trading Account and Profit and Loss account, we dm arrive at exact profit or loss.

## III. JOURNAL

Meaning: The book in which the business transactions are recorded in a chronological order, after analyzing them and classifying the benefits according to the principles of debit and credit is called 'Journal". It.is also called as Daily record or Day book.

All the transactions like, purchases, returns, sales, cash receipts and payments, loans and advances, advances given, assets acquired and disposed etc., are first recorded in the 'Journal'. Hence, this book is also called as "Book of Prime Entry or Original entry'.

When the size of the business is large, the number of transactions increases. If all the transactions are recorded in a single journal, there will be complication. Hence modern firms are preparing different journals, which are called 'Subsidiary Journals".

### Proforma of Journal

| Date | Particulars | Ledger Folio | Debit Rs. | Credit Rs. |
|---|---|---|---|---|
| | | | | |

**Journal entry:** The process of recording the business transactions in a chronological order in the journal after analyzing, classifying and identifying them as 'Debit' and 'Credit' is called 'Entry'. All these transactions are in the form of entries; hence, these are called" Journal Entries'. For easy identification, a brief description is given under each entry within brackets, which is called as ' narration'.

### Advantages of Journal entries:

1. A trader can find out the required information quickly and easily as the transactions are recorded in a chronological order (date-wise)
2. It helps in the preparation of the final accounts at the end of the year.

### POSTING OF JOURNAL ENTRIES:

Journalise the following transactions in the books of Raju:

2002.

| | | | |
|---|---|---|---|
| April | 1 | - Raju commenced business with a cash of | Rs. 40,000 |
| " | 3 | - Cash purchases | Rs. 20,000 |
| " | 5 | - Paid salaries | Rs. 10,000 |
| " | 13 | - Sold goods to Ravi | Rs. 35,000 |
| " | 15 | - Sold Furniture | Rs. 25,000 |
| " | 20 | - Commission Received | Rs. 1,000 |
| " | 22 | - Discount allowed | Rs. 2,000 |
| " | 28 | - Bought goods from Venkat | Rs. 50,000 |
| " | 29 | - Sold goods for cash | Rs. 15,000 |

**Illustration:** Analyse the following transactions.

(a) Ramesh started his business with cash

(b) Borrowed from Nikhil

(c) Purchased furniture

(d) Purchased furniture from Mohan on credit

(e) Purchased goods for cash

(f) Purchased goods from Ram on credit

(g) Sold goods for cash

(h) Sold goods to Hari on credit

(i) Received cash from Hari

(j) Paid cash to Ram

(k) Deposited into bank

(1) Withdrew cash for personal use

(m) Withdrew from bank for office use

(n) Withdrew from bank for personal use

(o) Received cash from a customer, Shyam

(p) Paid salary by cheque

(q) Received donation in cash

(r) Paid to Ram by cheque

(s) Paid salary

(t) Paid rent by cheque

(u) Goods withdrawn for personal use

(v) Paid an advance to suppliers of goods

(w) Received an advance from customers

(x) Paid interest on loan

(y) Paid instalment of loan

(z) Interest allowed by bank.

**Solution**

ANALYSIS OF TRANSACTIONS

| Transaction | Accounts involved | Nature of accounts | How affected | Whether to be debited or credited |
|---|---|---|---|---|
| (a) | Cash A/c | Real | Cash is coming in | Debit |
| | Capital A/c | Personal | Ramesh is the giver | Credit |
| (b) | Cash A/c | Real | Cash in coming in | Debit |
| | Loan from Nikhil A/c | Personal | Nikhil is the giver | Credit |
| (c) | Furniture A/c | Real | Furniture is coming in | Debit |
| | Cash A/c | Real | Cash is going out | Credit |
| (d) | Furniture A/c | Real | Furniture is coming in | Debit |
| | Mohan's A/c | Personal | Mohan is the giver | Credit |
| (e) | Purchases A/c | Real | Goods are coming in | Debit |
| | Cash A/c | Real | Cash is going out | Credit |
| (f) | Purchases A/c | Real | Goods are coming in | Debit |
| | Ram's A/c | Personal | Ram is the giver | Credit |
| (g) | Cash A/c | Real | Cash is coming in | Debit |
| | Sales A/c | Real | Goods are going out | Credit |
| (h) | Hari's A/c | Personal | Hari is the receiver | Debit |
| | Sales A/c | Real | Goods are going out | Credit |
| (i) | Cash A/c | Real | Cash is coming in | Debit |
| | Hari's A/c | Personal | Hari is the giver | Credit |
| OJ | Ram'sA/c | Personal | Ram is the receiver | Debit |
| | Cash A/c | Real | Cash is going out | Credit |
| (k) | BankA c | Personal | Bank is the receiver | Debit |
| | Cash A/c | Real | Cash is going out | Credit |
| (1) | Drawings A/c | Personal | Ramesh is the receiver | Debit |
| | Cash A/c | Real | Cash is going out | Credit |

| Transaction | Accounts involved | Nature of accounts | How affected | Whether to be debited or credited |
|---|---|---|---|---|
| (m) | Cash A/c | Real | Cash is coming in | Debit |
| | Bank A/c | Personal | Bank is the giver | Credit |
| (n) | Drawings A/c | Personal | Ramesh is the receiver | Debit |
| | Bank A/c | Personal | Bank is the giver | Credit |
| (0) | Cash A/c | Real | Cash is coming in | Debit |
| | Shyam's A/c | Personal | Shyam is the giver | Credit |
| (p) | Salary A/c | Nominal | Salary is an expense | Debit |
| | BankA/c | Personal | Bank is the receiver | Credit |
| (q) | Cash A/c | Real | Cash is coming in | Debit |
| | Donation A/c | Nominal | Donation is a gain | Credit |
| (r) | Ram'sA/c | Personal | Ram is the receiver | Debit |
| | Bank A/c | Personal | Bank is the giver | Credit |
| (s) | Salary A/c | Nominal | Salary is an expense | Debit |
| | Cash A/c | Real | Cash is going out | Credit |
| (t) | Rent A/c | Nominal | Rent is an expense | Debit |
| | Bank A/c | Personal | Bank is the giver | Credit |
| (u) | Drawing's A/c | Personal | Ramesh is the receiver | Debit |
| | Purchases A/c | Real | Goods are going out | Credit |
| (v) | Advance to Suppliers A/c | Personal | Suppliers are the receivers | Debit |
| | Cash A/c | Real | Cash is going out | Credit |
| (w) | Cash A/c | Real | Cash is coming in | Debit |
| | Adv. from Customers A/c | Personal | Customers are the givers | Credit |
| (x) | Interest on Loan A/c | Nominal | Interest on loan is an expense | Debit |
| | Cash A/c | Real | Cash is going out | Credit |
| (y) | Loan A/c | Personal | Lender is the receiver | Debit |
| | Cash A/c | Real | Cash is going out | Credit |
| (z) | Bank A/c | Personal | Bank is the receiver | Debit |
| | Bank Interest A/c | Nominal | Bank Interest is a gain | Credit |

**JOURNAL ENTRIES**

| Date | Particulars | Ledger Folio | Debit Rs. | Credit Rs. |
|---|---|---|---|---|
| 2002 April 1 | Cash A/c ...................... Dr. | | 40,000 | |
| | To Capital A/c | | | 40,000 |
| | (Being the business commenced with investment) | | | |
| 2002 April 3 | Purchases A/c ............... Dr | | 20,000 | |
| | To Cash A/c | | | 20,000 |
| | (Being the goods purchased for cash) | | | |
| 2002 April 5 | Salaries A/c ................. Dr | | 10,000 | |
| | To Cash A/c | | | 10,000 |
| | Being the salaries paid) | | | |
| 2002 April 13 | Ravi A/c .................. Dr | | 35,000 | |
| | To Sales A/c | | | 35,000 |
| | Being the salaries paid) | | | |
| 2002 April 15 | Cash A/c .................. Dr | | 35,000 | |
| | To Furniture A/c | | | 35,000 |
| | (Being the Furniture sold for Cash) | | | |
| 2002 April 20 | Cash A/c .................. Dr | | 1,000 | |
| | To commission A/c | | | 1,000 |
| | (Being the commission received) | | | |
| 2002 April 22 | Discount A/c .................. Dr | | 2,000 | |
| | To Cash A/c | | | 2,000 |
| | (Being the discount allowed) | | | |
| 2002 April 28 | Purchases A/c .................. Dr | | 50,000 | |
| | To Venkat A/c | | | 50,000 |
| | (Being goods purchased from Venkat on credit) | | | |
| 2002 April 29 | Cash A/c .................. Dr | | 15,000 | |
| | To Sales A/c | | | 15,000 |
| | (Being goods sold for cash) | | | |

**Illustration:** Prepare Journal m the books of K.K. Co. from the following transactions:

| 1999 | | Rs. | 1999 | | Rs. |
|---|---|---|---|---|---|
| Dec. 1 | Started business with a capital of | 50,000 | Dec. 15 | Purchased goods from Ram | 4,000 |
| Dec. 6 | Paid into bank | 20,000 | Dec. 18 | Paid wages to workers | 300 |
| Dec. 8 | Purchased goods for cash | 4,000 | Dec. 20 | Recd. from Pankaj<br>Allowed him discount Rs. 50 | 1,000 |
| Dec. 9 | Paid to Ram | 1,980 | Dec. 22 | Withdrawn from bank | 3,000 |
| Dec. 9 | Discount allowed by him | 20 | Dec. 25 | Paid Ram by cheque | 500 |
| Dec. 10 | Cash sales | 3,000 | Dec. 31 | Withdrawn for personal use | 200 |
| Dec. 12 | Sold to Hari for cash | 2,000 | | | |

