UNIT – I

FUNDAMENTALS OF ACCOUNTING

Bookkeeping is the recording of financial transactions, and is part of the process of accounting in business. Transactions include purchases, sales, receipts, and payments by an individual person or an organization/corporation. There are several standard methods of bookkeeping, including the single-entry and double-entry bookkeeping systems. While these may be viewed as "real" bookkeeping, any process for recording financial transactions is a bookkeeping process.

Bookkeeping is the work of a **bookkeeper** (or book-keeper), who records the day-to-day financial transactions of a business. They usually write the *daybooks* (which contain records of sales, purchases, receipts, and payments), and document each financial transaction, whether cash or credit, into the correct daybook—that is, petty cash book, suppliers ledger, customer ledger, etc.—and the general ledger or journal proper. Thereafter, an accountant can create financial reports from the information recorded by the bookkeeper.

Double-entry bookkeeping, in accounting, is a system of book keeping where every entry to an account requires a corresponding and opposite entry to a different account. The double-entry has two equal and corresponding sides known as debit and credit. The left-hand side is debit and right-hand side is credit. In a normally debited account, such as an asset account or an expense account, a debit increases the total quantity of money or financial value, and a credit decreases the amount or value. On the other hand, for an account that is normally credited, such as a liability account or a revenue account, it is credits that increase the account's value and debits that decrease it. In double-entry bookkeeping, a transaction always affects at least two accounts, always includes at least one debit and one credit, and always has total debits and total credits that are equal. This is to keep the accounting equation (below) in balance. For example, if a business takes out a bank loan for `10,000, recording the transaction would require a debit of `10,000 to an asset account called "Cash", as well as a credit of `10,000 to a liability account called "Notes Payable".

Cash A/c	Dr.	10,000	
To Loan A/c			10,000

Need for Accounting

A businessman invests capital with the objective of making profit and thereby increasing his resources. He incurs various expenses like salaries, rent and stationery to operate his business. He receives income from different sources like commission, interest and discount. He deals with several persons in the course of buying and selling of goods,

purchasing and selling of assets and borrowing money for financing the business. He acquires various properties and assets like building, machinery, furniture to generate revenue.

In practice, it is impossible for any businessman to memories and recollects all his business dealings. Moreover, he will be interested in knowing at the end of the each year

(i) What he owes?

(ii) What he owns?

(iii) How much profit he has earned?

(iv) What his financial position is?

To relieve businessmen from the burden of memorizing all the business dealings and for providing necessary information, Accounting was developed.

Definition of Accounting

"Accounting is the arts of ***recording***, ***classifying*** and ***summarizing*** in a ***significant manner*** and ***in terms of money*** transactions and event which are of a ***financial character*** and ***interpreting the results*** thereof"

– American Institute of Certified Public Accountants (AICPA)

Meaning of Debit and Credit

The word *debit* is derived from the Latin word *Debitum* which means *Due for that*. In short, the benefit receiving aspect of a transaction is known as debit.

The word *Credit* is derived from the Latin word Creder which means *Due to that.* The benefit giving aspect of a transaction is known as credit.

The abbreviations 'Dr' for debit and 'Cr' for credit are usually used.

By conventions, the left hand side of an account is termed as debit side and right hand side of an account is termed as credit side.

Types of Accounts

The object of book keeping is to keep a complete record of all the transactions that take place in the business.

Practically every business

(i) Deals with other persons, firms and companies

(ii) Possesses assets like cash, stock, buildings, furniture, etc. and receives incomes such as commission, interest etc.

It is necessary to maintain the following to record all the above dealings

1. An account of each person, firm, or company with which the business deals. The accounts under this class are known as *Personal Accounts* e.g. if Mr. Raj, a cloth

dealer, has dealings with four wholesalers and twenty customers to whom he sells on credit, he must operate an account for each one of them separately.

2. An account of each type of asset which a business owns. It comes under the class of *Real Accounts.*
3. An account for each express and gain. The accounts under this class are known as *Nominal or Fictitious Accounts*.

An account is a statement in the ledger which records the transactions relevant to the person, asset, expenses or profit named in the heading. Accounts can be divided into:

(a) Personal Accounts

(b) Impersonal Accounts

Impersonal accounts can be further divided into real and nominal accounts. Thus, there are three kinds of accounts maintained by a business.

(1) Personal Accounts

(2) Real Accounts

(3) Nominal Accounts

1. **Personal Accounts:** Accounts of persons with whom the business has dealings are known as *personal accounts.* It takes the following forms:

   (a) Natural Persons: The name of an individual – customers or suppliers. (e.g.) Raj's account, Sharma's account, Anusha's account, Priya's account. Both males and females are included in it.

   (b) Artificial persons or legal bodies: Firms' accounts, limited companies' accounts, educational institutions' account, bank account, co-operative society account etc., are known as artificial persons' account.

   (c) Representative personal accounts: All accounts representing outstanding expenses and accrued or prepaid incomes are personal account. (e.g.) prepaid insurance, outstanding wages, salary, rent etc.

   When a person starts a business, he is called proprietor. This proprietor is represented by capital account for that entire he invests in business and by drawings accounts for all that which he withdraws from business. So, capital account and drawings account are also personal accounts.

2. **Real Accounts:** Accounts in which the business records the real things owned by it. i.e. assets of the business are known as *real accounts.*

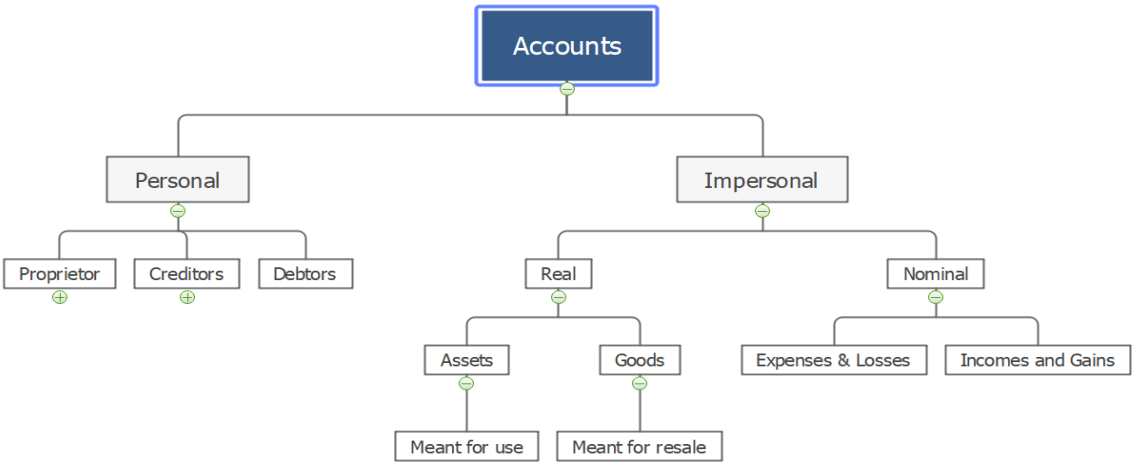
   Real accounts are of two types

Tangible real accounts, these can be touched and felt and they have a physical shape. (Buildings, furniture, cash and machinery etc.)

