Pondicherry University

Directorate of Distance Education

MBA 1st Semester

Accounting for Manager

Unit -1 - Financial Accounting

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Bookkeeping and Accounting

Bookkeeping is the systematic recording and is the part of accounting that records transactions and business events in the form of journal entries in the accounting system.

Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, the transactions and events which are, in part at least of a financial character and interpreting the results thereof."

Bookkeeping and accounting are often heard being used interchangeably, however, accounting is the overall practice of managing finances of a business or individual, while bookkeeping refers more specifically to the tasks and practices involved in recording the financial activities.

Bookkeeping System

There are two types of bookkeeping i.e. Single entry and Double entry system of bookkeeping.

Single Entry system of Bookkeeping

- Under this system both debit and credit aspects of transaction are not recorded.
- Only Personal accounts & cash book are opened.
- Under this system balance sheet is not prepared.
- It is improper system of bookkeeping.

Double Entry system of Bookkeeping

The double entry system of bookkeeping is based on the fact that every transaction has two aspects, which therefore affects two ledger accounts. Every transaction involves a debit* entry in one account and a credit** entry in another account. Each and Every debit aspect has its equal and corresponding credit aspect and vise versa.

- Based on principle of duel aspect of each transaction.
- For correct presentation both of them should be recorded.
- Requires maintenance of records of assets, liabilities, revenues and expenditure.
- Impact of each transaction can be seen or measured.
- Total assets are equal to total equities.

Accountants often use **T-accounts** to visualize the debit and credit effects on the accounts' balances.

*To debit an account means to enter an amount on the left side of the account.

**To credit an account means to enter an amount on the right side of an account.

Classification of Accounts

Concept of Debit & Credit (Golden Rules)

PERSONAL ACCOUNT

Debit the Receiver
Credit the Giver

IMPERSONAL ACCOUNT

REAL ACCOUNT

Debit what comes in
Credit what goes out

NOMINAL ACCOUNT

Debit all Expenses and Losses
Credit all Incomes and Gains

- **Personal Account**: Personal accounts are accounts relating to persons or organisations with whom the business has transactions.

E.g Customer, Supplier, Money lenders etc.

- **Real Accounts**: Real accounts refer to accounts in which property and possession are recorded.

E.g Land, Building, Plant & Machinery, Vehicle Cash, Bank etc.

- **Nominal Accounts**: Nominal accounts are revenue, expenses, gains, and losses.

E.g. Wages, Salary, Discount etc .

Accounting Concepts and Conventions

These generally accepted accounting principles lay down accepted assumptions and guidelines and are commonly referred to as accounting concepts.

Accounting Concepts:

1. Business entity
2. Money Measurement
3. Going Concern
4. Cost concept
5. Objectivity
6. Accruals/matching
7. Realization
8. Periodicity
9. Dual aspect

Accounting Conventions:

I. Materiality
II. Accounting for Conservatism
III. Consistency
IV. Accounting for full Disclosure

Accounting Concepts

1. **Business Entity**: The business and its owner(s) are two separate existence entity. Any private and personal incomes and expenses of the owner(s) should not be treated as the incomes and expenses of the business. ***Economic Entity*** - company keeps its activity separate from its owners and other businesses.

   - **Example:** Insurance premiums for the owner's house should be excluded from the expense of the business.

2. **Money Measurement**: All transactions of the business are recorded in terms of money and it provides a common unit of measurement.

   - **Example:** Market conditions, technological changes and the efficiency of management would not be disclosed in the accounts.

3. **Going Concern Concept:** The business will continue in operational existence for the foreseeable future. Financial statements should be prepared on a going concern basis unless management either intends to liquidate the enterprise or to cease trading, or has no realistic alternative but to do so.

   - **Example**: Possible losses form the closure of business will not be anticipated in the accounts.

Accounting Concepts

4. **Cost Concept**: Assets should be shown on the Balance sheet at the cost of purchase instead of current value.

   - **Example**: The cost of fixed assets is recorded at the date of acquisition cost. The acquisition cost includes all expenditure made to prepare the asset for its intended use. It included the invoice price of the assets, freight charges, insurance or installation costs.

5. **Objectivity:** The accounting information should be free from bias and capable of independent verification. The information should be based upon verifiable evidence such as invoices or contracts.

   - **Example:** The recognition of revenue should be based on verifiable evidence such as the delivery of goods or the issue of invoices.

6. **Accruals/Matching:** Revenues are recognized when they are earned, but not when cash is received. Expenses are recognized as they are incurred, but not when cash is paid. The net income for the period is determined by subtracting expenses incurred from revenues earned. ***Matching*** - efforts (expenses) should be matched with accomplishment (revenues) whenever it is reasonable and practicable to do so.

   - **Example**: Expenses incurred but not yet paid in current period should be treated as accrual/accrued expenses under current liabilities.

Accounting Concepts

7. **The Realization concept**: This concept holds to the view that profit can only be taken into account when realization has occurred. Generally, sales revenue arising from the sale of goods is recognized when the goods are delivered to the customers. ***Revenue Recognition*** - generally occurs (1)when realized or realizable and (2) when earned.

   - Example: Profit is earned when goods or services are provided to customers. Thus it is incorrect to record profit when order is received, or when the customer pays for the goods.

8. **Periodicity:** The life of an entity is divided into short economic time periods on which reporting statements are fashioned. ***Periodicity*** - company can divide its economic activities into time periods.

   - **Example:** Based on this assumption assets are classified into current and fixed Assets**.** Current assets have benefits within **t**welve months period and fixed assets have benefits beyond 12 months.

9. **Dual Aspect**: Transaction has two fold effect: Debit &Credit. Each and every debit aspect has equal and corresponding credit aspect and vise versa. ***Accounting Equation***: Assets = Capital + Liability

Accounting Conventions

I. **Materiality:** Financial statement should separately disclose significant items for they would influence decisions of users. Accounting does not serve a useful purpose if the effort of recording a transaction in a certain way is not worthwhile. In other words do not waste your time in the elaborate recording of trivial items.

e.g. A stock of stationery worth Rs.10 should be treated as an expense when it was bought.

II. **Accounting for Conservatism**: The accountant should always be on the side of safety. The prudence concept means that normally he will take the figure which will understate rather than overstate the profit. Provision is made for all known liabilities. Conservatism means anticipate the expected future losses

e.g. Provision for doubtful debts should be deducted from debtors in balance sheet.

Accounting Conventions

III. **Consistency:** When a firm has once fixed a method for the accounting treatment of an item, it will enter all similar items that follow in exactly the same way. Frequent changes in the accounting methods would lead to misleading profits calculated from the accounting records.

e.g. Depreciation method of certain fixed assets once adopted should be used in the following years.

IV. **Disclosure:** The financial statements of a firm must include all information necessary for the formation of valid decisions by the users. Any information that might be relevant to an investor or creditor should be disclosed, either in the body of the financial statements or in the notes attached thereto.

e.g. Method of Issue of stock (FIFO/LIFO/Weighted average), Method of Depreciation (SLM/WDV) Method of Valuation of Goodwill etc..