**Solution**

**IN THE BOOKS OF K.K. CO.**

**Journal**

| Date | Particulars | L.F. | Dr. Rs. | Cr. Rs. |
|---|---|---|---|---|
| 1999 | | | | |
| Dec. 1. | Cash Ale Dr. | | 50,000 | |
| | To Capital A/c | | | 50,000 |
| | (Being business started with capital) | | | |
| 6. | Bank Ale Dr. | | 20,000 | |
| | To Cash A/c | | | 20,000 |
| | (Being cash paid into bank) | | | |
| 8. | Purchase A/c Dr. | | 4,000 | |
| | To Cash A/c | | | 4,000 |
| | (Being goods purchased for cash) | | | |
| 9. | Ram A/c Dr. | | 2,000 | |
| | To Cash A/c | | | 1,980 |
| | To Discount Received A/c | | | 20 |
| | (Being cash paid to Ram and discount received Rs. 20) | | | |

| | | | Dr. | Cr. |
|---|---|---|---|---|
| Date | Particulars | L.F. | Rs. | Rs. |
| 10. | Cash A/c Dr. | | 3,000 | |
| | To Sales A/c | | | 3,000 |
| | (Being goods sold for cash) | | | |
| 12. | Cash A/c Dr. | | 2,000 | |
| | To Sales A/c | | | 2,000 |
| | (Being goods sold for cash) | | | |
| 15 | Purchases A/c Dr. | | 4,000 | |
| | To Ram A/c | | | 4,000 |
| | (Being goods purchased from Ram) | | | |
| 18. | Wages A/c Dr. | | 300 | |
| | To Cash A/c | | | 300 |
| | (Being wages paid) | | | |
| 20. | Cash A/c Dr. | | 1,000 | |
| | Discount Allowed A/c Dr. | | 50 | |
| | To Pankaj A/c | | | 1,050 |
| | (Being cash received from Pankaj and allowed him discount Rs. 50) | | | |
| 22. | Cash A/c Dr. | | 3,000 | |
| | To Bank A/c | | | 3,000 |
| | (Being cash withdrawn from bank) | | | |
| 25. | Ram A/c Dr. | | 500 | |
| | To Bank A/c | | | 500 |
| | (Being paid by cheque) | | | |
| 31. | Drawings A/c Dr. | | 200 | |
| | To Cash A/c | | | 200 |
| | (Being withdrawn for personal use) | | | |
| | **Grand Total** | | **90,050** | **90,050** |

## IV. LEDGER

Introduction: Journal records all business transactions separately and date-wise. The transactions relating to a particular person, asset, expense or income are recorded at different places in the journal as they occur on different dates. Hence, it fails to bring the similar transactions together at one place. Thus, to have a consolidated view of the similar transactions different accounts are prepared in the Ledger.

A Ledger account may be defined as a summary statement of all the transactions relating to a person, asset, expense or income, which have taken place during a given period of time and show their net effect. So every entry recorded in the journal must be posted into the Ledger. It is a register having a number of pages, which are serially numbered. One account is usually assigned one page in the Ledger. It is the principal book of accounts.

Proforma of an Account

**Dr** **Account** **Cr**

| Date | Particulars | Journal Folio | Amount Rs. | Date | Particulars | Journal Folio | Amount Rs. |
|---|---|---|---|---|---|---|---|
| | | | | | | | |

- Debit on the left hand side and Credit on the right hand side.
- The left side of the account describes the benefit received by the firm and the right side describes the information about the benefit given by the firm.
- The debit aspect of business transaction should be recorded on the debit side, this is known as debiting the account
- The credit aspect of the transaction is recorded on the credit side of the account, which is known as crediting the account.

## CLASSIFICATION OF LEDGER:

The number of transactions depends on the size of the business firm. When the firm is small in size, its transactions are usually limited, hence, only one Ledger account maybe enough but with the expansion of business, the number of transactions will also increase, so there is a possibility of have more number of Ledger Accounts that is why large scale business organizations maintain different Ledger accounts like:

**Debtors Ledger:** When the customer purchases goods on credit basis, they become the Debtors ofthe firm and all their transactions are recorded in one book known as 'Debtors Ledger', which show only debit balances, the total of these accounts indicate the amount to be received from debtors.

**Creditors Ledger:** When the firm purchases goods on credit basis the suppliers become 'creditors' and these transactions are recorded in one book known as 'Creditors Ledger' on the credit side. The total balances of these accounts indicate the total amount to be paid by the company to the supplier.

**General Ledger:** When the company record all the accounts related to assets, income and expenditure in one book, which is known as ' General Ledger'. In this accounts related to real account and the balances of all types of accounts related to nominal accounts always show only debit balance. On the other hand all the accounts related to incomes show only credit balances.

**Self Ledger:** When accounts relating to the proprietor of the business are recorded in one book . which is known as ' Self Ledger'. Which is very confidential.

## BALANCING THE ACCOUNT:

Generally, the balances of various accounts in the Ledger are tallied either at the end of the accounting year or whenever the business needs information.

**The following is the procedure to balance the account:**

- Take the totals of both sides and find out the difference between debit and credit.
- The total of lesser side should deducted from the total amount of the higher side, the difference is called as balance carried down (Balance *C/d)* that difference should be put in total column of lesser side, to get the same amount on both sides.
- Date of balancing should be written in the date column.
- The balance cld should be shown as balance bid on the next day, on the opposite side. Some times the totals of both the sides of an account are equal. In such case balance cld or balance bid does not occur.

**LEDGER POSTINGS:** ILLUSTRA nON

Journalise the followmg transactions, post them into the Ledger and the balance the accounts:.

| | | |
|---|---|---|
| 2003 May 1 | Ratan commenced business with a capital of | Rs. 50,000 |
| " 2 | Purchased goods from Jagan | Rs. 5,000 |
| " 4 | Sold goods to Gopal | Rs. 10,000 |
| " 5 | Cash purchases | Rs. 10,000 |
| " 7 | Paid salaries | Rs. 3,000 |
| " 8 | Cash sales | Rs. 10,000 |
| " 9 | Bought machinery and paid through bank | Rs. 2,000 |
| " 14 | Cash paid to Jagan in full settlement | Rs. 4,800 |
| " 17 | Cash received from Gopal and | Rs. 9,500 |
| | discount allowed | Rs. 500 |
| " 18 | Deposited with bank | Rs. 5,000 |
| " 24 | Sold old machinery | Rs. 1,500 |
| " 26 | Interest received through Cheque | Rs. 500 |
| " 31 | Ratan's personal use | Rs. 1,000 |

**Solution:**

## JOURNAL ENTRIES

| Date | Particulars | Ledger Folio | Debit Rs. | Credit Rs. |
|---|---|---|---|---|
| 2003 May 1 | Cash Alc ...................... Dr. | | 50,000 | |
| | To Capital A/c | | | 50,000 |
| | (Being the business commenced with investment) | | | |
| " 2 | Purchases A/c ............... Dr | | 5,000 | |
| | To lagan A/c | | | 5,000 |
| | (Being the goods purchased on credit) | | | |
| " 4 | Gopal A/c .................. Dr | | 10,000 | |
| | To Sales A/c | | | 10,000 |
| | Being the goods sold on credit paid) | | | |
| " 5 | Purchases A/c ............... Dr | | 10,000 | |
| | To Cash A/c | | | 10,000 |
| | Being the goods purchased for cash) | | | |
| " 7 | Salaries A/c .................. Dr | | 3,000 | |
| | To Cash A/c | | | 3,000 |
| | (Being the Salaries paid received) | | | |
| " 8 | Cash A/c .................. Dr | | 10,000 | |
| | To Sales A/c | | | 10,000 |
| | Being the goods sold for cash) | | | |
| " 9 | Machinery A/c .................. Dr | | 2,000 | |
| | To BankA/c | | | 2,000 |
| | (Being machinery bought and paid through cheque) | | | |
| " 14 | Jagan A/c ............... Dr | | 5,000 | |
| | To Cash A/c | | 4,800 | |
| | To Discount A/c | | 200 | |
| | (Being lagan,s account settled) | | | |
| " 17 | Cash A/c ...................... Dr | | 9,500 | |
| | Discount allowed A/c ....... Dr | | 500 | |
| | To Gopal's A/c | | | 10,000 |
| | (Being Cash received with discount) | | | |

| | | | | |
|---|---|---|---|---|
| " 18 | Bank A/c ................. Dr | | 5,000 | |
| | To Cash A/c | | | 5,000 |
| | (Being the Being cash deposited with bank) | | | |
| " 24 | Cash A/c ................. Dr | | 1,500 | |
| | To Machinery A/c | | | 1,500 |
| | (Being the sale of old machinery) | | | |
| " 26 | Bank A/c ................. Dr | | 500 | |
| | To Interest A/c | | | 500 |
| | (Being the interest received through cheque) | | | |
| " 31 | Drawings A/c ................. Dr | | 1,000 | |
| | To Cash A/c | | | 1,000 |
| | (Being the owner used cash for personal use) | | | |

**Dr** **Cash Account** **Cr**

| Date | Particulars. | J. F No | Amount Rs. | Date | Particulars | J.F No | Amount Rs. |
|---|---|---|---|---|---|---|---|
| 2003 | | | | 2003 | | | |
| May 1 | To capital A/c | | 50,000 | May 5 | By Purchases A/c | | 10,000 |
| ,, 8 | To Sales A/c | | 10,000 | 7 | By Salaries Alc | | 3,000 |
| ,, 17 | To Gopal A/c | | 9,500 | 14 | By Jagan Alc | | 4,800 |
| ,, 24 | To Machinery A/c | | 1,500 | 18 | By Bank Alc | | 5,000 |
| | | | | 31 | By Drawings | | 1,000 |
| | | | | 31 | By Balance cld | | 47,200 |
| | | | **71,000** | | | | **71,000** |
| 2003 June l | To Balance b/d | | **47,200** | | | | |