Intangible real accounts, which cannot be touched because they have no physical shape. (trademark, goodwill, patents and copyright etc.)

3. **Nominal Accounts:** It relates to the items which exist in name only. Expenses, incomes etc., are there in business activities. Accounts which record expenses, losses, incomes and gains of the business are known as nominal accounts.

   e.g. rent a/c, salaries a/c, telephone charges a/c, postage a/c, advertising a/c, commission received a/c, interest received a/c.



ACCOUNTING RULES

The double entry system of book-keeping is a scientific and complete system. Hence, the transactions should be recorded according to the following rules. As we have already discussed, each transaction must have two aspects, the benefit receiving aspect and benefit giving aspect. A transaction should be divided into two aspects.

1. Debit aspect
2. Credit aspect

The rules for making entries under double entry system can be summarized as follows

1. Personal Accounts	**:**	**Debit the receiver**
		Credit the giver
2. Real Accounts	**:**	**Debit what comes in**
		Credit what goes out
3. Nominal Accounts	**:**	**Debit all expenses and losses**
		Credit all incomes and gains

BASES OF ACCOUNTING

There are three bases of accounting in common usage. Any one of the following bases may be used to finalise accounts.

1. **Cash basis** (*Government system of accounting is mostly on cash basis. Professionals like doctors, lawyers, brokers also prefer to follow this method, since it is simple to understand and easy to practice*)
2. Accrual or Mercantile basis
3. Mixed or Hybrid basis

Accounting Terminology

1. Capital
2. Liability
3. Assets
4. Revenue
5. Expenses
6. Debtors
7. Creditors
8. Tangible Assets
9. Intangible Assets
10. Fictitious Assets
11. Wasting Assets
12. Fixed Assets
13. Current or Floating Assets (Stock, Debtors, Bills receivable, etc….)
14. Purchases
15. Sales
16. Stock
17. Losses
18. Drawings
19. Invoice
20. Voucher
21. Goods
22. Current Liability
23. Long term Liabilities
24. Solvent
25. Insolvent

JOURNAL

The French word *'Jour'* means *'day'*. Journal, therefore means a daily record of business transactions.

Journal is a book of *'Primary entry'* or *'original entry'*. All transactions are initially recorded in the journal. The ruling of the journal is such that any business transaction can be analysed under the heads of debit and credit. A thorough understanding of the principles of debit and credit which are the basis for journal is essential for every student of accountancy to get a thorough grasp of the subject.

Specimen form of Journal

Date	Particulars	L.F.	Debit Amount (`)	Credit Amount (`)
16.10.2020	**Cash A/c Dr.** **To Raman A/c** **(Being cash received from Raman)**		**20,000**	**20,000**

Problem

Journalise the following transactions

1. Purchased goods for cash `10,000
2. Purchased stationery for cash `500
3. Purchased furniture for cash `3,000
4. Sold goods for cash `8,000
5. Sold goods to Jane for cash `3,000
6. Sold goods to James `2,000
7. Paid Rent to Krishnan, the landlord `800
8. Paid Salary of `8,000
9. Paid Lokesh, the manager his salary of `3,000
10. Paid freight on goods purchased `300

Solution

Date	Particulars	L.F.	Debit `	Credit `
1	Purchases A/c Dr. To Cash A/c (Being purchase goods for cash)		10000	 10000
2	Stationary A/c Dr. To Cash A/c (Being Purchases of stationary)		500	 500
3	Furniture A/c Dr. To Cash A/c (Being cash purchase of furniture)		3000	 3000
4	Cash A/c Dr. To Sales A/c (Being cash sales made)		8000	 8000
5	Cash A/c Dr. To Sales A/c (Being cash sales to Jane)		3000	 3000
6	James A/c Dr. To Sales A/c (Being goods sold to credit)		2000	 2000
7	Rent A/c Dr. To Cash A/c (Being rent paid to Krishnan)		800	 800
8	Salary A/c Dr. To Cash A/c (Being salary paid in cash)		8000	 8000

9	Salary A/c Dr. To Cash A/c (Being Manager's Salary paid in cash)		3000	 3000
10	Freight A/c Dr. To Cash A/c (Being paid freight on goods purchased)		300	 300

Problem

Give journal entry for the following transactions

2020

Jan. 1 Paid freight on machine purchased `400

Jan. 3 Paid wages `500

Jan. 10 Paid wages to erect a machine `1000

Jan. 13 Received `800 from Kamal

Jan. 20 Received `600 from Kamal as interest

Jan. 28 Received `7000 from Kamal as loan at 5% interest

Jan. 31 Salary Paid `10000

Jan. 31 Rent Paid `8000

Solution

Date	Particulars	L.F.	Debit `	Credit `
2020 Jan. 1	Machinery A/c Dr. To Cash A/c (Being freight paid on machine purchased)		400	 400
Jan.3	Wages A/c Dr. To Cash A/c (Being wages paid)		500	 500
Jan.10	Machinery A/c Dr. To Cash A/c (Being wages paid to erect machine)		1000	 1000
Jan. 13	Cash A/c Dr. To Kamal A/c		800	 800

	(Being amount received from Kamal)			
Jan. 20	Cash A/c Dr. To Interest A/c (Being interest received from Kamal)		600	 600
Jan. 28	Cash A/c Dr. To 5% loan a/c (Being loan from Kamal for Interest)		7000	 7000
Jan. 31	Salary A/c Dr. To Cash A/c (Being Salary paid)		10000	 10000
Jan. 31	Rent A/c Dr. To Cash A/c (Being Rent Paid)		8000	 8000

Problem

Enter the following transactions in the journal of Hariparasad of Hyderabad.