JOURNAL

Journal is a primary set of books in which daily business transactions are to be recorded.

According to Cropper "A journal is a book employ to classify or sort out transactions in a form convenient for their subsequent entry in the ledger".

NECESSITY OF JOURNAL

- Convenient recording of transaction
- Maintaining and preserving the identity of transaction
- Ascertaining the true nature of transaction
- Maintaining permanent record of information

FUNCTIONS OF JOURNAL

- To analyze each transaction into debit and credit so as to enable their posting in the ledger
- To arrange transaction, chronological i.e in order of date.

JOURNAL

ADVANTAGES OF JOURNAL

- Show all necessary information relating to a transaction
- Provide the explanation of the transaction
- Date wise record of all the transaction can be obtained
- Help in locating and preventing the errors

LIMITATIONS OF JOURNAL

- Recording all the transaction in a journal requires:
  1) writing down name of account involved
  2) individual posting of each account debited and credited
- Does not provide information on prompt basis
- Does not facilitate the internal check system since the journal can be handled only by one person
- Journal become bulky and voluminous

Journal Problems

Problem 1:

- On ***April 01, 2016*** Mr.Anees started business with Rs. 100,000 and other transactions for the month are:
- ***April 02.*** Purchase Furniture for Cash Rs. 7,000.
- ***April 08.*** Purchase Goods for Cash Rs. 2,000 and for Credit Rs. 1,000 from Khalid Retail Store.
- ***April 14.*** Sold Goods to Khan Brothers Rs. 12,000 and Cash Sales Rs. 5,000.
- ***April 18.*** Owner withdrew of worth Rs. 2,000 for personal use.
- ***April 22.*** Paid Khalid Retail Store Rs. 500.
- ***April 26.*** Received Rs. 10,000 from Khan Brothers.
- ***April 30.*** Paid Salaries Expense Rs. 2,000

Journal solution for Problem 1.

General Journal

Date		Account Title and Explanations	Ref	Amount (Rs) Debit	Credit
2016					
April	*1*	Cash		100,000	
		Owner's Equity_ Anees			100,000
		(Started business with cash)			
	2	Furniture		7,000	
		Cash			7,000
		(Purchase furniture for cash)			
	8	Purchases		3,000	
		Cash			2,000
		Account Payable_ Khalid Retail Store			1,000
		(Purchase good on cash and credit)			
	14	Cash		5,000	
		Account Receivables_ Khan Brothers		12,000	
		Sales			17,000
		(Cash and Credit Sales recorded)			
	18	Drawing		2,000	
		Cash			2,000
		(Owner withdrew for personal use)			
	22	Account Payable_ Khalid Retail Store		500	
		Cash			500
		(Paid credit to Khalid Retail Store)			
	26	Cash		10,000	
		Account Receivable_ Khan Brothers			10,000
		(Receive cash from credit customer)			
	30	Salaries Expense		2,000	
		Cash			5,000
		(Paid expenses)			
		Total		**Rs. 141,500**	**Rs. 141,500**

Journal problem 2

Prepare general journal entries for the following transactions of a business called Pose for Pics in 2016:

- ***Aug. 1:*** Hashim Khan, the owner, invested Rs. 57,500 cash and Rs. 32,500 of photography equipment in the business.
- ***Aug 04:*** Paid Rs. 3,000 cash for an insurance policy covering the next 24 months.
- ***Aug 07:*** Services are performed and clients are billed for Rs. 10,000.
- ***Aug 13:*** Purchased office supplies for Rs. 1,400. Cash paid Rs. 400 and remaining outstanding.
- ***Aug 20:*** Received Rs. 2,000 cash in photography fees earned previously.
- ***Aug 24:*** The client immediately pays Rs. 15,000 for services to be performed at a later date.
- ***Aug 29:*** The business acquires photography equipment. The purchase price is Rs. 100,000, pays Rs. 25,000 cash and signs a note for the balance.

General Journal

Date		Account Title and Explanations	Ref	Amount (Rs) Debit	Amount (Rs) Credit
2016					
Aug.	*1*	Cash		57,500	
		Photography Equipment		32,500	
		Owner's Equity_ Hashim Khan			81,000
		(Started business with cash and equipments)			
	4	Prepaid Insurance		3,000	
		Cash			3,000
		(Purchase two year insurance policy)			
	7	Account Receivable		10,000	
		Photographic Services			10,000
		(Revenue earned but not received)			
	13	Office Supplies		1,400	
		Cash			400
		Account Payable			1,000
		(Cash and Credit purchases recorded)			
	20	Cash		2,000	
		Account Receivable			2,000
		(Account receivables are converted into cash)			
	24	Cash		15,000	
		Unearned Photographic Services			15,000
		(Liability created)			
	29	Photography Equipment		100,000	
		Cash			25,000
		Note Payable			75,000
		(Purchase asset by cash and credit)			
		Total		**Rs. 221,400**	**Rs. 221,400**

Journal Problem 3

Problem 3:

- On ***March 2017,*** Farhan Rahim, starts wholesaling business. Following transactions as follows:
- ***1.*** He started business with capital of Rs. 15,000 and Land worth Rs. 10,000.
- ***8.*** Bought goods from Bilal and Friends Rs. 1,000 and by cash from XYZ Co. Rs 2,000.
- ***13.*** Sold goods to Rehman & sons Rs. 1,500 and sale by cash Rs. 5,000.
- ***17.*** Gave away charity of cash Rs. 50 and merchandising worth Rs. 30.
- ***21.*** Paid Bilal and Friends cash Rs. 975; discount received Rs. 25.
- ***28.*** Received cash from Rehman & Sons Rs. 1,450; allowed him discount of Rs. 50.

General Journal

Date		Account Title and Explanations	Ref	Amount (Rs.) Debit	Credit
2017					
March	*1*	Cash		15,000	
		Land		10,000	
		Owner's Equity_ Farhan Rahim			25,000
		(Owner started business by assets)			
	8	Purchases		3,000	
		Account Payable_ Bilal and Friends			1,000
		Cash			2,000
		(Purchases by cash and by credit)			
	13	Account Receivable_ Rehman & sons		1,500	
		Cash		5,000	
		Sales			6,500
		(Purchases by cash and Credit from Ahmed)			
	17	Charity		80	
		Cash			50
		Purchases			30
		(Charity by cash and by goods)			
	21	Account Payable_ Bilal and Friends		1,000	
		Cash			975
		Discount			25
		(Discount received and liability payoff)			
	28	Cash		1,450	
		Discount		50	
		Account Receivable_ Rehman & sons			1,500
		(Account receivable realized and discount allowed)			
		Total		**Rs. 37,080**	**Rs. 37,080**

Ledger Accounts

General ledger accounts are used to post the economic activities. Posting is the name of transferring accounts from the book of prime entry to related ledger accounts. When all the transactions for a given period have been **Journalized**, the next step is to classify them according to the **account** affected.

Ledger is a **Book of Account** that keeps separate record for each account. Ledger is the **book of secondary entry**. An account in its simplest form is a **T-shape.** It should be noted that journal contains a chronological record while Ledger contains a classified record of all economic activities.