**Dr** **Capital Account** **Cr**

| Date | Particulars | J. F No | Amount Rs. | Date | Particulars | J. F No | Amount Rs. |
|---|---|---|---|---|---|---|---|
| 2003 May 1 | To Balance c/d | | 50,000 | 2003 May 1 | By cash Alc | | 50,000 |
| | | | **50,000** | | | | **50,000** |
| 2003 Junel | By Balance b/d | | 50,000 | | | | |

Dr **Purchases Account** Cr

| Date | Particulars | J. F No | Amount Rs. | Date | Particulars | J. F No | Amount Rs. |
|---|---|---|---|---|---|---|---|
| 2003 | | | | 2003 | | | |
| May 2 | To Jagan A/c | | 5,000 | May31 | By Balance Cld | | 15,000 |
| 5 | To Cash A/c | | 10,000 | | | | |
| | | | **15,000** | | | | **15,000** |
| 2003 June 1 | To Balance b/d | | 15,000 | | | | |

Dr **Jagan Account** Cr

| Date | Particulars | J. F No | Amount Rs. | Date | Particulars | J.F No | Amount Rs. |
|---|---|---|---|---|---|---|---|
| 2003 | | | | 2003 | | | |
| May14 | To Cash alc | | 4,800 | May 2 | By Purchases Alc | | 5,000 |
| 14 | To Discount Received | | 200 | | | | |
| | | | **5,000** | | | | **5,000** |

Dr **Sales Account** Cr

| Date | Particulars | J.F No | Amount Rs. | Date | Particulars | J.F No | Amount Rs. |
|---|---|---|---|---|---|---|---|
| 2003 | | | | 2003 | | | |
| May31 | To Balance c/d | | 20,000 | May 4 | By Gopal A/c | | 10,000 |
| | | | | 8 | By Cash A/c | | 10,000 |
| | | | **20,000** | | | | **20,000** |
| 2003 June1 | By Balance b/d | | 20,000 | | | | |

Dr **Gopal Account** Cr

| Date | Particulars | J. F No | Amount Rs. | Date | Particulars | J.F No | Amount Rs. |
|---|---|---|---|---|---|---|---|
| 2003 | | | | 2003 | | | |
| May4 | To Sales a/c | | 10,000 | May 17 | By cash A/c | | 9,500 |
| | | | | 17 | By discount allowed | | 500 |
| | | | **10,000** | | | | **10,000** |

**Dr** **Salaries Account** **Cr**

| Date | Particulars | J. F No | Amount Rs. | Date | Particulars | J. F No | Amount Rs. |
|---|---|---|---|---|---|---|---|
| 2003 May7 | To Cash alc | | 3,000 | 2003 May31 | By Balance c/d | | 3,000 |
| | | | **3,000** | | | | **3,000** |
| June1 | To Balance b/d | | 3,000 | | | | |

**Dr** **Machinery Account** **Cr**

| Date | Particulars | J. F No | Amount Rs. | Date | Particulars | J.F No | Amount Rs. |
|---|---|---|---|---|---|---|---|
| 2003 May9 | To Bank a/c | | 7,000 | 2003 May 24 | By cash A/c | | 1,500 |
| | | | | 31 | By Balance c/d | | 500 |
| | | | **2,000** | | | | **2,000** |
| 2003 June1 | To Balance b/d | | 500 | | | | |

**Dr** **Bank Account** **Cr**

| Date | Particulars | J. F No | Amount Rs. | Date | Particulars | J. F No | Amount Rs. |
|---|---|---|---|---|---|---|---|
| 2003 May18 | To Cash a/c | | 5,000 | 2003 May9 | By Machinery A/c | | 2,000 |
| 26 | To Interest a/c | | 500 | 31 | By Bal c/d | | 3,500 |
| | | | 5,500 | | | | 5,500 |
| 2003 Junel | To Balance b/d | 3,500 | | | | | |

**Dr** **Discount Received Account** **Cr**

| Date | Particulars | J.F No | Amount Rs. | Date | Particulars | J.F No | Amount Rs. |
|---|---|---|---|---|---|---|---|
| 2003 May31 | To Balance cld | | 200 | 2003 May 14 | By Jagan Alc | | 200 |
| | | | 200 | | | | 200 |
| | | | | 2003 June 1 | By Balance b/d | | 200 |

**Dr** **Discount Allowed Account** **Cr**

| Date | Particulars | J. F No | Amount Rs. | Date | Particulars | J. F No | Amount Rs. |
|---|---|---|---|---|---|---|---|
| 2003 May 17 | To Gopal a/c | | 500 | 2003 May 31 | By Balance c/d | | 500 |
| | | | **500** | | | | **500** |
| | | | | 2003 June1 | By Balance b/d | | **500** |

**Dr** **Interest Account** **Cr**

| Date | Particulars . | J. F No | Amount Rs. | Date | Particulars | J.F No | Amount Rs . |
|---|---|---|---|---|---|---|---|
| 2003 May31 | To Balance c/d | | 500 | 2003 May 26 | By Bank A/c | | 500 |
| | | | **500** | | | | **500** |
| | | | | 2003 June1 | By Balance b/d | | **500** |

Dr **Drawings Account** Cr

| Date | Particulars | J.F No. | Amount Rs. | Date | Particulars | J.F No | Amount Rs. |
|---|---|---|---|---|---|---|---|
| 2003 May31 | To Cash A/c | | 1,000 | 2003 May 31 | By Balance cld | | 1,000 |
| | | | 1,000 | | | | 1,000 |
| | | | | 2003 June1 | By Balance b/d | | 1,000 |

## Advantages of Ledger:

The following are the advantages derived from ledger:

1. It is the ledger through which successful application of double entry system of bookkeeping is ensured. Each and every transaction is divided into two parts -receiver and giver - and recorded in the two concerned accounts in ledger.
2. Transactions relating to different persons or concerns are recorded in the account of each person or concern separately. As a result, complete and reliable information is available in respect of each and every account.

3. Different types of income and expenses are recorded in different accounts separately. So, it is possible to ascertain the amount of income and expenditure under each head and the overall result at the year end through trading and profit and loss account.
4. Separate account is opened for each item of assets and liabilities. It is, therefore, possible to ascertain the value of different assets and liabilities and the true financial position at the year end through balance sheet.
5. Transactions being recorded primarily in journal and thereafter finally in ledger, the possibility of errors and defalcations is remote.
6. Valuable information and statistics are collected from ledger and supplied to the management to' enable them to run the concern efficiently.

# Unit III

# Introduction

## SUBSIDIARY BOOKS:

When the size and the number of transactions of the business increase, it would be difficult to record the transactions and post them in various Ledger accounts. To overcome, such problems, a separate book is maintained to record each transaction. As all the other similar kind of transactions is recorded in a separate book, it becomes easier to post all such transactions in Ledger at a time.

Thus, the different transactions are classified into various groups and relevant transactions are recorded in a separate journal. Such journal is called "Subsidiary journal' or 'Books of original entry'.

## KINDS OF SUBSIDIARY BOOKS:

**PURCHASE BOOK:** Only the credit purchases of goods are recorded in this book. Cash purchases and purchase of assets are not recorded in this book.

**SALES BOOK:** Only the credit sale of goods is recorded in the sales book. Cash sales and sale of assets are not recorded her in this book.

**PURCHASE RETURNS BOOK:** This book keeps a record of the returns outwards. When goods are purchased on credit basis and returned to the supplier for some reasons.

**SALES RETURNS BOOK:** This book keeps a record of all return inwards. When goods are sold on credit basis and returned by the customer due to some reasons.

**CASH BOOK:** This book is maintained to record all cash transactions. All cash receipts and payments are recorded in the book.

**BILLS RECEivABLE BOOK:** The bills on which the amount is yet to be received and promissory notes drawn by the seller or creditor are recorded in this book.

**BILLS PAYABLE BOOK:** All bills and promissory notes accepted by the buyer or debtor are recorded in this book.

**JOURNAL PROPER:** This book is used for recording only those transactions, which cannot be recorded in any other subsidiary books.

**PROFORMA OF PURCHASE BOOK**

| Date | Particulars | Invoice No. | Ledger Folio No | Amount Rs. |
|---|---|---|---|---|
| | | | | |

**PROFORMA OF SALES BOOK**

| Date | Particulars | Outward Invoice No. | Ledger Folio No | Amount Rs. |
|---|---|---|---|---|
| | | | | |

**PROFORMA OF PURCHASE RETURNS BOOK**

| Date | Particulars | Debit Note No. | Ledger Folio No | Amount Rs. |
|---|---|---|---|---|
| | | | | |

**DEBIT NOTE:** When the trader returns the material purchased for any reason, the net amount is calculated and the purchaser prepares a debit note. The amount is debited to supplier ale and the debit note should be sent to him.

**PROFORMA OF SALES RETURNS BOOK**

| Date | Particulars | Credit Note No. | Ledger Folio No | Amount Rs. |
|---|---|---|---|---|
| | | | | |

**CREDIT NOTE:** When the goods are sold on credit, an account is opened under the customer's name and the total amount of goods sold is noted in the debit side of his account. When he returns the goods, his account should be credited with the exact amount of the goods returned. To inform the customer about this a credit note is prepared and sent to him.