2020		`
July 1	Commenced business with cash	1,80,000
3	Deposited into Bank	55,000
4	Purchases goods for cash	22,000
5	Bought goods of Swaminathan	72,000
8	Cash Sales	16,200
11	Cash deposited into Bank	23,000
14	Purchased furniture for cash	4,000
16	Sold goods to Vivek	12,700
17	Received cash from Vivek	12,446
	Allowed his discount	254
18	Paid Swaminathan cash	12,000
	Discount allowed by him	240
20	Paid wages	1,800
21	Sold goods to Jagadeesan	35,000
22	Paid cash for trade expenses	150
24	Sold goods to Rajan	23,280
25	Received from Jagadeesan	21,000

	Allowing him discount	525
26	Paid Swaminathan cash on account	24,000
28	Sold goods for cash	9,000
29	Paid cash for stationery	180
30	Paid cash for miscellaneous expenses	150
31	Bought goods from Sridhar	17,870
31	Withdrew cash for private expenses	1,480

Dr. **Cash A/c** Cr.

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
2020				2020			
July 1	To Capital A/c		180000	July 3	By Bank A/c		55000
8	To Sales A/c		16200	4	By Purchase A/c		22000
17	To Vivek A/c		12446	11	By Bank A/c		23000
25	To Jagadeesan A/c		21000	14	By Furniture A/c		4000
28	To Sales A/c		9000	18	By Swaminathan A/c		12000
				20	By Wages A/c		1800
				22	By Trade Expenses A/c		150
				26	By Swaminathan A/c		24000
				29	By Stationery A/c		180
				30	By Miscellaneous Exp. A/c		150
				31	By Drawings A/c		1480
				31	By Balance c/d		94886
			238646				238646
Aug. 1	To Balance b/d		94886				

LEDGER

Ledger is the second important stage in the accounting cycle or process. In this stage of accounting cycle, all recorded business transactions or entries are grouped on a predetermined basis. Such classification or grouping takes the form of 'Accounts' in a separate book known as ledger. The 'accounts' in the ledger provide identifiable 'grouping' to the numerous business transactions.

An account is usually 'T' format and contains two sides – the left hand side called 'debit side' and the right hand side called 'credit side'. The heading mentions the name of the account. On both sides of the account, date column in maintained.

Problem

Enter the following transactions in the Journal and ledger of Hari prasad of Hyderabad

			Rs.
2000			
July	1	Commenced business with cash	1,80,000
	3	Deposited into Bank	55,000
	4	Purchases goods for cash	22,000
	5	Bought goods of Swaminathan	72,000
	8	Cash Sales	16,200
	11	Cash deposited into Bank	23,000
	14	Purchased furniture for cash	4,000
	16	Sold goods to Vivek	12,700
	17	Received cash from Vivek	12,446
		Allowed him discount	254
	18	Paid Swaminathan Cash	12,000
		Discount allowed by him	240
	20	Paid Wages	1,800
	21	Sold goods to Jagadeesan	35,000
	22	Paid cash for trade expenses	150
	24	Sold goods to Rajan	23,280
	25	Received from Jagadeesan	21,000
		Allowed him discount	525
	26	Paid Swaminathan cash on account	24,000
	28	Sold goods for cash	9,000
	29	Paid cash for stationery	180
	30	Paid cash for miscellaneous expenses	150
	31	Bought goods from Sridhar	17,870
	31	Withdrew Cash for private expenses	1,480

Solution

BOOKS OF HARI PRASAD OF HYDERABAD

JOURNAL ENTRIES

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2000					
July 1	Cash A/c	Dr		1,80,000	
	To Capital A/c				1,80,000
	[Being Cash brought in as capital]				
3	Bank A/c	Dr		55,000	
	To Cash A/c				55,000
	[Being the amount deposited into Bank]				
4	Purchases A/c	Dr		22,000	
	To Cash A/c				22,000
	[Being goods bought for cash]				

5	Purchases A/c	Dr		72,000	
	To Swaminathan A/c				72,000
	[Being goods bought on credit]				
8	Cash A/c	Dr		16,200	
	To Sales A/c				16,200
	[Being goods sold for cash]				
11	Bank A/c	Dr		23,000	
	To Cash A/c				23,000
	[Being the amount deposited into Bank]				
14	Furniture A/c	Dr		4,000	
	To Cash A/c				4,000
	[Being furniture bought for cash]				
16	Vivek A/c	Dr		12,700	
	To Sales A/c				12,700
	[Being goods sold on credit)				
17	Cash A/c	Dr		12,446	
	Discount allowed A/c	Dr		254	
	To Vivek A/c				12,700
	[Being amount received from Vivek and discount allowed to him]				
18	Swaminathan A/c	Dr		12,240	
	To Cash A/c				12,000
	To Discount received A/c				240
	[Being part payment made to Swaminathan and discount received from him]				
20	Wages A/c	Dr		1,800	
	To Cash A/c				1,800
	[Being Cash paid for wages]				
21	Jagadeesan A/c	Dr		35,000	
	To Sales A/c				35,000
	[Being goods sold on credit]				
22	Trade expenses A/c	Dr		150	
	To Cash A/c				150
	[Being Cash paid for trade expenses]				
24	Ranjan A/c	Dr		23,280	
	To Sales A/c				23,280
	[Being goods sold on credit]				

25	Cash A/c	Dr		21,000	
	Discount allowed A/c	Dr		525	
	To Jagadeesan A/c				21,525
	[Being Part payment received from Jagadeesan & discount allowed to him]				
26	Swaminathan A/c	Dr		24,000	
	To Cash A/c				24,000
	[Being Part payment made to Swaminathan]				
28	Cash A/c	Dr		9,000	
	To Sales A/c				9,000
	[Being goods sold for cash]				
29	Stationery A/c	Dr		180	
	To Cash A/c				180
	[Being Cash paid for stationery]				
30	Miscellaneous expenses A/c	Dr		150	
	To Cash A/c				150
	[Being cash paid for Miscellaneous Expenses)				
31	Purchases A/c	Dr		17,870	
	To Sridhar A/c				17,870
	[Being goods bought on credit]				
31	Drawings A/c	Dr		1,480	
	To Cash A/c				1,480
	[Being cash withdrawn for private expenses]				