Account #				Title of Account			Page #
Date	*Description*	*Ref*	*Amount*	*Date*	*Description*	*Ref*	*Amount*
	Total				**Total**		

General Ledger Posting and Balancing Process

The process of posting and balancing involves the following Steps:

- The debit part of journal entry is recorded on the debit side of the relevant account by credit account name (Source).
- The credit part of **Journal Entry** is recorded on the credit side of the relevant account by debit account name (Source).
- In the reference column of the general journal the code or page number of ledger account are noted.
- In the reference column of the ledger account the page number of the journal is noted.
- Find the total of debit side and find the total of credit side. Put bigger value both sides in Total.
- Calculate the difference between the two sides. This is the Balance (The balancing figure between the two sides).
- Write the balance on the smaller side with key words "Balance c/d". However, the balance will be known by the larger side i.e. if the debit side is greater than the credit side, the balance will be known as debit balance and vice versa.
- Bring down the debit balance on the debit side writing the words in Description column "Balance b/d". Similarly, bring down the credit balance on the credit side be writing the words in the Description column "Balance b/d".

General Journal　　Page # 177

Date		Account Title and Explanations	Ref	Amount (Rs) Debit	Credit
2015					
July	1	Cash		100,000	
		Owner's equity			100,000
	5	Purchases		15,000	
		Cash			15,000
	8	Cash		25,000	
		Sales			25,000
	12	Account Receivable_ Raheel Store		13,000	
		Sales			13,000
	16	Drawing		4,000	
		Cash			4,000
	19	Cash		2,000	
		Commission			2,000
	21	Machine		10,000	
		Account Payable_ Ali sons			10,000
	23	Cash		10,000	
		Account Receivable_ Raheel Store			10,000
	27	Salary		1,000	
		Cash			1,000
	29	Account Payable_ Ali Sons		8,000	
		Cash			8,000
		Total		Rs. 188,000	Rs. 188,000

Account # 102　　Cash Account　　Page # 880

Date	Description	Ref	Amount	Date	Description	Ref	Amount
July 1	Owner's Equity		100,000	July 5	Purchases		15,000
8	Sales		25,000	16	Drawing		4,000
19	Commission		2,000	27	Salary		1,000
23	A/R_ Raheel Store		10,000	29	A/P_ Ali Sons		8,000
					Balance c/d		*109,000*
	Total		137,000		Total		137,000
Aug 1	*Balance b/d*		*109,000*				

Problem No.2

Mr. Ramu has the following transactions in the month of July.

Record them into the journal and show postings in the ledger and balance the accounts.

July 1st	Ramu started business with a capital of 75,000
1st	Purchased goods from Manu on credit 25,000
2nd	Sold goods to Sonu 20,000
3rd	Purchased goods from Meenu 15,000
4th	Sold goods to Tanu for cash 16,000
5th	Goods retuned to Manu 2,000
6th	Bought furniture for 15,000
7th	Bought goods from Zenu 12,000
8th	Cash paid to Manu 10,000
9th	Sold goods to Jane 13,500
10th	Goods returned from Sonu 3,000
11th	Cash received from Jane 5,500
12th	Goods taken by Ramu for domestic use 3,000
13th	Returned Goods to Zenu 1,000
14th	Cash received from Sonu 12,000
15th	Bought machinery for 18,000
16th	Sold part of the furniture for 1,000
17th	Cash paid for the purchase of bicycle for Ramu's son 1,500
19th	Cash sales 15,000
20th	Cash purchases 13,500

Cash a/c					
Dr					**Cr**
Date	Particulars	Amount	Date	Particulars	Amount
01/10/_5	To Capital a/c	75,000	06/10/_5	By Furniture a/c	15,000
04/10/_5	To Goods/stock a/c	16,000	08/10/_5	By Manu a/c	10,000
11/10/_5	To Jane a/c	5,500	15/10/_5	By Machinery a/c	18,000
14/10/_5	To Sonu a/c	12,000	17/10/_5	By Drawings a/c	15,000
16/10/_5	To Furniture a/c	1,000	20/10/_5	By Goods/stock a/c	13,500
19/10/_5	To Goods/stock a/c	15,000	30/07/_5	By Balance c/d	53,000
	tl	1,24,500		tl	1,24,500
31/07/_5	To Balance b/d	53,000			

Capital a/c					
DrCr					
Date	Particulars	Amount	Date	Particulars	Amount
30/07/_5	To Balance c/d	75,000	01/10/_5	By Cash a/c	75,000
	tl	75,000		tl	75,000
			31/07/_5	By Balance b/d	75,000

Purchases a/c

Dr					Cr
Date	Particulars	Amount	Date	Particulars	Amount
01/10/_5	To Manu a/c	25,000	02/10/_5	By Sonu a/c	20,000
03/10/_5	To Meenu a/c	15,000	04/10/_5	By Cash a/c	16,000
07/10/_5	To Zenu a/c	12,000	05/10/_5	By Manu a/c	2,000
10/10/_5	To Sonu a/c	3,000	09/10/_5	By Jane a/c	13,500
20/10/_5	To Cash a/c	13,500	12/10/_5	By Drawings a/c	3,000
30/07/_5	To Balance c/d	2,000	13/10/_5	By Zenu a/c	1,000
			19/10/_5	By Cash a/c	15,000
	tl	70,500		tl	70,500
			31/07/_5	By Balance b/d	2,000

Manu a/c

Dr					Cr
Date	Particulars	Amount	Date	Particulars	Amount
05/10/_5	To Goods/stock a/c	2,000	01/10/_5	By Goods/stock a/c	25,000
08/10/_5	To Cash a/c	10,000			
30/07/_5	To Balance c/d	13,000			
	tl	25,000		tl	25,000
			31/07/_5	By Balance b/d	13,000

Sonu a/c

Dr			Cr		
Date	Particulars	Amount	Date	Particulars	Amount
02/10/_5	To Goods/stock a/c	20,000	10/10/_5 14/10/_5 30/07/_5	By Goods/stock a/c By Cash a/c By Balance c/d	3,000 12,000 5,000
	tl	20,000		tl	20,000
31/07/_5	To Balance b/d	5,000			

Meenu a/c

Dr			Cr		
Date	Particulars	Amount	Date	Particulars	Amount
30/07/_5	To Balance c/d	15,000	03/10/_5	By Goods/stock a/c	15,000
	tl	15,000		tl	15,000
			31/07/_5	By Balance b/d	15,000

Furniture a/c

Dr				Cr			
Date	Particulars		Amount	Date	Particulars		Amount
06/10/_5	To Cash a/c		15,000	16/10/_5 30/07/_5	By Cash a/c By Balance c/d		1,000 14,000
	tl		15,000		tl		15,000
31/07/_5	To Balance b/d		14,000				

Trial Balance Problems

Problem 1: Prepare a Trial Balance for Shining Brothers Pvt. Ltd. at March 31st, 2017?