## PROFORMA OF CASH BOOK

**Dr** **Cash Account** **Cr**

| Date | Particulars | L. F No | Discount Allowed | Cash Rs. | Bank Rs | Date | Particulars | L.F No | Discount received | Cash Rs. | Bank Rs |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | | |

The proforma of a cash book resembles the Ledger alc and consists of debit and credit columns. All the amounts received directly or by Cheque, draft, money order is recorded on the debit side. All transactions in which cash is paid by the firm through Cheque, draft or money order are recorded on the credit side of the cash book.

### PROFORMA OF BILLS RECEIVABLE BOOK

| S.No | Date | From whom received | Acceptor | Date of Bill | Term | Maturity Date | Amount Rs. | L.F No | How disposed off | Remarks |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | |

### PROFORMA OF BILLS PAYABLE BOOK

| S.No | Date | Drawn by | Payee | Term | Maturity Date | Amount Rs. | L.F No | Payable at | How met | Remarks |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | |

### PROFORMA OF JOURNAL PROPER

| Date | Particulars | Ledger Folio No | Debit Amount Rs. | Credit Amount Rs. |
|---|---|---|---|---|
| | | | | |

## ADVANTAGES OF SUBSIDIARY BOOKS:

No narration is required while writing in subsidiary books as done in journal entries. So, labour is reduced.

- The accounting staff can record the transactions quickly and easily, as there are eight different books.

- Efficiency and specialization can be attained as the work is classified and allocated to the accountants.
- The rectification of errors, if any, becomes easy.
- They will provide the information related to a particular transaction with In the stipulated time.

**Illustration :** Record the following transactions in Purchase book.

2010

Jan1 Purchased from Sudhakar & Co on Credit
40 units @ Rs. 25
Trade discount 10%

Jan 4 Purchased from R & Co on credit
40 units @ Rs. 10
20 units @ Rs. 25

Jan 18 Purchased from TM & Co on credit
20 units @ 40
Trade discount 5%

Jan 30 Purchased from MN & Co on credit
30 units @ Rs. 20
40 units @ Rs. 50

**Solution :**

**Purchase Book**

| Date | Invoice No. | Particulars | L.F. | Details Amount | Amount |
|---|---|---|---|---|---|
| Jan 1 | | Sudhakar & Co | | | |
| | | 40 units @ Rs. 25 | | 1,000 | |
| | | Less: 10% Trade Discount | | 100 | 900 |
| Jan 4 | | R & Co | | | |
| | | 40 units @ Rs. 10 | | 400 | |
| | | 20 units @ Rs. 25 | | 500 | 900 |
| Jan 18 | | TM & Co | | | |
| | | 20 units @ Rs. 40 | | 800 | |
| | | Less: Trade Discount 5% | | 40 | 760 |
| Jan 30 | | MN & Co | | | |
| | | 30 units @ Rs. 20 | | 600 | |
| | | 40 units @ Rs. 50 | | 2,000 | 2,600 |
| Jan 31 | | | | | **5,160** |

Section 2(46) of the Indian Companies Act 1956 defines share as “a share in the share capital of a company and includes stock except when a distinction between stock and shares is expressed and implied”.

Owned capital of a company divided into a large number of equal parts or units. Each such part having the same face value is called share

### Types of shares:

1. **Equity Shares:** Equity shares are those shares which do not have, preferential rights with regards to: (a) Payment of dividend (b) Repayment (return) of capital, in case of winding up of the company. Equity shares are also known as **Ordinary shares**. There are no types of equity shares.
2. **Preference Shares:** Preference shares are those shares which have preferential rights over the equity shares with regards to: (1) Repayment of capital in the event of liquidation *I* winding up of the company. (2) Payment of dividend.

## VI. CASH BOOK:

The cash book or cash account is most important of all subsidiary books. Only cash transactions are recorded in this book. Cash transactions are two types:

1. Cash receipts and .2) Cash payments. Cash receipts should be shown on debit side and cash payments on the credit side. The difference between the debit total and credit total reveals the cash balance available within the firm. Under any circumstances payments should not exceed receipts as no business concern can pay more than what it receives. Sometimes balance of debit and credit will be equal. Then the cash balance of the firm is ‘nil’.

It can be used either as a book of original entry or a Ledger. It is also called as ‘Book of original entry’.

### TYPES OF CASH BOOK:

The form of the cash book depends on the need, nature and scope of business activity of a business firm. The cash book is of the following types:

1. Simple Cash book
2. Double column cash book:
   a) Containing Cash and Discount columns
   b) Containing Bank and Discount columns
3. Triple column cash book
4. Petty cash book

Simple Cash book: It is maintained usually by newly started business firms, whose trade transactions are limited. Only cash transactions are recorded in this book.

**Cash Book Containing Cash and Discount columns:** The transactions pertaining to cash and cash discounts are also recorded. The transactions involving discounts are recorded here. There are 2 types of discounts: 1) Trade discount 2) Cash discount:

**Trade discount:** The discount offered by the seller to the buyer on the price or- the goods purchased. It is shown in invoice only and does appear either in the cash book or any other book.

**Cash discount:** If a debtor clears his debt before or on the date specified, he may receive some rebate in the form of cash from the creditor, which is treated as 'cash discount received'. In the same way rebate given by the creditor it is treated by him as 'discount allowed'. This always related to transactions involving cash, so it is recorded in cash book. The discount column on the debit side should be named 'discount allowed' and that on the credit side should be named 'discount received'. The balance of the discount columns should not be balanced.

**Cash Book Containing Bank and Discount columns:** The modern business concerns, do not usually carry on their transactions only in the form of cash, for safety reasons the transactions are usually carried out through banks. The receipts and payments are usually made through Cheques. The cash and Cheques deposited in the bank are recorded on the debit side and Cheques drawn are shown on the credit side. Usually the bank column shows a debit balance, but sometimes, it can show a credit balance also, if it shows a credit balance we call it overdraft.

Triple Column Cash Book: The modem organizations, in which the cash transactions are made in big amounts, deal with banks regularly to get the following advantages:

- Cheques received can be deposited in their bank accounts
- All payments can be made through Cheques
- Interest can be earned by depositing the cash balance in the bank.

As the business firms deal largely with banks they prepare a cash book containing cash, discount and bank columns. So this book is called 'Triple Column Cash Book'.

**Important points to be noted while recording the transactions:**

- When opening cash and bank balances are given, record on the debit side of cash and bank columns
- When opening bank balance is given as overdraft, it should be recorded on the credit side in the bank column
- When cash is received, it should be recorded on the debit side cash column, in the same way cash payments made by the firm shown in the cash column on credit side.

- When cash or Cheque is received from debtors through cash sales or any other sources, it is recorded in the cash column on debit side, if the Cheque is deposited into bank on the same. day or assumed to be deposited on the same day, it is recorded in the bank column on the debit side.
- If any payment is made or debt is cleared in the form of Cheques, it is recorded in the bank column on the credit side.
- If the firm allows discount, it is recorded in the discount column on the debit side.
- If the discount is received, it is recorded on the discount column on the credit side.
- If the Cheques sent to bank for collection are dishonored, these should be recorded in the bank column on the credit side. Similarly, if we receive any information that the Cheques issued by us are dishonored, it should be promptly noted in the bank column on the debit side.
- If cash is withdrawn from the bank for the business use, it should be recorded in the cash column on debit side and bank column on the credit side.
- Ifwe deposit cash into bank it should be recorded in the bank column on debit side and credit side in the cash column. This type of transaction is called as contra entry. Where both the sides are affected. To indicate that is a contra entry, the alphabet 'C" is mentioned in the Ledger folio column on the both sides.

**Illustration 1 :** Enter the following transactions in single -column cash book

| | | |
|---|---|---|
| 2011 | | |
| Jan 1 | Cash in hand | 1,700 |
| Jan 5 | Paid to Ramu | 300 |
| | Discount allowed by him | 10 |
| Jan 8 | Purchased goods from Somu & Co from cash | 400 |
| Jan 10 | Record from Ramesh | 980 |
| | Discount allowed | 20 |
| Jan 16 | Sold goods to Suresh & Co for cash | 400 |
| Jan 21 | Paid to Harish | 295 |
| | Discount received | 5 |
| Jan 22 | Paid wages | 50 |
| Jan 25 | Paid to Jagan | 390 |
| | Discount Received | 10 |
| Jan 30 | Furniture purchased | 200 |

**Solution :**

**Cash Book**

| Date | Particulars | Amount Rs. | Date | Particulars | Amount Rs. |
|---|---|---|---|---|---|
| Jan1 | To Balance b/d | 1,700 | Jan 5 | By Ramu | 300 |
| Jan10 | To Ramesh | 980 | Jan 8 | By Purchase | 400 |
| Jan17 | To Sales | 400 | Jan 21 | By Harish | 295 |
| | | | Jan 22 | By Wages A/c | 50 |
| | | | Jan 25 | By Jagan | 390 |
| | | | Jan 30 | Furniture | 200 |
| | | | Jan 31 | Balance C/d | 1445 |
| | | **3,080** | | | **3,080** |
| Feb 1 | To Balance b/d | 1,445 | | | |

**Illustration 2 :** Record the following transactions in Two Column Cash book.

| | | |
|---|---|---|
| Jan1 | Cash balance | 15,000 |
| Jan 15 | Cash received from Sudhakar | 3,900 |
| | Discount allowed to him | 100 |
| Jan 20 | Paid to Krishna | 5,830 |
| . | Discount received | 170 |
| Jan 31 | Received cash from Naresh | 2,900 |
| | Discount allowed to him | 100 |

**Solution :**

**Cash Book**

| Date | Particulars | Discount | Cash Rs. | Date | Particulars | Discount | Cash Rs. |
|---|---|---|---|---|---|---|---|
| Jan1 | To Balance b/d | | 15,000 | Jan 20 | By Krishna | 170 | 5,830 |
| Jan18 | To Sudheer | 100 | 3,900 | Jan 8 | By Balaced c/d | | 15,970 |
| Jan31 | To Naresh | 100 | 2,900 | | | | |
| | | **200** | **21,800** | | | **170** | **21,800** |

# Unit IV

# Final Accounts

## TRIAL BALANCE

It is a must for the businessman to prepare 'final accounts' with a specific object to find out the profitability of the transactions made and the true and fair financial position of the firm. These final accounts are prepared from the balances of Ledger accounts which are available in a common list called 'Trial Balance'. It contains the Debit and Credit balances of all Ledger accounts and are very essential for preparation process of final accounts.