LEDGER

Cash A/c

		Rs.			Rs.
1.7.2000	To Capital A / c	1,80,000	3.7.2000	By Bank A / c	55,000
6.7.2000	To Sales A / c	16,200	4.7.2000	By Purchases A / c	22,000
17.7.2000	To Vivek A / c	12,446	11.7.2000	By Bank A / c	23,000
25.7.2000	To Jagadeesan A / c	21,000	14.7.2000	By Furniture A / c	4,000
28.7.2000	To Sales A / c	9,000	18.7.2000	By Swaminathan A / c	12,000
			20.7.2000	By Wages A / c	1,800
			22.7.2000	By Trade expenses A / c	150
			26.7.2000	By Swaminathan A / c	24,000
			29.7.2000	By Stationery A / c	180
			30.7.2000	By Miscellaneous Expenses A / c	150
			31.7.2000	By Drawings A / c	1,480
				By Balance C / d	94,886
		2,38,646			2,38,646
1.8.2000	To Balance b / d	94,886			

Capital A/c

		Rs.			Rs.
			1.7.2000	By Cash A / c	1,80,000
31.7.2000	To Balance C / d	1,80,000			
		1,80,000			1,80,000
			1.8.2000	By Balance b / d	1,80,000

Bank A/c

		Rs.			Rs.
3.7.2000	To Cash A / c	55,000			
11.7.2000	To Cash A / c	23,000	31.7.2000	By Balance C / d	78,000
		78,000			78,000
1.8.2000	To Balance b / d	78,000			

Purchases A/c

		Rs.			Rs.
4.7.2000	To Cash A / c	22,000			
5.7.2000	To Swaminathan A / c	72,000			
31.7.2000	To Sridhar A / c	17,870	31.7.2000	By Balance c / d	1,11,870
		1,11,870			1,11,870
1.8.2000	To Balance b / d	1,11,870			

Swaminathan A/c

		Rs.			Rs.
18.7.2000	To Cash A / c	12,000	5.7.2000	By Purchases A / c	72,000
18.7.2000	To Discount received A / c	240			
26.7.2000	To Cash A / c	24,000			
31.7.2000	To Balance C / d	35,760			
		72,000			72,000
			1.8.2000	By Balance b / d	35,760

Sales A/c

		Rs.			Rs.
			6.7.2000	By Cash A / c	16,200
			16.7.2000	By Vivek A / c	12,700
			21.7.2000	By Jagadeesan A / c	35,000
			24.7.2000	By Ranjan A / c	23,280
1.7.2000	To Balance C / d	96,180	28.7.2000	By Cash A / c	9,000
		96,180			96,180
			1.8.2000	By Balance b / d	96,180

Furniture A/c

		Rs.			*Rs.*
14.7.2000	To Cash A / c	4,000	31.7.2000	By Balance c / d	4,000
		4,000			4,000
1.8.2000	To Bal. b / d	4,000			

Vivek A/c

		Rs.			Rs.
16.7.2000	To Sales A / c	12,700	17.7.2000	By Cash A / c	12,446
			17.7.2000	By Discount allowed	254
		12,700			12,700

Discount Allowed A/c

		Rs.			Rs.
17.7.2000	To Vivek A / c	254			
25.7.2000	To Jagadeesan A / c	525	31.7.2000	By Balance c / d	779
		779			779
1.8.2000	To Balance b / d	779			

Discount Received A/c

		Rs.			Rs.
			18.7.2000	By Swaminathan A / c	240
31.7.2000	To Balance C / d	240			
		240			240
			1.8.2000	By Balance b / d	240

Wages A/c

		Rs.			Rs.
20.7.2000	To Cash A / c	1,800			
			31.7.2000	By Balance C / d	1,800
		1,800			1,800
1.8.2000	To Balance b / d	1,800			

Jagadeesan A/C

		Rs.			Rs.
21.7.2000	To Sales A / c	35,000	25.7.2000	By Cash A / c	21,000
			25.7.2000	By Discount allowed A / c	525
			31.7.2000	By Balance C / d	13,475
		35,000			35,000
1.8.2000	To Balance b / d	13,475			

Trade Expenses A/c

		Rs.			Rs.
22.7.2000	To Cash A / c	150	31.7.2000	By Balance C / d	150
		150			150
1.8.2000	To Balance b / d	150			

Ranjan A/c

		Rs.			Rs.
24.7.2000	To Sales A / c	23,280	31.7.2000	By Balance C / d	23,280
		23,280			23,280
1.8.2000	To Balance b / d	23,280			

Stationery A/C

		Rs.			Rs.
29.7.2000	To Cash A / c	180	31.7.2000	By Balance C / d	180
		180			180
1.8.2000	To Balance b / d	180			

Miscellaneous Expenses A/c

		Rs.			Rs.
30.7.2000	To Cash A / c	150	31.7.2000	By Balance C / d	150
		150			150
1.8.2000	To Balance b / d	150			

Sridhar A/c

		Rs.			Rs.
31.7.2000	To Balance C / d	17,870	31.7.2000	By Purchases A / c	17,870
		17,870			17,870
			1.8.2000	By Balance b / d	17,870

Drawings A/c

		Rs.			Rs.
31.7.2000	To Cash A / c	1,480	31.7.2000	By Balance C / d	1,480
		1,480			1,480
1.8.2000	To Balance b / d	1,480			

UNIT – II

FINAL ACCOUNTS

Trial Balance

A trial balance is a list of all the general ledger accounts (both revenue and capital) contained in the ledger of a business. This list will contain the name of each nominal ledger account and the value of that nominal ledger balance. Each nominal ledger account will hold either a debit balance or a credit balance. The debit balance values will be listed in the debit column of the trial balance and the credit value balance will be listed in the credit column. The trading profit and loss statement and balance sheet and other financial reports can then be produced using the ledger accounts listed on the same balance.

Definition

According to M.S. Gosav (the Substance of Accountancy) "Trial balance is a statement containing the balances of all ledger accounts, as at any given date, arranged in the form of debit and credit columns placed side by side and prepared with the object of checking the arithmetical accurancy of ledger postings".

Methods of preparation of Trial Balance

The following are the methods of preparing trial balance

(i) Total Method

(ii) Balance Method

The following balances were extracted from the ledger of Ramakrishna Engineering Works on 31st March 1997. You are required to prepare a trial balance as on that date in proper form.