Description	*Amount*	*Description*	*Amount*	*Description*	*Amount*
Bank Loan	Rs. 14,000	Insurance Expense	Rs. 7,300	Equipments	Rs. 40,000
Marketable Security	6,500	Owner's Investments	95,000	Maintenance Exp.	5,000
Bill Payable	1,000	Rent & Rates Expense	400	Miscellaneous Expenses	4,800
Unearned Revenue	3,500	Acc. Dep. _ Equipments	14,000	Accrued Expenses	1,500
Sundry Debtors	12,000	Accrued Revenue	15,000	Dep. Exp. _ Equipments	2,000
Outstanding Salaries	2,500	Machinery	25,000	Unexpired Insurance	8,500
Prepaid Rent	2,000	Drawings	3,500	Vendor's Payables	500

Shining Brothers Pvt. Ltd.

Trial Balance

As on March 31st, 2017

S. No	Description	Ref	Amount (Rs.) Dr.	Cr.
1	Bank Loan			14,000
2	Marketable Security		6,500	
3	Bill Payable			1,000
4	Unearned Revenue			3,500
5	Sundry Debtors		12,000	
6	Outstanding Salaries			2,500
7	Prepaid Rent		2,000	
8	Insurance Expense		7,300	
9	Owner's Investments			95,000
10	Rent & Rates Expense		400	
11	Accumulated Dep. _ Equipments			14,000
12	Accrued Revenue		15,000	
13	Machinery		25,000	
14	Drawings		3,500	
15	Equipments		40,000	
16	Maintenance Exp.		5,000	
17	Miscellaneous Expenses		4,800	
18	Accrued Expenses			1,500
19	Depreciation Exp. _ Equipments		2,000	
20	Unexpired Insurance		8,500	
21	Vendor's Payables			500
Total			**Rs. 132,000**	**Rs. 132,000**

Final Accounts

Popularly, the Trading and Profit & Loss Account and the Balance Sheet are together called the ***final accounts***. The trading and profit & loss account is prepared to show the financial results of a business, may be in the form of profit or loss during an ***accounting period*** or year. Balance sheet is prepared to show the financial position or conditions of business in terms of position of ***assets and liabilities*** of a business as on a particular date.

Trading Account

Trading means buying and selling. The trading account shows the result of buying and selling of goods. End result of trading account is ***gross profit*** or gross loss. Following are format for Trading Account.

Profit and Loss Account

After calculating the gross profit or gross loss the next step is to prepare the profit and loss account. To earn ***net profit*** a trader has to incur many **expenses** apart from those spent for purchases and manufacturing of goods. If such expenses are less than gross profit, the result will be ***net profit***. When total of all these expenses are more than gross profit the result will be net loss.

Balance Sheet

Balance sheet is prepared by taking up all personal accounts and real accounts (assets and properties) together with the net result obtained from profit and loss account. On the left hand side of the statement, the liabilities and capital are shown. On the right hand side, all the assets are shown. Balance sheet is not an account but it is a statement prepared from the ledger balances. Balance sheet is defined as ‘a statement which sets out the assets and liabilities of a business firm and which serves to ascertain the financial position of the same on any particular date’.

Trading Account format

Trading Account
for the year ending 31st March 2003

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		xxx	By Sales	xxx	
To Purchases	xxx		Less : Returns		
Less: Returns			Inward	xxx	xxx
outward	xxx	xxx	By Closing stock		xxx
To Wages		xxx	By Gross Loss c/d		xxx
To Freight		xxx	(transferred to		
To Carriage			P&L A/c)		
Inwards		xxx			
To Clearing charges		xxx			
To Packing charges		xxx			
To Dock dues		xxx			
To Power (factory)		xxx			
To Octroi Duty		xxx			
To Gross Profit c/d		xxx			
(transferred to					
P&L A/c)					
		xxx			xxx

Radhakrishnan, G. Thiru, et. al (2004); Accountancy; Tamilnadu Textbook Corporation.

Profit and Loss Account format

Profit and Loss Account
for the year ended ....

Dr. | Cr.

Particulars	Rs.	Particulars	Rs.
To Trading A/c (Gross Loss)	x x x	By Trading A/c (Gross profit)	x x x
To Salaries	x x x	By Commission earned	x x x
To Rent & rates	x x x	By Rent received	x x x
To Stationeries	x x x	By Interest received	x x x
To Postage expenses	x x x	By Discount received	x x x
To Insurance	x x x	By Net Loss (Transferred to Capital A/c)	x x x
To Repairs	x x x		
To Trading expenses	x x x		
To Office expenses	x x x		
To Interest paid	x x x		
To Bank charges	x x x		
To Sundry expenses	x x x		
To Commission paid	x x x		
To Discount allowed	x x x		
To Advertisement	x x x		
To Carriage outwards	x x x		
To Travelling expenses	x x x		
To Distribution expenses	x x x		
To Repacking charges	x x x		
To Bad debts	x x x		
To Depreciation	x x x		
To Net Profit (transferred to Capital A/c)	x x x		
	x x x		x x x

Radhakrishnan, G. Thiru, et. al (2004); Accountancy; Tamilnadu Textbook Corporation.

Balance Sheet format

Balance Sheet of ....
as on ....

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry creditors		xxx	Cash in hand		xxx
Bills payable		xxx	Cash at bank		xxx
Bank overdraft		xxx	Bills receivable		xxx
Outstanding expenses		xxx	Sundry debtors		xxx
Mortgage loans		xxx	Investments		xxx
Reserve fund		xxx	Closing stock		xxx
Capital	xxx		Prepaid expenses		xxx
Add: Net profit (or)			Furniture & fittings		xxx
Less: Net loss	xxx		Plant & machinery		xxx
	xxx		Land & buildings		xxx
Less: Drawings	xxx		Business premises		xxx
	xxx		Patents & trade marks		xxx
Less: Income tax	xxx		Good will		xxx
		xxx			
		xxx			xxx

Radhakrishnan, G. Thiru, et. al (2004); Accountancy; Tamilnadu Textbook Corporation.

MEANING AND NEED OF ADJUSTMENT ENTRIES

Transactions omitted relate to the current year must be entered in books. If a transaction entered is not related to the current year, fully or partly, that portion of income or expense must be excluded. This process is made through adjustment entries in the books of accounts. If we ignore to make the necessary adjustments, the trading, profit & loss accounts do not show the true profit or loss and in consequence balance sheet fails to depict true financial position of the business. This situation defeats the very purpose of final accounts. Hence, adjustment entries play an important role in presenting correct picture of accounts.

Accounting Treatment:

Trading and Profit and Loss and Balance sheet, together, are called as final accounts. Item appearing in the trial balance appears only once in final accounts, either on the debit or credit. Any adjustment entry requires two postings, debit and credit for the same amount. Important point is students should do the posting (debit and credit) in the concerned accounts, simultaneously.

Accounting treatment for adjustment entries - 1

1. **Closing Stock:** Every concern prepares a list of unsold goods at the end of the period and puts value against it. It is to be remembered that stock is valued at cost or market price, whichever is less.