Trial Balance may be simply defined as a statement prepared by putting all debits on one side and all credits on the other side to check the arithmetical accuracy of the Ledger accounts. It is a link between the Ledger accounts and final accounts.

M.S. Gosav: defined the Trial balance as " it a statement containing the balances of all Ledger accounts, as at any given date, arranged in the form of debit and credit columns laced side by side and prepared with the object of checking the arithmetical accuracy of the Ledger postings.

- Characteristics of Trial Balance:
- It is a statement or a list
- It contains all the debit and credit balances
- The total of debit balances and credit balances must be equal.
- It is the only base for preparation of final accounts
- It can be prepared at any time.

**Advantages:**

- Preparation of final accounts will become easy
- One can rely on the results derived out of trial balance when the total of debit is equal to the total balance of credit.
- Some accounting flaws in respect of postings can easily be detected by p[repairing trial balance.
- The work of accountant will become easy for ascertaining the profitability and financial position with the preparation of trial balance.

**PREPARATION OF TRIAL BALANCE:**

**A: The following accounts will always appear with <u>debit balances</u> in Trial Balance:**

**Asset Accounts:** Land accounts,· building accounts, machinery accounts, furniture accounts, Debtors account, stock account, Bills receivable etc.,

**Accounts relating to expenses and losses:** Salaries account, wages account, rent account, carriage account, discount account, bad debts account, depreciation account, and also purchases account, return inward account etc.,

**B: The following accounts will always appear with <u>credit balances</u> in Trial Balance:**

**Liabilities accounts:** Creditors account. Loan account, mortgage account, Bills Payable account, Bank overdraft account. All types of Reserves and Funds accounts.

**Income and gain accounts:** Interest realsied account, rent collected account, discount received account, and sales account, return outward account etc.,

The Trial Balance is prepared at any given date but not for a particular period:

**PROFORMA:**

| S.No. | Particulars (Name ofthe account) | LFNo. | Debit Balance Rs. | Credit Balance Rs. |
|---|---|---|---|---|
| | | | | |

## METHODS OF PREPARING TRIAL BALANCE:

There are two methods of preparing trial balance: 1) Total balances method 2) Net balances method.

Total balances method: In this, debit as well as credit sides of all the accounts will be summed up and with this totals the Trial Balance will be prepared. It is called as ' gross trial balance method'. This is method is out of use now

Net balances method: This is most commonly used method in preparing the Trial Balance. In this the net balance of the accounts were ascertained on a particular date and arranged in the proforma of Trial balance. If these totals of debit and credit agree, we can say the Trial Balance has the arithmetical accuracy.

**EXAMPLE :** Prepare a Trial Balance from the following Ledger balance relate to *MIs.* Vandana and co. as on 31-3-2003.

| Particulars | Amount Rs. | Particulars | Amount Rs. |
|---|---|---|---|
| Cash in bank | 200 | Debtors | 34,000 |
| Capital | 78,000 | Bills payable | 1,140 |
| Lease Property | 46,000 | Opening Stock | 5,000 |
| Furniture | 10,500 | Bank Loan | 46,000 |
| Sales | 1,31,020 | Plant and Machinery | 48,000 |
| Discount allowed | 540 | Purchases | 81,900 |
| Carriage Inward | 350 | Discount Received | 70 |
| Returns Inward | 1,500 | Carriage outward | 240 |
| Wages & Salaries | 17,000 | Returns outward | 380 |
| Advances paid | 29,960 | Sundry expenses | 1,370 |
| Bank charge | 1,000 | Taxes | 500 |
| Creditors | 22,760 | Commission received | 1,690 |
| | | Drawings | 3,000 |

**Solution: Trial Balance ofM/s. Vandana & Co. as on 31-3-2003**

| Particulars (Name of the account) | LF No. | Debit Balance Rs. | Credit Balance Rs. |
|---|---|---|---|
| Cash in bank | | 200 | |
| Capital | | | 78,000 |
| Lease Property | | 46,000 | |
| Furniture | | 10,500 | |
| Sales | | | 1,31,020 |
| Discount allowed | | 540 | |
| Carriage Inward | | 350 | |
| Returns Inward | | 1,500 | |
| Wages & Salaries | | 17,000 | |
| Advances paid | | 29,960 | |
| Bank charge | | 1,000 | |
| Greditors | | | 22,760 |
| Debtors | | 34,000 | |
| Bills payable | | | 1,140 |
| Opening Stock | | 5,000 | |
| Bank Loan | | | 46,000 |
| Plant and Machinery | | 48,000 | |
| Purchases | | 81,900 | |
| Discount Received | | | 70 |
| Carriage outward | | 240 | |
| Returns outward | | | 380 |
| Sundry expenses | | 1,370 | |
| Taxes | | 500 | |
| Commission received | | | 1,690 |
| Drawings | | 3,000 | |
| | | **2,81,060** | **2,81,060** |

**Model Questions:**

1. Define 'Trial Balance' and its need.
2. List out the various accounts, which appear on Debit side and credit side.
3. Prepare a Trial Balance from the following Ledger balances :

| Particulars | Rs | Particulars | Rs |
|---|---|---|---|
| Capital | 1,00,000 | Wages | 8,000 |
| Motor van | 60,000 | Rent | 10,000 |
| Purchases | 50,000 | General Expenses | 5,000 |
| Sales | 90,000 | Cash in Hand | 13,000 |
| Debtors | 30,000 | Bank Overdraft | 1,000 |
| Creditors | 10,000 | Furniture | 16,000 |
| Salaries | 12,000 | Investments | 7,000 |
| Depreciation Fund | 10,000 | | |

The package of accounts and statements that are used to ascertain the Gross Profit, Net Profit and Financial position are called "Final Accounts. The Trial Balance is the base from which the final accounts are prepared.

**OBJECTIVES:**

· To assess the profit earned or loss incurred by the business in a specific period.

· To find out the financial position of the firm and to know the total assets and liabilities and the net capital of the business on a particular date.

A trading concern will prepare final accounts in 3 stages:

1. Trading Account - To find out Gross profit / loss for the period
2. Profit & Loss account - The assess the net profit
3. Balance Sheet - To show total assets and liabilities

A Manufacturing concern will prepare final accounts in 4 stages:

1. Manufacturing Account - To know the total cost of production
2. Trading Account - To find out Gross profit
3. Profit & Loss account - The assess the net profit / Net loss for the period
4. Balance Sheet - To show total assets and liabilities

**The total transactions of the business are divided into:**

Transactions of Capital nature: i) Capital Expenditure ii) Capital income

Transactions of Revenue nature: i) Revenue Expenditure ii) Revenue income

The classification of transactions is a key factor in the Accountancy: From the expenditure point of view, we can classify the total items of expenditure into: a) Capital Expenditure b) Revenue Expenditure

**Capital Expenditure:** The transactions of capital expenditure give benefits for more than one accounting period, such as acquisition and improvement of assets, acquisition of special rights, increasing of earning capacity, restoration of operating efficiency. It is non-recurring in nature. Therefore, they are shown on the assets side of the Balance Sheet.

**Revenue Expenditure:** It is incurred for generating revenue in the current accounting period and its benefit expires with such period. It helps to maintain the normal working condition of a business. It is charged as expenses in Trading / Profit & Loss Account on debit side. Ex: Purchases, carriage expenses, wages, fuel, salaries, postage, telephone rent, rates, taxes salaries, advertisements, traveling charges, interest and depreciation.

The receipts of a business firm can be divided into a) Capital receipts and b) Revenue receipts.

**Capital receipts:** are defined as "non-recurring receipts' from the owner of the business or lender of money creating a liability to either of them". Which include proceeds out of sale of assets: capital, bank loan, issue of debentures, loan, sale of assets. They are to be shown on liabilities side of the balance sheet or deducted from the asset value on assets side of the balance sheet.

**Revenue receipts:** Revenue receipts are defined as " a recurring receipt against sale of goods in the normal course of business. It may be a non-trading income of regular or recurring nature. Ex. Interest, discount, dividend received etc., these items should be credited to Trading account, Profit and Loss account.

## TRADING ACCOUNT:

Trading account is prepared at the end of each accounting period to assess the gross profit or Gross loss. Gross profit is nothing but the excess of the total of credit column over the total of the debit column. If the net sales amount is more than the 'cost of production' the difference is called 'Gross profit', it should be transferred to Profit and Loss Account and posted on credit side and if the sale proceeds are lower, the result is called 'gross loss'. It should be transferred to Profit and Loss account on the debit side.