	Rs.		Rs.
Drawings	6,000	Salaries	9,500
Capital	24,000	Sales Returns	1,000
Sundry creditors	43,000	Purchase Returns	1,100
Bills payable	4,000	Travelling expenses	4,600
Sundry debtors	50,000	Commission paid	100
Bills receivable	5,200	Trading expenses	2,500
Loan from Karthik	10,000	Discount earned	4,000
Furniture & fixtures	4,500	Rent	2,000
Opening stock	47,000	Bank overdraft	6,000
Cash in hand	900	Purchases	70,800
Cash at bank	12,500		
Tax	3,500		
Sales	1,28,000		

Solution :

Trial balance of Ramakrishna Engineering Works as on 31-3-1997

S. No.	*Name of Account*	*L.F.*	*Debit balance Rs.*	*Credit balance Rs.*
1.	Drawings		6,000	–
2.	Capital		–	24,000
3.	Sundry creditors		–	43,000
4.	Bills payable		–	4,000
5.	Sundry debtors		50,000	–
6.	Bills receivable		5,200	–
7.	Loan from Karthik		–	10,000
8.	Furniture & Fittings		4,500	–
9.	Opening stock		47,000	–
10.	Cash in hand		900	–
11.	Cah at bank		12,500	–
12.	Tax		3,500	–

13.	Sales	–	1,28,000
14.	Salaries	9,500	–
15.	Sales returns	1,000	–
16.	Purchase returns	–	1,100
17.	Travelling expenses	4,600	–
18.	Commission paid	100	–
19.	Trading expenses	2,500	–
20.	Discount earned	–	4,000
21.	Rent	2,000	–
22.	Bank overdraft	–	6,000
23.	Purchases	70,800	–
		2,20,100	2,20,100

Final Accounts

Final Accounts are the accounts, which are prepared at the end of a fiscal year. It gives a precise idea of the financial position of the business/organization to the owners, management, or other interested parties. Financial statements are primarily recorded in a journal; then transferred to a ledger; and thereafter, the final account is prepared (*as shown in the illustration*).

Usually, a final account includes the following components −

- Trading Account
- Manufacturing Account
- Profit and Loss Account
- Balance Sheet

Prepare a trading and P & L A/c for the year ending 31.03.2001 and a balance sheet as on that date from the following trial balance:

Trial Balance

Particulars	*Dr. (Rs.)*	*Cr. (Rs.)*
Opening Stock	16,000	
Capital		45,000
Salaries	13,000	
Drawings	4,000	
Carriage Inwards	500	
Carriage Outwards	1,000	
Sales Return	1,000	
Purchase Return		7,00
Loan to Mr. X	11,000	
Loan from Mr. Y		7,000
Rent	1,300	
Rent Outstanding		200
Purchase	40,000	
Sales		73,100
Debtors	25,000	
Creditors		8,000
Bad Debt	800	
Reserve for Bad Debt		1,200
Discount Allowed/Received	600	
Furniture	11,700	
Wages	500	
Insurance Premium	1,200	
Rent by Sub-letting		800
Cash	700	
Bank	8,000	
Total	**1,36,300**	**1,36,300**

Adjustments:

1. Closing Stock ` 10,500, but the market value of closing stock was ` 9,500.
2. Insurance premium prepaid ` 200.
3. Loan to Mr. X, given at 10% interest p.a. and loan taken from Mr. Y carries 9% interest p.a.
4. Depreciation is to be provided at 5% on furniture.
5. Goods worth `500 have been taken by the proprietor for private use.
6. Bad and doubtful debts are to be provided at 10%.

Solution

Trading Account for the Year ending March 31, 2001

Dr. ***Cr.***

Particulars		*Amount*	*Particulars*		*Amount*
To Opening Stock		16,000	By Sales:	73,100	
To Purchase:	40,000		Less Return:	1,000	72,100
Less Return	700	39,000	By Proprietor [I]		500
To Carriage Inward		500	By Closing Stock [II]		9,500
To Wages		500			
To Gross Profit b/d		**25,800**			
Total		**82,100**	**Total**		**82,100**

Profit and Loss Account for the Year ending March 31, 2001

Dr. ***Cr.***

Particulars		*Amount*	*Particulars*	*Amount*
To Salary		13,000	By Gross Profit c/d	25,800
To Carriage Outward		1,000	(From Trading A/c)	
To Rent		1,300		
To Reserve for Bad Debts[III]		2,100	By Discount Received	300
To Discount Allowed:		600	By Rent by Sub-letting	800
To Insurance Premium:	1,200		By Interest Receivable [VII]	1,100
Less pre-paid [IV]	200	1,000		
To Interest Payable to Mr. Y[V]		630		
To Depreciation A/c: [VI]		585		
To Net Profit		**7,785**		
Total		**28,000**	**Total**	**28,000**

Balance Sheet as on March 31, 2001

Liabilities		*Amount*	*Assets*		*Amount*
Capital	45,000		**Fixed Assets:**		
Less Drawings [I]	4,000		Furniture	11,700	
Less Goods taken			Less Depreciation [VI]	585	
by owner	500				11,115
Add Profit during year	7,785		**Current Assets:**		
		48,285	Loan to Mr. X	11,000	
Loan from Mr. Y [V]	7,000		Add Outstanding		
Add Interest	630		Interest [VII]	1,110	
		7,630			12,100
Rent Outstanding		200	Debtors	25,000	
Creditors		8,000	Less Provision for Bad		
			Debt [III]	2,500	22,500
			Prepaid Insurance [IV]		200
			Cash		700
			Bank		8,000
			Closing Stock [II]		9,500
Total		**64,115**	**Total**		**64,115**

UNIT – III

ACCOUNTING ERRORS, BRS, ACCOUNT CURRENT AND AVERAGE DUE DATE

Rectification of Errors

'To Err is human' is a familiar proverb. Errors or mistakes may be committed in different stages of the accounting process. The errors have to be located and corrected at the earliest to ensure the correctness of accounts. If errors are not rectified, the profit disclosed by the profit and loss account cannot be relied upon. Similarly, the Balance sheet also becomes undependable.

Classification of errors

Numerous errors are usually committed in maintaining accounts. Appropriate classification of all the errors provides the necessary comprehension to rectify them. There are three ways in which the errors can be classified:

I. Nature of error as Basis:

Depending on the nature of error committed, errors can be classified as follows.

A. Errors of omission
B. Errors of commission
C. Errors of principle
D. Compensating errors

A. Errors of omission

This category includes omission of a transaction either in the journal or subsidiary books or in the ledger. The omission can be complete or partial.

(i) When a transaction is not at all recorded in journal or subsidiary books, it is complete omission. Similarly, when a transaction is not at all posted to the ledger, (both debit and credit) it is also complete omission.

(ii) When a part of a transaction is recorded and the remaining portion is omitted, it is partial omission. For example, cash received from a customer is entered in the cash book but not posted to the customer's account.