Note: Closing Stock appears below the Trial Balance as an adjustment entry

For example, if the value of stock at the end of the period is Rs. 30,000 and is shown below the trial balance, then the following adjusting entry will be passed:

Closing Stock A/c … Dr. 30,000

To Trading Account 30,000

The two-fold effect of this entry will be:

(i) Stock will have a debit balance. Being a real account, it will be shown on the assets side of the Balance Sheet.

Trading Account for the year ending…..

Particulars	Amount	Particulars	Amount
		By Closing Stock	**30,000**

Balance Sheet as on …….

Liabilities	Amount	Assets	Amount
		Closing Stock	**30,000**

Accounting treatment for adjustment entries - 2

2. Outstanding Expenses There are certain expenses, which have been incurred but not paid. These expenses are called outstanding expenses.

For example, salary to the clerk Rs. 10,000 is due for the month of December. Books are closed at the end of December. In order to bring this transaction into accounts, the following adjustment entry will be passed:

Salary Account …..Dr. Rs. 10,000

To Outstanding Salary A/c. Rs. 10,000

The two fold effect of this entry will be:

(i) Outstanding salary will be added to salary, if any, on the debit side of Profit & Loss Account.

(ii) (ii) Outstanding Salary Account, being personal and having credit balance, will be shown on the liabilities side of the Balance Sheet.

Profit and Loss Account for the year ending…..			
Particulars	Amount	Particulars	Amount
To Salary Account	**10,000**		
Balance Sheet as on …….			
Liabilities	Amount	Assets	Amount
Outstanding Salary	**10,000**		

Accounting treatment for adjustment entries - 3

3. **Prepaid or Unexpired Expenses:** Those expenses which have been paid, in full, but their utility or benefit has not expired during the accounting period are called prepaid or unexpired expenses.

For example, annual premium Rs. 12,000 is paid on 1st July, where accounting year closes on 31st December. Rs. 6000 will be insurance paid in advance. To bring this into account, the following adjusting entry will be passed:

Prepaid Insurance Premium Account…..Dr. Rs. 6,000

To Insurance Premium Rs. 6,000

The double effect of this adjusting entry will be:

(i) Prepaid insurance will be deducted from the insurance premium on the debit side of the Profit & Loss Account.

(ii) (ii) Prepaid insurance, being personal account and having debit balance, will be shown on the assets side of the Balance Sheet.

Profit and Loss Account for the year ending…..			
Particulars	Amount	Particulars	Amount
To Insurance Premium 12,000			
Less: Prepaid Insurance **<u>6,000</u>**	**6,000**		
Balance Sheet as on …….			
Liabilities	Amount	Assets	Amount
		Prepaid Insurance	**6,000**

Accounting treatment for adjustment entries - 4

4. Accrued Income: Income earned but not received during the accounting period is called accrued Income.

Example: the interest on investments shown in the trial balance is Rs. 19,500. The adjustment may run like this. Interest @10% is due on investments of Rs. 10,000 for 6 months, though accrued, has not been yet been received. This interest Rs. 500 will be accrued income. In order to bring this into account, the following adjusting entry will be passed:

Accrued Interest on Investments Account …..Dr. Rs. 500

To Interest on Investment Account Rs. 500

The two fold effect of this entry will be:

(i) Interest on Investment account (accrued interest) will be added to the interest account on the credit side of the profit & loss account.

(ii) (ii) Accrued interest, being personal account and having debit balance, will be shown on the debit side of the Balance Sheet.

Profit and Loss Account for the year ending…..			
Particulars	Amount	Particulars	Amount
		By Interest 19,500	
		Add: Interest Accrued 500	20,000

Balance Sheet as on …….			
Liabilities	Amount	Assets	Amount
		Accrued Interest on Investments	**500**

Accounting treatment for adjustment entries - 5

5. **Unearned Income or Income Received in Advance:**

Sometimes, the amount received in respect of an income during the year pertains, partially, to the next year. Suppose a landlord collects rent for one quarter, in advance, and closes his account on 30th June each year. Suppose, a tenant has occupied a house on 1st June and pays Rs. 1,800 as rent for 3 months. The landlord must not treat the whole of the rent received as income for the current year. Two months' rent pertains to the next year and should be credited to the Profit and Loss Account of next year. This will ensure that the income for the current year is not overstated. The required entry is:

Rent Account ….Dr. Rs. 1,200

To Rent Received in Advance Account Rs. 1,200

The double effect of this adjusting entry will be:

(i) Rent Received in advance account will be deducted from the Rent received account on the credit side of the Profit & Loss Account.

(ii) (ii) Rent Received in advance account is a liability and having credit balance, will be shown on the Liabilities side of the Balance Sheet.

Profit and Loss Account for the year ending…..			
Particulars	Amount	Particulars	Amount
		By Rent Account 1,800	
		Add: Rent Received in advance 1,200	600

Balance Sheet as on …….			
Liabilities	Amount	Assets	Amount

Accounting treatment foradjustment entries - 6

6. Depreciation: The value of fixed assets goes on reducing year by year because of wear, tear and efflux of time. This fall in the value should be treated as a loss or expense, to be considered before profit or loss is ascertained. The value to be shown in the Balance Sheet must also be reduced.

Depreciation is usually computed on the basis of the life of the assets. Suppose, a machine costs Rs. 1,00,000 and has a life of 5 years. Then, each year 1/5th of the cost, i.e., Rs. 20,000 should be treated as an expense; only the remaining amount is to be shown in the balance sheet. The entry is:

Depreciation Account …Dr. 20,000

To Machinery Account 20,000

Depreciation is debited to the Profit & Loss Account. In the final accounts, the item will figure as shown below:

Profit and Loss Account for the year ending…..			
Particulars	Amount	Particulars	Amount
To Depreciation Account	**20,000**		

Balance Sheet as on …….			
Liabilities	Amount	Assets	Amount
		Machinery Account 1,00,000	
		Less: Depreciation **<u>20,000</u>**	**80,000**

Accounting treatment for adjustment entries - 7

7. **Interest on Capital**: The proprietor may wish to ascertain his profit, after considering the interest for the amount invested in the firm.

Suppose, the capital is Rs. 2,00,000 and the rate of interest is 5%. Then, the interest will be Rs. 10,000. It will be treated like other expenses and debited to the Profit and Loss Account; the amount will also be credited to the Capital Account.

The entry is:

Interest on Capital Account …Dr. 10,000

To Capital Account 10,000

In the final statements of account, the item will appear as shown below:

Profit and Loss Account for the year ending…..			
Particulars	Amount	Particulars	Amount
To Interest on Capital Account	**10,000**		
Balance Sheet as on …….			
Liabilities	Amount	Assets	Amount
Capital 2,00,000			
ADD: Interest on capital <u>10,000</u>	**2,10,000**		

Accounting treatment for adjustment entries - 8

8. **Interest on Drawings:** The proprietor may also realize that when he draws money for private use, the firm loses interest as funds for business are reduced. Therefore, the proprietor's capital may be debited with the interest on the money drawn by him. Interest will depend on the amount and the date of withdrawal concerned.