## PROFORMA OF TRADING ACCOUNT

**Trading Account of ............ For the period ended ............**

Dr | Cr

| Particulars | Amount Rs | Amount Rs | Particulars | Amount Rs | Amount Rs |
|---|---|---|---|---|---|
| To Opening stock | | Xx | By Sales | Xxx | |
| To Purchases | Xxx | | Less Sales returns | xx | Xx |
| Less: Returns | xx | xx | By Closing stock | | Xx |
| To Carriage inward | | Xx | By goods destroyed by fire | | Xx |
| To wages | | Xx | | | |
| To Freight / cartage | | Xx | By Gross Loss | | xxx |
| To Import / Export | | Xx | (Transferred to P& L a/c) | | |
| duty | Xx | | | | |
| To Royalties/Octroi | | Xx | | | |
| To coal, fuel & power | | Xx | | | |
| To Factory expenses | | Xx | | | |
| To Manufacturing Expenses | | Xx | | | |
| To Gross Profit (Transfer to P & L a/c) | | xxx | | | |
| | | xxxx | | | xxxx |

### Importance of Trading Account:

Trading account is the first step in the preparation of the process of final accounts. We can ascertain Gross Profit / Gross Loss

We can observe the changes in direct expenses

We can establish the relation between the costs and revenues

We can analyse the trend in sales

We can decide the earning capacity ofthe firm.

**Illustration:**

1. From the following balances of Mr. Ram ascertain the Gross profit by preparing a Trading Account for year ended 31-3-2002.

| | |
|---|---|
| Stock | Rs. 15,000 |
| Sales | Rs. 28,000 |
| Purchase returns | Rs. 400 |
| Carriage inward | Rs. 500 |
| Wages | Rs. 5,000 |
| Sales Returns | Rs. 1,000 |
| Manufacturing expenses | Rs. 200 |
| Octroi | Rs. 600 |
| Fuel | Rs. 800 |
| Electricity | Rs. 600 |
| Purchases | Rs. 10,000 |
| Closing stock | Rs. 9,000 |

**Trading Account** of Mr. **Ram For the period ended 31-3-2002**

Dr Cr

| Particulars | Amount Rs | Amount Rs | Particulars | Amount Rs | Amount Rs |
|---|---|---|---|---|---|
| To Opening stock | | 15,000 | By Sales | 28,000 | |
| To Purchases | 10,000 | | Less Sales returns | 1,000 | 27,000 |
| Less: Returns | 400 | 9,600 | | | |
| To Carriage inward | | 500 | By Closing stock | | 9,000 |
| To Wages | | 5,000 | | | |
| To Manufacturing Expenses | | 200 | | | |
| To Octroi | | 600 | | | |
| To Fuel | 800 | | | | |
| To Electricity | | 600 | | | |
| To Gross Profit (Transfer to P & L a/c) | | 3,700 | | | |
| | | **36,000** | | | **36,000** |

## PROFIT AND LOSS ACCOUNT:

Profit and loss account has to be prepared to ascertain the net profit or net loss of the firm for the accounting period. It can be arrived by deducting the ‘ Administrative expenses’ from the Gross profit. It is a common practice to prepare the Profit and Loss account in continuation to the Trading Account. By nature Profit and Loss account is a nominal account and should not have any opening balance or closing balance. It is started either with Gross profit or Gross and the Trading and bon-trading incomes are credited to this account. Similarly all the administrative, general and financial charges, writing down of assets values are to be debited to profit and loss account.

If the total of the credit column exceeds the total of debit column the difference is called’ Net profit’ which is to be transferred to the Capital Account or added to the existing share capita while preparing the balance sheet. If the total of the debit column exceeds the total of the credit column the difference is “net loss’ which is to be deducted from the capital in the balance sheet. That is to say that the net profit will increase the capital where as the net loss will decrease the capital.

### FORMAT OF PROFIT AND LOSS ACCOUNT:

**Profit and Loss Account of Sri.......... For the period ended ...............**

Dr Cr

| Particulars | Amount Rs | Amount Rs | Particulars | Amount Rs | Amount Rs |
|---|---|---|---|---|---|
| To Gross Loss | | Xx | By Gross profit | | Xx |
| General Administrative | | | By Discount Received | | Xx |
| Expenses: | | | By Interest received | | Xx |
| | | | By commission | | Xx |
| To Salaries | | Xx | received | | |
| To Rent, Rates and | | Xx | By Reserve for bad | | Xx |
| Taxes | | | Debts (decrease) | | |
| To Postage, printing & | | Xx | By Interest on Drawings | | Xx |
| Stationery | | | By reserve for Discount | | Xx |
| To Legal charges | | Xx | On Creditors | | |
| To Audit Fee | | Xx | By dividends Received | | Xx |
| To Telephone | | Xx | By Apprentice Premium | | Xx |
| To Electricity | | xx | By Profit on sale of Assets | | Xx |
| To Insurance | | xx | | | |

| | | | | | |
|---|---|---|---|---|---|
| **Selling and Distribution Expenses** | | | | | |
| To Salaries to staff | | Xx | | | |
| To Travel Expenses | | Xx | | | |
| To Advertisements | | Xx | | | |
| To commission and Brokerage | | Xx | | | |
| To Carriage outward | | Xx | | | |
| To Commission on Sales | | Xx | | | |
| To Packing charges | | Xx | | | |
| To Godown expenses | | Xx | | | |
| To Free Samples | | Xx | | | |
| To Van expenses | | Xx | | | |
| To Trade Expenses | | Xx | | | |
| **Maintenance and Financial charges** | | | | | |
| To Interest on capital | | Xx | | | |
| To interest | | Xx | | | |
| To Discount allowed | | Xx | | | |
| To Repairs | | Xx | | | |
| To Loss on sale of assets | | Xx | | | |
| To Depreciation on assets | | Xx | | | |
| To Bad debts | | Xx | | | |
| To Reserve for Bad Debts | | Xx | | | |
| To Discount on | | Xx | | | |
| Debtors | | Xx | | | |
| To Net Profit | | Xx | | | |
| | | xxxx | | | xxxx |

## Items not be shown in the Profit and Loss Account:

1. Income tax: is a tax on the income of the proprietor, but not the firm. So, it should not be shown in the Profit and Loss account. But it should be deducted from the capital in the Liabilities side of the Balance sheet.

2. Domestic Expenses: Household expenses like, taking material to home, paying club membership subscription from business are drawings. They are also to be deducted from the capital in the liabilities of the balance sheet.
3. Capital Expenses: Expenses incurred to purchase an asset, installation expenses, wages paid for installation are some of the examples, which increase the value of the asset, hence they should not be debited to the Profit and Loss Account.

## IMPORTANCE OF PROFIT & LOSS ACCOUNT:

1. The main" purpose is to' ascertain Net profit / Net Loss of a firm for a specific period.
2. It is useful to establish a relationship between the sales and total indirect expenses through percentages.
3. To analyse the trend in profit earning by preparing a net profit and operating ratios.
4. To compare the actual expenses with the standards already set. Which is useful to analyse the positive and the negative variances.
5. It will make it possible to allocate funds for reserves and other provisions for future contingencies.

**1. Example:** From the following Ledger balance of M/s. Ram & Co. Prepare a Trading and a Profit and Loss Account for the period ended 31-12-2003.

| | |
|---|---|
| Stock 1-1-2003 | 5,000 |
| Purchases | 50,000 |
| Returns outward | 5,000 |
| Sales | 1,00,000 |
| Returns inward | 5,000 |
| Direct Wages | 2,000 |
| Indirect wages | 1,000 |
| Carriage | 500 |
| Carriage outward | 1,000 |
| Distribution expenses | 500 |
| Office Rent | 2,000 |
| Repairs | 1,000 |
| Import Duty | 500 |
| Coal & Gas | 1,500 |
| Office Lighting | 1,000 |
| Closing Stock | 15,000 |

**Solution:**

**Trading Account and Profit & Loss Account of Mr. Ram & Co**

**For the period ended 31-12-2003.**

Dr Cr

| Particulars | Amount Rs | Amount Rs | Particulars | Amount Rs | Amount Rs |
|---|---|---|---|---|---|
| To Opening stock | | 5,000 | By Sales | 1,00,000 | |
| To Purchases | | 50,000 | Less Sales returns | 5,000 | 95,000 |
| Less: Returns | 5,000 | 45,000 | | | |
| To Carriage | | 500 | By Closing stock | | 15,000 |
| To Direct Wages | | 2,000 | | | |
| To Import Duty | | 500 | | | |
| To coal and Gas | | 1,500 | | | |
| To Gross Profit | | | | | |
| (Transfer to P & L a/c) | | 55,500 | | | |
| | | 1,10,000 | | | 1,10,000 |
| To Indirect wages | | 1,000 | By Gross Profit | | 55,500 |
| To Carriage outwards | | 1,000 | | | |
| To Distribution Expenses | | 500 | | | |
| To Office Rent | | 2,000 | | | |
| To Repairs | | 1,000 | | | |
| To Office Lighting | | 1,000 | | | |
| To Net Profit | | | | | |
| (Transfer to Capital A/c) | | 49,000 | | | |
| | | **55,500** | | | **55,500** |

## BALANCE SHEET:

The preparation of Balance Sheet is the third and final stage of final accounts. **Balance Sheet is a statement prepared on a particular date to show the financial position of the firm with all assets and liabilities of the firm.** The Trading A/c and Profit & Loss Account are prepared for a period of time where as the Balance Sheet is prepared on a particular date.

The excess of assets over the third party liabilities is called 'Capital'. The balances of the Real accounts and personal accounts appearing in Trial balance are grouped as assets or liabilities depending on their nature of balance. Which are arranged in a systematic manner i.e. all the assets on the right side and all the liabilities on the left side of the balance sheet after making all the adjustments like depreciation, provision for bad debts etc.,

## Characteristics of Balance Sheet:

1. Balance sheet is prepared on a particular date. So, the financial information is restricted to the particular date.
2. It is a statement but not an account. Hence, the Dr and Cr should not be used
3. It is aimed at.to reveal the true financial position of the firm on a particular date.