B. Errors of commission

'Commission' means doing something which should not have been done. This applies to all mistakes due to lack of concentration or carelessness.

The following errors of commission are usually committed in subsidiary books.

1. *Wrong entry:* Entering wrong amount in a subsidiary book.
2. *Entry in wrong book:* Entering correct amount or wrong amount in a wrong subsidiary book.
3. *Wrong casting:* Subsidiary books are to be totalled periodically and posted to the ledger. The totalling of any particular subsidiary book may be wrong.

Wrong entry and entry in wrong book usually affect both the debit and credit. So, mistake occurs in two different accounts. Wrong casting affects only one account. There will not be any mistake in the personal account.

The following errors of commission are usually committed in ledger:

1. Errors of posting and 2. Errors of balancing.

Errors of posting may be:

Right amount in the right side of wrong account.
Right amount in the wrong side of correct account.
Wrong amount in the right side of correct account.
Wrong amount in the wrong side of correct account.
Wrong amount in the wrong side of wrong account.
Wrong amount in the right side of wrong account, etc.

Errors of balancing can occur in one or more accounts in the ledger while ascertaining the balance, either periodically or at the time of preparing trial balance.

C. Errors of principle

These mistakes occur due to improper application of principles of accounts. Errors of principle may relate to different aspects.

1. *Capital and revenue items*: Purchase of assets may be recorded in purchases book, treating capital expenditure like a revenue item. Similarly, sale of fixed assets may be shown in sales book. Expenditure on repairs may be debited to machinery account. Wages spent for erection of equipment may be debited to wages account.
2. *Improper valuation:* Valuation of investments and stocks against the recognised practices.
3. *Erratic provisioning* : Providing insufficient or excess provisions for depreciation, provision for doubtful debts, etc.

D. Compensating errors

Errors which neutralise each other are called compensating errors. The error is usually in unrelated accounts but the amount will be the same. Thus, excess debit in one account may be compensated by excess credit in another account.

Need for Bank Reconciliation Statement

We had already seen that in the triple column cash book, a separate bank column is provided on both the sides to record all transactions relating to bank. So, whenever cheques and cash are paid in, they are entered on the debit side in the bank column and whenever cheques are issued or cash is withdrawn from Bank they are entered on the credit side of the bank column. The balance found in the bank column is termed as 'Bank balance' as per cash book. The balance of bank column may be favourable (debit balance) or unfavourable (credit balance). Favourable balance indicates the balance of deposit at the bank. Unfavourable balance indicates the excess of withdrawls over deposits and is called 'Bank overdraft'.

Customer's account is maintained in the books of banker. Details of customer's account are supplied to customer by the bank in the form of a 'Bank statement' or a book known as 'Pass book'. In the pass book transactions which increase the customer's balance (i.e., deposits) are recorded on credit side and transactions which decrease customer's balance (i.e., withdrawls) are shown on debit side. Balance of customer's account in the books of banker as shown by pass book is termed as 'Bank balance as per pass book'. The balance as per pass book may also be favourable (Credit balance) or unfavourable (debit balance). Unfavourable balance as per pass book indicates the amount of 'Bank overdraft' and favourable balance as per pass book shows the amount of deposit at a particular point of time.

It is clear from the above that deposits in Bank Account are recorded (a) on debit side in the cash book and (b) on credit side in the pass book. Similarly, withdrawls from bank are recorded (a) On credit side in the cash book and (b) On debit side in the pass book. As transactions relating to deposits and withdrawls made during a certain period are recorded in both the books – Cash book and Pass book – the balance shown by the two at the end of the period should be the same. But in practice, these two balances do not agree on account of reasons given later in the chapter. So, in order to reconcile and explain the causes of difference between the 'Bank balance as per Cash book' and the 'Balance as per pass book' at a particular date, it is necessary to prepare a statement which is called 'Bank Reconciliation Statement'.

Proforma of a bank reconciliation statement

The following statements indicate the effect of each 'difference' on cash book balance or pass book balance.

I. If we take cash book balance or overdraft as per pass book as the starting point:

Bank Reconciliation Statement as on .....

		Rs.	Rs.
	Balance as per cash book or overdraft as per pass book		xxx
Add:	(i) Cheques issued / drawn but not presented	xxx	
	(ii) Direct deposit made by customers into bank not recorded in cash book	xxx	
	(iii) Dividend or other incomes collected by the bank not recorded in cash book	xxx	
	(iv) Interest credited by the bank but not debited in cash book	xxx	xxx
			xxx
Less:	(i) Cheques paid/ deposited into bank but not credited	xxx	
	(ii) Payments by the bank as per standing instruction, not entered in cash book	xxx	
	(iii) Bank charges debited in pass book but not recorded in cash book	xxx	
	(iv) Cheques deposited but dishonoured, not recorded in cash book	xxx	
	(v) Cheques issued and recorded in cash book as deposited into bank but the same was not deposited into bank	xxx	
	(vi) Cheques issued but not recorded in cash book		
	(vii) Interest on bank deposits recorded in cash book but not credited by the bank	xxx	xxx
	Balance as per pass book or overdraft as per cash book.		xxx

II. If we take pass book balance or overdraft as per cash book as starting point:

Bank Reconciliation Statement as on .....

		Rs.	Rs.
	Balance as per pass book or overdraft as per cash book		xxx
Add:	(i) Cheques paid / deposited into bank but not credited	xxx	
	(ii) Payments made by the bank as per standing instruction, not entered in cash book	xxx	
	(iii) Bank charges debited in pass book but not recorded in cash book	xxx	
	(iv) Cheques deposited but dishonoured not recorded in cash book	xxx	
	(v) Cheques issued and recorded in cash book as deposited into the bank but the same was not deposited into the bank	xxx	
	(vi) Cheques issued but not recorded in cash book	xxx	
	(vii) Interest on bank deposits recorded in cash book but not credited, by the bank	xxx	xxx
			xxx
Less:	(i) Cheques issued/ drawn but not presented	xxx	
	(ii) Direct deposit made by customers into bank, not recorded in cash book	xxx	
	(iii) Dividends or other income collected by the bank but not recorded in cash book	xxx	
	(iv) Interest credited by the bank but not debited in cash book	xxx	xxx
	Balance as per cash book or overdraft as per pass book		xxx

From the under-mentioned particulars of Mr. M. Mohan prepare a Bank Reconciliation Statement as on 31st July 1994.