In absence of information about the date of drawings, it should be assumed that the drawings were made, evenly, throughout the year; therefore, interest should be charged for six months on the full amount. Suppose, capital is Rs. 2,00,000 and the total drawings are Rs. 10,000. The rate of interest is 6% on the drawings. So, interest @ 6% for six months on drawings Rs. 10,000 will be Rs. 300.

The entry to be passed is:

Interest on Drawings ...Dr. Rs. 300

To Profit & Loss Account Rs. 300

Profit and Loss Account for the year ending.....			
Particulars	Amount	Particulars	Amount
		By Interest on drawings	**300**

Balance Sheet as on …….			
Liabilities	Amount	Assets	Amount
Capital 2,00,000			
Less: Drawings 10,000			
Less: Interest on Drawings 300	1,89,700		

Accounting treatment for adjustment entries - 9

9. Interest on Loan: Interest must be paid on loans, whether there is profit or loss. It is calculated by reference to the rate of interest agreed to be paid by the firm.

Suppose a loan of Rs. 20,000 is taken on 1st May 2008 at 18%, if the accounts are closed on 31st December, the interest for the year will be Rs. 2,400 i.e., Rs. 20,000 × 18/ 100 × 8/ 12.

The amount of the interest, if not paid, the entry is:

Interest on Loan Account …. Dr. Rs. 2,400

To Outstanding Interest Account Rs. 2,400

The item will figure as follows in the final accounts:

Profit and Loss Account for the year ending…..			
Particulars	Amount	Particulars	Amount
To Interest on loan	**2,400**		
Balance Sheet as on …….			
Liabilities	Amount	Assets	Amount
Loan Account	20,000		
Outstanding Interest on loan	**2,400**		

Accounting treatment for adjustment entries - 10

10. Bad Debts: An unrecovered debt is called as Bad Debt and it occur, when there are credit sales. The following journal entry should, therefore, be passed in the event of a debt becoming bad.

Bad Debts A/c Dr.
To Debtor's Personal A/c

e.g. Kalyan & Co. has been running its cloth business. At the end of Dec. 2008, the firm's books of accounts show the debtors at Rs. 4,00,000. Out of those debtors, Rs. 20,000 have been recognized as bad debts.

Note: Bad debts, appearing in Trial Balance, have already seen provided for. Now, the adjustment relates to additional bad debts for the amount appearing in sundry debtors.

Profit and Loss Account for the year ending…..			
Particulars	Amount	Particulars	Amount
To Bad Debts A/c	**20,000**		

Balance Sheet as on …….			
Liabilities	Amount	Assets	Amount
		Debtors 4,00,000	
		Less: Bad debts <u>20,000</u>	**3,80,000**

Accounting treatment for adjustment entries - 11

11**. Provision for Bad and Doubtful Debts**: Prudent accounting principle is to make provision for expected losses. All credit sales would not be realized in the year in which the sales are made. A firm, therefore, makes provision at the end of the accounting year, for likely bad debts, which may happen during the course of the next year.

The following journal entry is passed for creating a provision for bad debts.

Profit & Loss A/c Dr.

To Provision for Bad and Doubtful Debts

The provision for bad and doubtful debts is charged to the Profit & Loss Account and is deducted from debtors in the Balance Sheet.

Calculation of Provision for Bad and Doubtful Debts:

Normally, problem states the % of Provision for Bad and Doubtful Debts. On which amount of debtors, this % of Provision for Bad and Doubtful Debts is to be calculated?

- Provision for Bad and Doubtful Debts is to be calculated on that amount of debtors, after deducting bad debts written off given in the adjustments .

From the following Trial Balance prepare Trading and Profit and Loss Account for the year ended 31st December, 2009 and Balance Sheet as on the date:

	Dr. (Rs.)	Cr (Rs.)
Drawings	10000	
Stock as on 1-1-2009	46000	
Purchase and Purchase returns	150000	600
Cash in hand	3400	
Bank balance	22660	
Freehold Premises	38600	
Trade expenses	840	
Printing, Stationery and advertising	1640	
Professional charges	280	
Commission received		3300
Investment as on 1st Jan. @10%	4000	
Interest on Deposits		200
Sundry debtors and creditors	36000	29000
Wages	25000	
Salaries	14000	
Rent Rates and Insurance	4000	
Capital		114700
Income Tax	1600	
Discount allowed and received	6300	4600
Sales Returns and Sales	500	208000
Bills Receivables and Bills Payables	3200	10000
Office Furniture	3050	
Bad Debts Provision		670
	371070	371070

Adjustments:

1. Provide for wages Rs.5000.
2. Write off 5% depreciation on freehold premises and 10% on office furniture.
3. Insurance to the extent of Rs.200 belongs to 2010.
4. Closing stock as on 31.12.2009 is Rs.52000.
5. Charge interest on capital @ 5%.

Trading and Profit and Loss A/c for the year ending 31st Dec., 2009

Dr. | Cr.

Particulars		Rupees	Particulars		Rupees
Opening Stock		46,000	Sales	208000	207500
Purchases	150000		Less Sales Returns	500	
Less Purchase Returns	600	149400	Closing Stock		52000
Wages A/c	25000				
Add Outstanding Wages	5000	30000			
Gross Profit c/f		34100			
		259,500			259,500
Trade Expenses		840	Balance b/f		34100
Painting, Stationery & Advt.		1640	Commission Received		3300
Professional Charges		280	Interest on Deposit	200	
Salaries		14000	Add Accrued Interest	200	400
Discount		6300	Discount received		4600
Rent, Rates & Insurance	4000				
Less Prepaid	200	3800			
Interest on Capital		5735			
Depreciation on Premises		1930			
Depreciation on Furniture		305			
Net Profit		7570			
		42400			42400

Balance Sheet as on 31st December, 2009

Particulars		Rupees	Particulars		Rupees
Capital	114700		Freehold Premises	38600	36670
Add Profit	7570		Less Depreciation	1930	
Add Interest on Capital	5735		Office Furniture	3050	
	128005		Less Depreciation	305	2745
Less Drawings	10000		Closing Stock		52000
Less Income Tax	1600	116405	Debtors	36000	
Sundry Creditors		29000	Less Prov. for Debtors	670	35330
Bills Payable		10000	Bills Receivables		3200
Outstanding Wages		5000	Investments	4000	
			Add accrued interest	200	4200
			Prepaid Insurance		200
			Bank		22660
			Cash		3400
		160405			160405

Prob.2 From the following particulars taken out from the books of Abdul Hanan & Co. You are required to prepare Trading and Profit & Loss Account and Balance Sheet as at December 31st, 2019

Sundry debtors ………………….	Rs. 52,000	Insurance premium (paid on 1.10.19)……………	Rs. 2,400
Account payable ………………..	22,000	Cash at bank ………………………………………..	6,200
Cash in hand ……………………	2,392	Machinery ……………………………………………	24,000
Furniture ………………………..	3,500	Wages ……………………………………………….	23,600
Motor car ……………………….	22,000	General expenses …………………………………..	2,680
Purchases ……………………….	145,000	Carriage inward …………………………………….	2,040
Sales …………………………….	292,000	Carriage outward ……………………………………	1,630
Sales return …………………….	2,600	Transportation in …………………………………..	6,430
Salaries ………………………….	8,420	Owner equity ……………………………………….	20,000
Opening stock ………………….	11,400	Drawing ……………………………………………..	8,000
Motor car expenses …………….	3,600	Rent and taxes ………………………………………	3,600
Equipment ……………………..	2,508		

Adjustments:

(a) Closing stock Rs, 35,000.