## Classification of Assets and Liabilities:

**Assets can be divided into three types:**

1. Fixed Assets
2. Current Assets
3. Fictitious or Intangible Assets

1. **Fixed Assets:** Fixed assets are permanent assets. They are long lasting and useful to the production, re-use and increase the earning capacity of the business.

   Ex: land, Buildings, plant, machinery, vehicles, furniture etc.,

2. **Current Assets:** Cash and other short-term assets or circulating assets like debtors, stock, bills receivable which can easily be converted into cash are called current assets.

   Ex: Prepaid expenses, accrued incomes

3. **Fictitious Assets:** These are type of peculiar assets whose existence is invisible but whose benefit is enjoyed.

   Ex. Good will, copyrights, patents.

**Like wise Liabilities are classified into three types:**

1. Fixed liabilities
2. Current liabilities
3. Contingent liabilities

1. **Fixed liabilities:** Fixed or long term liabilities are the loans payable after a reasonable long-term duration say 5 to 10 years. Ex. Debentures, long term loans, Mortgage loans.
2. **Current liabilities:** Current liabilities are the repayment obligations payable from one year to three years. Sundry creditors, Bills payable, Bank loan etc., Liquid liabilities which are to be paid

at very short notice can be included in this category. Ex. Outstanding expenses, income received in advance, bank over draft etc.,

3. **Contingent liabilities:** are the liabilities, which may arise in future depending on happening of an uncertain event. Ex. Damages payable but still under dispute, bills discounted but likely to be dishonoured.

**Proforma of Balance Sheet of Sri ................. As on .................**

**( Under Rigidity Preference Order)**

| Liabilities | Rs. | Rs. | Assets | Rs. | Rs. |
|---|---|---|---|---|---|
| Capital | Xx | | Intangible Assets | | |
| Add Addnl. Capital | Xx | | Goodwill, Copy right, | | xxx |
| Add Interest on capital | | | patents, trade marks | | |
| Add Net Profit | Xx | | Fixed Assets: | | |
| Less drawings | Xx | | Land and buildings | | xxx |
| " Interest on drawings | xx | | Plant and Machinery | | xxx |
| " Net Loss | xx | | Leasehold property | | xxx |
| " Income Tax | xx | xxx | Loose Tools | | xxx |
| Long Term Debits | | xxx | Furniture. & Fittings | | xxx |
| Short Term Debits | | xxx | | | |
| Current Liabilities: | | | Current Assets: | | |
| Creditors | | xxx | Investments | | xxx |
| Bills Payable | | xxx | Debtors | | xxx |
| Bank Overdraft | | xxx | Bills receivable | | xxx |
| Outstanding Expenses | | xxx | Closing stock | | xxx |
| Income received in | | xxx | Cash at Bank | | xxx |
| advance | | | Cash in Hand | | xxx |
| | | | Prepaid Expenses | | xxx |
| | | | Accrued Incomes | | xxx |
| | | xxxx | | | xxxx |

**2. Proforma of Balance Sheet of Sri.. .................. As on ..........**
**(Under Liquidity Preference Order)**

| Liabilities | Rs. | Rs. | Assets | Rs. | Rs. |
|---|---|---|---|---|---|
| Current Liabilities: | . | | Current Assets: | | |
| Outstanding Expenses | | Xxx | Prepaid Expenses | | xxx |
| Income received in | | Xxx | Accrued Incomes | | xxx |
| advance Bills Payable | | Xxx | Cash at Bank | | xxx |
| Bank Overdraft | | xxx | Cash in Hand | | xxx |
| Creditors | | xxx | Bills receivable | | xxx |
| | | | Closing stock | | xxx |
| Loans | | | Investments | | xxx |
| Long Term Debits | | xxx | Debtors | | xxx |
| Short Term Debits | | xxx | | | |
| | | | Fixed Assets: | | |
| Capital | xxx | | Land and buildings | | xxx |
| Add Addnl. Capital | xx | | Plant and Machinery | | xxx |
| " Interest on capital | xx | | Leasehold property | | xxx |
| " Net Profit | xx | | Loose Tools | | xxx |
| | xxx | | Furniture & Fittings | | xxx |
| Less drawings | xx | | Intangible Assets | | |
| " Interest on drawings | xx | | Patents | | xxx |
| " Net Loss | xx | | Trade marks | | xxx |
| " Income Tax | xx | xxx | Copy right | | xxx |
| | | | Goodwill | | xxx |
| | | xxxx | | | xxxx |

## FINAL ACCOUNTS - ADJUSTMENTS:

The final Accounts are prepared with a view to assess the Profit / loss of the business transactions and to know the financial position. The results revealed by the final accounts are reliable and accurate only when all the transactions are brought into the purview of the final accounts. But sometimes, some transactions pertaining to certain *incomesl* expenses may not enter into their respective accounts due to some reason or the other.

**For example:** Salaries of December 2001 will be paid on 1-1-2002. These, outstanding salaries are to be added to the existing balance of the salaries account. Otherwise the net profit will be shown at a higher level, which is not a true profit. Similarly, it the 'salaries outstanding' for December was not considered while preparing the balance sheet, the financial position shown by the Balance Sheet is not true and real. Hence, all these transactions are to be considered in the preparation process of the final accounts.

The adjustments are those posted in an account to show the correct balance for the accounting year. The items that were not included in the respective accounts can be included with the adjustment entry. When the adjustments relating to incomes and expenses are taken up, the item will first appear in the Trading Account or Profit and Loss Account at one time and in the Balance sheet at the second time.

The common Adjustment items and their relevant entries to be shown in Trading Ale, Profit & Loss Ale and Balance sheet

| | Adjustment | Trading and Profit & Loss A/c | Balance Sheet |
|---|---|---|---|
| 1. | Outstanding Expenses on the Debit side | Add to the respective expenses | Show on the Liabilities side |
| 2. | Prepaid expenses or Unexpired Expenses | Deduct from respective expenses on the Debit side | Show on the Assets side |
| 3. | Accrued Income | Add to the respective income on the Credit side | Show on the Assets side |
| 4. | Income received in advance | Deduct from the respective | Show on the Liabilities side income on the credit side |
| 5. | Depreciation | Show on the Debit side of P/L A/c | Deduct from the respective item asset on the Assets side |
| 6. | Bad Debts | **Add** to the Bad debts given in Trial Balance and show on the Debit side of P/L A/c. | Deduct from the Debtors on the Assets side |
| 7. | Bad Debts Reserve | | |
| a) | When it is given in the adjustment | Show on the Debit side of P/L A/c | Deduct from the Debtors on the Assets side |
| b) | When Bad debts Reserve is given both in Trial Balance and adjustment | | |
| i) | To increase the old Reserve | When the new reserve is more than old reserve the difference should be debited to P/L A/c | Deduct the new reserve from the Debtors on the Assets side |
| ii) | To reduce the old Reserve | When the new reserve is less **than** old reserve the difference should be **credited** to P/L A/c | Deduct the new reserve from the Debtors on the Assets side |

| | | | |
|---|---|---|---|
| c) | When Bad debts reserve is given only in Trial Balance | No need to show in any alc | Deduct the reserve from debtors on assets side |
| 8. | Discount on debtors | Show on the debit side of P/L a/c show on the assets side | Deduct from debtors and |
| 9. | Discount on creditors | Show on the credit side of P/L a/c show on the liabilities side | Deduct from creditors and |
| 10. | Interest on capital | Show on the debit side of P/L a/c on the liabilities side | Add to the capital and show |
| 11. | Interest on Drawings | Show on the credit side of P/L a/c show on the liabilities side | Deduct from the capital and |
| 12. | Interest on loan | Show on the debit side of P/L a/c | Show on the liabilities side |
| 13. | Interest on investments | Show on the credit side of P/L a/c | Show on the assets side |
| 14. | Closing Stock a/c | Show on the credit side of trading | Show on the assets side |

**Illustration:** From the following trial balance prepare the Final accounts of Mrs. Laxmi as on 31-3-2003.

**Trial Balance of Mrs. Laxmi as on 31-3-2003.**

| Particulars | | Amount Rs. | Particulars | | Amount Rs. |
|---|---|---|---|---|---|
| Cash in hand | | 800 | Sales | | 69,400 |
| Goodwill | | 40,000 | 10 % loan 1-1-2003 | | 51,000 |
| Purchases | | 68,000 | reserve for Bad Debts | | 500 |
| Cash at bank | | 1,200 | Creditors | | 8,000 |
| Direct wages | | 2,000 | Capital | | 90,000 |
| Opening stock | | 35,000 | Bills payable | | 2,000 |
| Interest on loan | | 2,500 | | | |
| Insurance | | 900 | | | |
| Carriage on sales | | 900 | | | |
| Carriage on purchases | | 400 | | | |
| Commission | | 500 | | | |
| Fittings | | 5,000 | | | |
| Bad debts | | 200 | | | |
| Buildings | | 25,000 | | | |
| Plant and Machinery | | 10,000 | | | |
| Postage & Telegram | | 500 | | | |
| Debtors | | 25,000 | | | |
| Salaries | | 3,000 | | | |
| | | 2,20,900 | | | 2,20,900 |

**Adjustments:**

1. Stock as on 31-3-2003 Rs. 75,000
2. Provide 5% for doubtful debts
3. Provide depreciation 10% on fittings, 10% on Plant and Machinery and 5% on buildings
4. Mrs. Laxmi has taken Rs. 500 worth of stock for her domestic use
5. Stock worth Rs. 10,000 was destroyed in a fire accident for which the insurance company agreed to reimburse Rs. 2,000

**Solution:**

Trading Account and Profit & Loss Account of Mrs. Laxmi For the period ended 31-03-2003.