(i) Cheques paid into Bank on the 28th July 1994 but credited to Mohan's account in the first week of August 1994.
K. Kalyan Rs. 1,000; J. Joy Rs. 800; R. Raghul Rs. 1,200.

(ii) The following cheques were issued by Mohan on 30th July 1994 but presented to bank for payment after the close of the year.
D. David Rs. 1,200; H. Hari Rs. 1,000; L. Lal Rs. 800.

(iii) A cheque for Rs. 300 was credited direct to the account and was not passed through the cash book.

(iv) The bank balance as per cash book on 31st July 1994 amounted to Rs. 30,000.

Solution:

Bank Reconciliation Statement of M. Mohan as on 31st July 1994

			Rs.	Rs.
		Bank Balance as per cash book		30,000
Add:	(i)	Cheques issued but not presented for payment		
		D. David Rs. 1,200		
		H. Hari Rs. 1,000		
		L. Lal Rs. 800	3,000	
	(ii)	Cheque credited direct to the account but not passed through the cash book	300	3,300
				33,300
Less:		Cheques paid into bank but not credited in the pass book		
		K. Kalyan Rs. 1,000		
		J. Joy Rs. 800		
		R. Raghul Rs. 1,200	3,000	3,000
		Bank balance as per pass book		30,300

The bank overdraft of Rajini on 31-12-93 as per cash book is Rs. 9,000. From the following particulars, prepare bank reconciliation statement:

		Rs.
(i)	Unpresented cheque	3,000
(ii)	Uncleared cheque	1,700
(iii)	Bank interest debited in the pass book only	500
(iv)	Bill collected and credited in the pass book only	800
(v)	Cheque of Renu dishonoured	500
(vi)	Cheques issued to Sekar entered in the Cash column of cash book	300

Solution:

Bank Reconciliation Statement as on 31-12-93

			Rs.	Rs.
		Bank Overdraft as per cash book		9,000
Add:	(i)	Uncleared cheques	1,700	
	(ii)	Interest debited	500	
	(iii)	Dishonoured cheques	500	
	(iv)	Cheques omitted from the Bank column	300	3,000
				12,000
Less:	(i)	Un presented cheques	3,000	
	(ii)	Bill Collected	800	3,800
		Bank Overdraft as per pass book		8,200

Account Current

Meaning

An account current is a running statement of transactions between two parties for a given period of time and includes interest allowed or charged on various items. It takes the form of an account. Particularly, when two parties have numerous transactions between themselves and settlement of each transaction is not separately made, it becomes necessary. Firstly, to take into account the loss or gain on account of interest and secondly, to ensure that there is no dispute regarding the net amount due. For this purpose, a statement is prepared by one party and sent to the other. Transactions between the two parties during a particular period are recorded. Such a statement is called 'Account current'. Thus, an account current is a copy of ledger account of the other party in the books of the party who sends it and contains an additional column on each side (for calculating interest) besides the usual amount columns. An example is of a manufacturer who sells goods frequently to a merchant on credit and receives payments from him in instalments at different intervals and charges interest on the amount which remains outstanding. Such a statement is generally rendered (i) by one trader to another (ii) by a banker to his client (iii) by an agent to his principal (iv) by a consignee to consignor and (v) by one co-venturer to another.

While preparing the account current, the transactions are arranged date wise (chronologically) and the interest is charged or allowed at an agreed rate. The party to whom the account current is sent, is named first. Interest may be calculated for each transaction separately or only the net amount of the interest may be entered. Usually, interest is calculated on the basis of number of days.

Heading of an Account Current

An account current being a copy of the ledger account of the opposite party, the sender writes the name of the opposite party at the beginning and writes his own name at the end. For instance, when 'A' sends the account current to 'B' the heading of the statement will be *'B' in Account Current with 'A'*. This would mean that a copy of 'B's A/c' is being sent to him (B) as it would appear in the books of A.

Definition

An account current may be defined as "an account of the transactions between two parties during a particular period, in which interest is calculated at an agreed rate on each debit and credit item and the net balance of interest is included on the debit or credit side of the account in the amount column".

Procedure for calculating days of interest

There are three methods of calculating the number of days for account current purpose:

(i) **Forward Method:**– Under this method, the days are counted from the date of transaction (if there is no credit period) or from the due date of transaction (where a period of credit is granted or bill is used) to the closing date or date of settlement of account current. It includes product method and interest table method.

(ii) **Backward or Epoque Method:**– In this method, days are counted from the due date of transaction to the opening date of the account current. (This method is useful where the opening date of the account current is given).

(iii) **Daily Balance Method or Periodical Balance Method:**– This method is generally followed in banks. In this method, days are calculated from the due date of one transaction to the due date of the next transaction.

Points to remember regarding counting of days

(1) The date of the transaction is left out of calculation. For example, the number of days between 10th February and 28th February will be 18. 10th February will not be counted.

(2) In case of bills transactions, due date should be computed after adding 'grace days', wherever applicable.

(3) In the case of balance brought forward from the previous period, the first day of the new period will also be counted. Suppose, the opening balance on 1st January 1990 is Rs. 10,000. Up to 10th February 1990, the number of days will be 41 (January 31 + February 10). If a new transaction is entered, say, on 1st January, then this day will not be counted.

(4) Where goods are bought or sold on 'some days credit' counting should be made from the due date of the transaction, after the period of credit is completed.

(5) Sometimes the date of the settlement of the transaction is different from the date of transaction itself. In that case the settlement date is to be considered.

Preparation of Account Current

There are four ways of preparing an account current. They are discussed in detail below.

(1) Product Method

In this method, separate columns for number of days, amount and products are to be opened on the both sides of the account. The number of days in respect of each transaction to the closing date is ascertained. The number of days is multiplied by the amount of the transaction, in order to get the product.

The products are entered in a separate column on both sides of the account. Then the product column is balanced and interest is calculated for one day on the balance. It has to be entered in the amount column on the side which has the larger of the total products.

The logic behind this method is simple. Interest on Rs. 1,000 for 5 days will be the same as on Rs. 5,000 for one day.

The interest is ascertained by the formula:

$$\text{Interest} = \frac{\text{Balance of the products} \times \text{Rate of interest}}{365 \times 100}$$

In case products are in terms of months,

$$\text{Interest} = \frac{\text{Balance of the products} \times \text{Rate of interest}}{12 \times 100}$$

Red-ink Interest: Many a time an account current contains transactions the due dates of which fall after the settlement date *i.e.,* the closing date of the account current. For example, an account current is prepared for the half year ended 30th June 1990. X receives a bill of exchange from Y for Rs. 2,000 on 15th June due one month after date. The due date of the transaction is, therefore, 18th July 1990 *i.e.,* 18 days after the closing date of the account current. In such a case, one of the following methods is adopted:

(i) The days of such transaction are calculated from – the settlement date to the due date of the transaction and put in the days column with (–) sign. The product of this is also marked with (–) sign. It is called *Red-ink Interest* because it is written in red ink in the books. Hence, the product of this type of transaction is to be deducted from the total of the products.