(b) Provision for doubtful debts at 5% of sundry debtors.

(c) Depreciation furniture and machinery by 10%.

(d) Commission of Rs. 3,600 has been earned but not received till the closing of accounts.

Abdul Hanan & Co.

Trading and Profit & Loss Account

For the Year ended 31st, December 2019

Particulars		*Amount*	*Particulars*		*Amount*
Opening Stock		11,400	Sales	292,000	
Purchases		145,000	Sales return	(2,600)	289,400
Wages		23,600	Closing stock		35,000
Carriage inward		2,040			
Transportation in		6,430			
Gross Profit c/d		*135,930*			
Total		**Rs. 324,400**	**Total**		**Rs. 324,400**
Salaries		8,420	*Gross Profit b/d*		*135,930*
Motor car expenses		3,600	Commission		3,600
Insurance premium	2,400				
Prepaid insurance	(1,800)	600			
General expenses		2,680			
Carriage outward		1,630			
Rent and taxes		3,600			
Provision for doubtful debts		2,600			
Dep. expense_ furniture		350			
Dep. expense_ machinery		2,400			
Net Profit c/f to B/S		*113,650*			
Total		**Rs. 139,530**	**Total**		**Rs. 139,530**

Abdul Hanan & Co.

Balance Sheet

As on 31st, December 2019

Equities		*Amount*	*Assets*		*Amount*
Owner's Equity:			***Fixed and Long Term:***		
Owner equity	20,000		Furniture	3,500	
Drawing	(8,000)		Dep. expense	(350)	3,150
Profit b/f	113,650	125,650	Motor car		22,000
			Machinery	24,000	
			Depreciation	(2,400)	21,600
			Equipment		2,508
Current Liabilities:					
Account payable		22,000			
			Current Assets:		
			Cash in hand		2,392
			Cash at bank		6,200
Long Term Liability:			Sundry debtors	52,000	
			Provision for bad debts	(2,600)	49,400
			Stock		35,000
			Commission receivable		3,600
			Prepaid insurance		1800
Total		**Rs. 147,650**	**Total**		**Rs. 147,650**

Prob: 3 From the following trial balance of Faris Ali Qureshi & Bros. and additional information, prepare Trading and Profit & Loss account and Balance sheet for the year ended June 30th, 2019.

Particular	Dr	Cr	Particular	Dr	Cr
Capital		100,000	Transportation out	7,000	
Furniture	20,000		Creditors		120,000
Purchases	150,000		Provision for bad debts		6,000
Debtors	200,000		Printing and stationery	8,000	
Interest earned		4,000	Insurance expense	12,000	
Salaries	30,000		Opening stock	50,000	
Sales		321,000	Office expenses	12,000	
Purchases returns		5,000	Bank overdraft		2,000
Wages	20,000		Drawing	24,000	
Rent	15,000				
Sales return	10,000		**Total**	**Rs. 558,000**	**Rs. 558,000**

Additional Information

1.Depreciation furniture by 10% by written down method (WDM).

2.A provision for doubtful debts is to be created to the extent of 5% on sundry debtors.

3.Salaries for the month of June, 2019 amounting to Rs. 3,000 were unpaid which must be provided for. However, salaries included Rs. 2,000 paid in advance. Office expenses outstanding Rs. 8,000.

4.Insurance amounting to Rs. 2,000 is prepaid.

5.Stock use for private purpose Rs. 6,000 and closing stock Rs. 60,000.

Solution:

Faris Ali Qureshi & Bros.

Trading and Profit & Loss Account

For the Year ended 30th, June 2019

Particulars		***Amount***	***Particulars***		***Amount***
Opening stock		50,000	Sales	321,000	
Purchases	150,000		Sales return	(10,000)	311,000
Purchases returns	(5,000)		Closing stock		60,000
Drawing	(6,000)	139,000			
Wages		20,000			
Gross Profit c/d		*162,000*			
Total		**Rs. 371,000**	**Total**		**Rs. 371,000**
Salaries	30,000		*Gross Profit b/d*		*162,000*
Outstanding	3,000		Interest earned		4,000
Prepaid	(2,000)	31,000			
Rent		15,000			
Transportation out		7,000			
Printing and stationery		8,000			
Insurance expense	12,000				
Prepaid	(2,000)	10,000			
Office expenses	12,000				
Outstanding	8,000	20,000			
Depreciation exp. _furniture		2,000			
Provision for bad debts:					
New	10,000				
Old	(6,000)	4,000			
Net Profit c/f to B/S		*69,000*			
Total		**Rs. 166,000**	**Total**		**Rs. 166,000**

Faris Ali Qureshi & Bros.

Balance Sheet

As on 30th, June 2019

Equities		*Amount*	*Assets*		*Amount*
Owner's Equity:			***Fixed and Long Term:***		
Capital	100,000		Furniture	20,000	
Drawing	(24,000)		Dep. expense	(2,000)	18,000
Stock withdrawal	(6,000)				
Profit b/f	69,000	139,000			
			Current Assets:		
			Debtors	200,000	
			Provision for b/d	(10,000)	190,000
Current Liabilities:			Stock		60,000
Bank overdraft		2,000	Prepaid Expenses:		
Creditors		120,000	Salaries		2,000
Outstanding liabilities:			Insurance		2,000
Salaries		3,000			
Office expenses		8,000			
Total		**Rs. 272,000**	**Total**		**Rs. 272,000**

Problems 4: The following are the balances taken from the books of Muhammad Zain Ammar Safdar & Co. on May 31st, 2020. You are required to prepare Trading and Profit and Profit and Loss Account / Income Statement for the year ended May 31st, 2020 and Balance Sheet as on that date.

Muhammad Zain Ammar Safdar & Co.

Trial Balance

31st, May 2020

Particulars	*Amount*	*Particulars*	*Amount*
Salaries	12,000	Bank Loan @ 10%	10,000
Opening stock	60,000	Sundry creditors	71,000
Drawings	22,000	Purchase return	2,600
Rent and rates	4,550	Capital	73,600
Sundry debtors	89,780	Sales	248,000
Furniture	10,000	Reserve for discount	1,000
Machinery	20,000		
Bad debts	20		
Buildings	19,200		
General expenses	1,060		
Purchases	150,000		
Sales returns	5,400		
Wages	7,000		
Travelling expenses	1,600		
Insurance	1,200		
Legal charges	210		
Cash in hand	2,180		
Total	**Rs. 406,200**	**Total**	**Rs. 406,200**

Adjustments:

1.Depreciation furniture and machinery at 10% p.a.

2.Insurance is paid in advance to the extent of Rs. 200.

3.Reserve for discount is no longer required and is to be written back.