Dr Cr

| Particulars | Amount Rs | Amount Rs | Particulars | Amount Rs | Amount Rs |
|---|---|---|---|---|---|
| To Opening stock | | 35,000 | By Sales | | 69,400 |
| To Purchases | 68,000 | | By Closing stock | | 75,000 |
| Less: Stock taken for personal use | 500 | 67,500 | By loss of stock in Fire accident | | 10,000 |
| To Carriage on purchases | | 400 | | | |
| To Direct Wages | | 2,000 | | | |
| To Gross Profit (Transfer to P & L a/c) | | 49,500 | | | |
| | 1,54,400 | | | 1,54,400 | |
| To Salaries | | 3,000 | By Gross Profit (Transferred from Trading a/c) | | 49,500 |
| To Insurance | | 900 | | | |
| To Postage & Telegrams | | 500 | | | |
| To Carriage on sales | | 900 | | | |
| To Commission | | 500 | | | |
| To Interest on loan | 2,500 | | | | |
| Add Outstanding Interest on loan | 2,600 | 5,100 | | | |
| To Loss of stock in fire accident (10,000 - 2,000) | | 8,000 | | | |
| To Bad Debts | | 200 | | | |

| | | | | | |
|---|---|---|---|---|---|
| To Reserve bad debts | 1,250 | | | | |
| Less Old fund | 500 | 750 | | | |
| To Depreciation | | 500 | | | |
| On Fittings | | | | | |
| (5000 x10/100) | | | | | |
| On Plant | | 1,000 | | | |
| (10,000 x10/100) | | | | | |
| On Buildings | | 1,250 | | | |
| (25,000 x5/1 00) | | | | | |
| To Net Profit | | 26,900 | | | |
| (Transfer to Capital A/c) | | | | | |
| | | 49,500 | | | 49,500 |

**Proforma of Balance Sheet ofSmt Laxmi As on 31-03-2003**

**(Under Rif!iditv Preference Order)**

| Liabilities | Rs. | Rs. | Assets | Rs. | Rs. |
|---|---|---|---|---|---|
| Capital | 90,000 | | Goodwill | | 40,000 |
| Add Net Profit | 26,900 | | Buildings | 25,000 | |
| | 1,16,900 | | Less Depreciation | 1,250 | 23,750 |
| Less Drawings | 500 | 1,16,400 | | | |
| | | | Plant and Machinery | 10,000 | |
| 10 % Loan | 51,000 | | Less Depreciation | 1,000 | 9,000 |
| Add Outstanding interest | 2,600 | | Fittings | 5,000 | |
| on loan | | 53,600 | Less Depreciation | 500 | 4,500 |
| Creditors | | 8,000 | Debtors | 25,000 | |
| Bills Payable | | 2,000 | Less Provision for Bad | 1,250 | |
| | | | debts | | 23,750 |
| | | | Closing stock | | 75,000 |
| | | | Cash at Bank | | 1,200 |
| | | | Cash in Hand | | 800 |
| | | | Claim from insurance | | 2,000 |
| | | | company | | |
| | | 1,80,000 | | | 1,80,000 |

**Note:**

1. **10 % interest on loan:** the business has to pay interest on the loan taken on 1-1-2003 as per the trial balance. Total interest payable for the year 2003 is: 51,000 x 10/100 = Rs. 5,100

   But, the trial balance shows that an amount of Rs. 2,500 was paid as interest on loan. The outstanding interest on loan is Rs. 5,100 - 2,500 = Rs. 2,600.

2. **Reserve for Bad debts:** Reserve for Bad Debts (New reserve) on debtors at 5% 25,000 x 5/ 100= 1,250 reserve for bad debts given in Trial balance (old reserve) = Rs. 500. New Reserve Rs. 1,250 is more than Rs. 500 old reserve. Hence, excess of Rs. 750 should be debited to PIL ale. In the Balance Sheet, asset side. new reserve Rs. 1,250 has to be deducted from debtors.

3. **Loss of stock in the fire accident:** The impact of the stock lost in fire accident should not be on Trading ale, the Stock lost is fire accident Rs. 10,000 should be credited to Trading ale. However, as the insurance company accepted a claim ofRs. 2,000, the net loss to the business is (Rs. 10,000-2,000) Rs. 8,000. So, Rs. 8,000 is to be debited on the PIL ale. The insurance company will pay Rs. 2,000, this is to shown as an asset in the Balance Sheet.

4. Goods for personal use: Purchases are to be reduced to the extent of goods used for personal, should be de4cuted from the Capital as drawings in the Balance Sheet on the liabilities side.

**IIlustration.2:** Prepare Trading, Profit and Loss account and Balance Sheet as on 31-12-2002 from the following Trial Balance ofNatasha.

**Trial Balance as 31-12-2002**

| | Debit (Rs) | | Credit (Rs) |
|---|---|---|---|
| Cash on hand | 3,000 | Capital | 50,000 |
| Purchases | 40,000 | Sales | 72,000 |
| Returns | 500 | Returns | 300 |
| Wages | 5,000 | Creditors | 4,000 |
| Salaries | 3,200 | Bills payable | 3,700 |
| Stock 1-1-2002 | 22,000 | | |
| Carriage inwards | 800 | | |
| Carriage outwards | 1,200 | | |
| Buildings | 25,000 | | |
| Machinery | 15,000 | | |
| Insurance | 700 | | |
| Debtors | 8,000 | | |
| Bills Receivable | 5,600 | | |
| | 1,30,000 | | 1,30,000 |

Make the following adjustments:

1. Closing stock Rs. 26,000
2. Outstanding salaries Rs. 550
3. Write off bad debts Rs. 600 and provision @ 5% has to be made on debtors
4. Machinery and Buildings are to be depreciated by 700 and 1,200 respectively.
5. Prepaid insurance Rs. 200

Ans: **Trading Account for the year ending 31-12-2002**

Dr Cr

| Particulars | Amount Rs | Amount Rs | Particulars | Amount Rs | Amount Rs |
|---|---|---|---|---|---|
| To Opening stock | | 22,000 | By Sales | 72,000 | |
| To Purchases | 40,000 | | Less Returns | 500 | 71,500 |
| Less: Returns | 300 | 39,700 | By Closing stock | | 26,000 |
| To Carriage inwards | | 800 | | | |
| To Wages | | 5,000 | | | |
| To Gross Profit (Transfer to P & L a/c) | | 30,000 | | | |
| | | 97,500 | | | 97,500 |

**Profit & Loss Account for the year ending 31-12-2002**

| | | | | | |
|---|---|---|---|---|---|
| To Salaries | 3,200 | | By Gross Profit (Transferred from Trading a/c) | | 30,000 |
| Add Outstanding | 550 | 3,750 | | | |
| To Carriage outwards | | 1,200 | | | |
| To Insurance | 700 | | | | |
| Less Prepaid | 200 | 500 | | | |
| To Bad debts | | 600 | | | |
| To Provision for Bad debts | | 370 | | | |
| To Depreciation on Machinery | | 700 | | | |
| To Depreciation on Building | | 1,200 | | | |
| To Net Profit (Transfer to Capital A/c) | | 21,680 | | | |
| | | 30,000 | | | 30,000 |

**Balance Sheet of Natash a as on 31-12-2002**

| Liabilities | Rs. | Rs. | Assets | Rs. | Rs. |
|---|---|---|---|---|---|
| Capital | 50,000 | | Buildings | 25,000 | |
| Add Net Profit | 21,680 | 71,680 | Less Depreciation | 1,200 | 23,800 |
| Creditors | | 4,000 | Machinery | 15,000 | |
| Bills Payable | | 3,700 | Less Depreciation | 700 | 14,300 |
| Outstanding Salaries | | 550 | Debtors | 8,000 | |
| | | | Less Bad Debts | 600 | |
| | | | | 7,400 | |
| | | | Less Provision for Bad debts | 370 | 7,030 |
| | | | Bills Receivable | | 5,600 |
| | | | Prepaid Insurance | | 200 |
| | | | Closing stock | | 26,000 |
| | | | Cash in Hand | | 3,000 |
| | | 79,930 | | | 79,930 |

**Working Notes:**

Provision for bad debts:

Debtors as per Trial Balance Rs. 8,000

Less Bad debts Rs. 600

Rs. 7,400

Reserve for Bad debts = 7400 x 5 /100 = 370

## Model Questions:

1. What is a Balance Sheet? How do you prepare a Balance sheet?
2. What is the importance of adjustments in the preparation of Final Accounts?

3. From the followil)g information prepare Final accounts of Mr. Pavan Kumar for the year 31-12-2002.

| Particulars | Debit Rs | Credit Rs. |
|---|---|---|
| Capital | | 80,000 |
| Drawings | 10,000 | |
| Furniture | 5,200 | |
| Bank Overdraft | | 8,400 |
| Taxes and Insurance | 4,000 | |
| Creditors | | 17,600 |
| Buildings | 40,000 | |
| Stock | 44,000 | |
| Debtors | 36,000 | |
| Rent | 2,000 | |
| Purchases | 2,20,000 | |
| Sales | | 3,00,000 |
| Returns inward | 4,000 | |
| General Expenses | 8,000 | |
| Salaries | 18,000 | |
| Commission | 4,400 | |
| Carriage on purchases | 3,600 | |
| Bad Debts | 1,600 | |
| Discount | 3,200 | 4,000 |
| Bills Receivable | 10,000 | |
| Bills Payable | | 4,000 |
| | 4,14,000 | 4,14,000 |

**Adjustments:**

1. Stock on 31-12-2002 Rs. 42,000
2. Provide depreciation of Rs. 2,000 on building and 5 % on furniture
3. Provide 4% for provision for doubtful debts
4. Charge interest on capital @ 5% per annum
5. Outstanding wages Rs. 300.

***