4.Closing stock is valued at Rs. 100,000.

5.Interest on bank loan is outstanding.

Muhammad Zain Ammar Safdar & Co.

Trading and Profit & Loss Account

For the Year ended 31st, May 2020

Particulars		***Amount***	***Particulars***		***Amount***
Opening stock		60,000	Sales	248,000	
Purchases	150,000		Sales returns	(5,400)	242,600
Purchase return	(2,600)	147,400	Closing stock		100,000
Wages		7,000			
Gross Profit c/d		*128,200*			
Total		**342,600**	**Total**		**342,600**
Salaries		12,000	*Gross Profit b/d*		*128,200*
Rent and rates		4,550	Reserve for discount		1,000
Bad debts		20			
General expenses		1,060			
Travelling expenses		1,600			
Insurance	1,200				
Prepaid	(200)	1,000			
Legal charges		210			
Depreciation exp._Furniture		1,000			
Depreciation exp._Machinery		2,000			
Interest on bank loan		1,000			
Net Profit c/f to B/S		*104,760*			
Total		**Rs. 129,200**	**Total**		**Rs. 129,200**

Muhammad Zain Ammar Safdar & Co.

Balance Sheet

As on 31^{st}, May 2020

Equities		***Amount***	***Assets***		***Amount***
Owner's Equity:			***Fixed and Long Term:***		
Capital	73,600		Furniture	10,000	
Drawings	(22,000)		Depreciation exp._Furniture	(1,000)	9,000
Profit b/f	104,760	156,360	Machinery	20,000	
			Depreciation exp._Machinery	(2,000)	18,000
			Buildings		19,200
Long Term Liabilities:			***Current Assets:***		
Bank Loan @ 10%		10,000	Cash in hand		2,180
			Sundry debtors		89,780
			Closing stock		100,000
Current Liabilities:			Prepaid insurance		200
Sundry creditors		71,000			
Interest on bank loan		1,000			
Total		**Rs. 238,360**	**Total**		**Rs. 238,360**

Capital And Revenue Expenditure and Receipts

The aim of accounting is to ascertain the financial performance of a firm. To do so the transactions have to be identified as capital or revenue in nature. This will determine whether they are placed in the Profit and Loss Account or the Balance Sheet. Determining capital or revenue nature is undoubtedly very important in the field of accounting.

Capital Nature and Revenue Nature

The capital nature and the revenue nature differ from each other on the basis of the time for which the purchases will be used.

Capital Nature

- Capital expenditures include large purchases of fixed assets that can be used for a longer duration. In other words, the acquisition of fixed assets for certainly longer durations represents the capital nature of expenditure. For example, the expenditures that are made for buying manufacturing equipment and as a result, the equipment can be used for longer durations.
- Also, the company providing the equipment cannot deduct the full cost and the cost is required to be updated according to the year-by-year devaluation of the product. These are basically non-recurring in nature.

Capital expenditures are classified into three main sections:

- Expenditures made to reduce the costs
- Expenditures made to increase the revenue
- Expenditure which is explainable on the non- economic grounds, that is, the expenses made without any relation to the money related profits.

Some examples of Capital Expenditures are

- The expenditures related to social activities.
- The expenses made for buying machinery.
- The investments made for doing research work and innovations.

Revenue Nature

In contrast to capital nature, short-term expenses represent the revenue nature. Unlike capital nature, this one is related to the expenditures that are made for specific operating periods. Furthermore, such expenses neither generate assets nor the liabilities. For example, the expenditures made to facilitate the current operation that is, repair costs and maintenance expenses.

Revenue nature Expenditure is of two types

- **Expenditure for generating revenue**: This type of expenditure is for the ongoing operational processes. Likewise, the operating expenses meet the running business or factory cost requirements. In the same year in which the expenses are occurring, in the revenue expenses, the tax liabilities also lowers.
- **Expenditure for maintaining the revenue-producing assets:** The expenses for the generic and ordinary repairing and preservation costs are revenue expenditure. The expectations are to keep the asset in the working condition without any involvement in increasing the life and workability of the asset.

Examples of the Revenue Expenditure are

- Paying rent for houses, shops, etc.
- Salaries for the various jobs.
- Advertising costs
- Legal expenses
- Insurance costs such as, vehicle insurance, life insurance etc.
- Water and electricity bill payments.
- Unlike capital nature expenses, revenue nature expenditures are recurring in nature.

Determining Capital Nature and Revenue Nature

There are certain basic considerations when we are determining the nature of a financial transaction, i.e. capital nature or revenue nature. Some such considerations are as follows.

- **Nature of Business**

  The capital or revenue nature is dependent on the type of business a person does. It is different for different types of business. For instance, a business that provides car insurance to people comes under the revenue nature but the manufacturer buying the machinery for his factory is capital expenditure.

- **Recurring Nature of Expenditure**

  Revenue nature expenditures are recurring in nature and capital nature expenditures are non-recurring in nature.

- **Purpose of Expenditure**

  The manufacturing process is an illustration of capital nature while renovation and repairing processes are expenses of revenue nature.

Capital Receipt and Revenue Receipt

Capital receipt and revenue receipt, both are the very important components of accounting. It is important to correctly differentiate between the two. Classification of these transactions reflects in the final statements of the company.

Capital Receipt

- These have a nature of non-recurrence, besides that, they are situated in the balance sheet in the liabilities portion of them. The capital receipt is always in the interchange for the income. The capital receipt is a kind of cash-flow in the business that does not occur over and over again and this eventually, leads to the creation of liabilities in the future and also, the decrement of assets takes place in the future.
- All of the capital receipts are free from taxation unless there is a provision to tax it. Various types of Gifts and loans are the types of the capital receipts that do not attract tax and are tax-free. So, in addition to non-recurring, Capital receipts are those non-routine receipts which either becomes a load and responsibility or cause a vivid depletion in the assets of the government or any organization and business.

The following sources are the generators of the capital receipt:

- Additional capital and mentioned assets introduced by the owner or the possessor
- Debentures and the other issues of debt instruments
- Loans borrowed from a bank or from a financial institution.
- Various insurance Claims.
- Issue of Shares
- So, basically, capital receipts are those that are the derivation of the not so normal operations of a business. Besides that, the effect of capital receipt is depicted in the balance sheet. These receipts are not at all a part of normal operations of government business. For example, a sale of fixed assets, etc.

Revenue Receipt

These receipts are a major source of income for any kind of a business and without it, a business can't survive for long. This is a result of the normal and core business activities. Being a normal business result is the reason for its recurring nature. However, there is a little shortcoming associated with it. The benefits of revenue receipts are enjoyable only for the current accounting year and not possibly after that.

The income received from the daily and periodic activities of business includes all the operations that indulge cash into the business like:

- The sale of any kind of an inventory
- Income from services rendered
- Different types of discount Received from the suppliers
- Sale of scrap
- Interest received.
- Rent received
- To sum it all, Revenue receipts are recurring receipts and their effect is shown on the income statement. For a successful business, both receipts play a prominent role as they both compliments each other.

Thank You