(ii) To avoid the confusion of *red-ink figures* in totalling the products, the products of such otherwise, red-ink transactions are written in blue ink on the opposite sides and are considered as usual.

Though the amounts of red-ink transactions are payable/receivable after the settlement date, these amounts are recorded within the account current. Therefore, interest for days beyond the settlement date is to be waived. Hence, the products of such transactions are deducted from the total of other products, the due dates of which are within the settlement date. The red-ink interest adjustments are not necessary in case of Epoque method.

(2) Interest Table Method / Forward Method

In this method, all the transactions are arranged in the form of an account. There are two additional columns on both sides of such an account.

(i) One column is meant to indicate the number of days counted from the due date of each transaction to the date of rendering the account. If no specific date is mentioned as the date on which payment is due, the date of transaction is presumed to be the due date.

(ii) The other column is meant for writing interest. Interest is calculated by tables, on each item separately. The interest columns on both sides of the account are then added and balanced. The balance is carried out into the principal (amount) column. This method is not very helpful since interest is to be calculated for each transaction separately.

(3) Daily Balance Method or Periodical Balance Method

This method is usually adopted in banks where the balance of an account is found after every transaction. In this case, the number of days written against each transaction are the days counted from its date or due date to the date of the following transaction. In the case of the last transaction, the number of days are counted to the closing date of the period.

Each amount is multiplied with the number of days. If the amount represents a debit balance, the product is written in the 'Dr. product column' and if it represents a credit balance, the product is written in the 'Cr. product column'. The Dr. product and Cr. product columns are then totalled up. Interest is calculated on each total at the given rate of interest and the net interest is ascertained. If the net interest is payable to the customer, it will appear as "By Interest A/c" under deposits and if it is due from the customer, it will appear as "To Interest A/c" under withdrawals.

(4) Backward / Epoque Method

Under this method, the columns in the debit and credit sides of Account current are made in the same manner as in product method. Number of days are counted from the opening date of the statement to the due date of each transaction. Since the opening date is considered as base, no interest is charged on the opening balance but interest for the whole period is charged on the closing balance. Number of days are ascertained and then multiplied by the amount paid / received and the products are calculated. The products on each side are then totalled and the difference is ascertained. Interest is calculated at the agreed rate for the said difference for one day and the same is posted on the shorter side in the amount column. Thereafter, the amount column is balanced.

Varying Rates of Interest

Sometimes both the parties agree to charge and to allow interest on debit and credit items at different rates of interest. In such a case, interest on the total of debit products is calculated at the rate of interest meant for debit items and interest on the total of credit products is calculated at the rate meant for credit items. The difference between interest so arrived on debit and credit products should be entered in the amount column on the side in which products total is heavier.

The following transactions took place between Ram and Krishna f 1-1-09 to 30-6-09.

2009		Rs.
Jan. 1	Sold goods to Ram	2,240
Jan. 10	Received Ram's acceptance at 2 months	1,000
Feb. 15	Received cash from Ram	1,200
Mar. 2	Bought goods from Ram	5,500
Mar. 3	Accepted Ram's bill at 1 month	2,000
Apr. 11	Paid cash to Ram	2,000
Apr. 30	Sold goods to Ram payable up to 31st May	2,400
May 11	Bought goods from Ram	1,500
May 31	Sold goods to Ram payable up to 10th June	2,200
June 15	Bought goods from Ram	3,000

Prepare the account current to be sent by Krishna on 30th June 2009. The r of interest is 5%. ***[Madras, B.Com.(PZA) Nov. 2006; Periyar BBA May 200***

Solution: **Books of Krishna**

Ram in Account Current with Krishna as on 30-6-2009

Date 2009	Particulars	Amount Rs.	Days	Products Rs.	Date 2009	Particulars	Amount Rs.	Days	Produc Rs
Jan. 1	To Sales	2,240.00	180	4,03,200	Jan. 10	By B/R (due on march 13)	1,000.00	109	1,09,00
Mar. 3	To B/P (due on April 6)	2,000.00	85	1,70,000	Feb. 15	By Cash	1,200.00	135	1,62,00
Apr. 11	To Cash	2,000.00	80	1,60,000	Mar. 2	By Purchases	5,500.00	120	6,60,00
Apr. 30	To Sales (due on May 31)	2,400.00	30	72,000	May 11	By Purchases	1,500.00	50	75,00
May 31	To Sales (due on June 10)	2,200.00	20	44,000	June 15	By Purchases	3,000.00	15	45,00
June 30	To Balance of products			2,01,800	June 30	By Interest on bal. of products $\left(2,01,800 \times \frac{5}{100} \times \frac{1}{365}\right)$	27.64		
June 30	To Bal. c/d	1,387.64							
		12,227.64		10,51,000			12,227.64		10,51,00
					July 1	By Balance b/d	1,387.64		

Prepare account current for Nagesh in respect of the following transactions with Basha:-

		Rs.
1994		
Sep. 16	Goods sold to Basha	400 (due 1st Oct.)
Oct. 1	Cash received from Basha	180
Oct. 21	Goods purchased from Basha	1,000 (due 1st Dec.)
Nov. 1	Paid to Basha	660
Dec. 1	Paid to Basha	600
Dec. 5	Goods purchased from Basha	1,000 (due 1st Jan.)
Dec. 10	Goods purchased from Basha	440 (due 1st Jan.)
1995		
Jan. 1	Paid to Basha	1,200
Jan. 9	Goods sold to Basha	40 (due 1st Feb.)

The account is to be prepared upto 1st Feb. Calculate interest @ 6% p.a.

[Periyar BBA, May 2004; Bharathidasan, B.Com., April 2002]

Solution:

Books of Nagesh

Basha in Account Current with Nagesh as on 1-2-95

Date	Particulars	Amount Rs.	Days	Product Rs.	Date	Particulars	Amount Rs.	Days	Product Rs.
1994					1994				
Sep. 16	To Sales A/c (due on Oct.1)	400.00	123	49,200	Oct. 1	By Cash A/c	180.00	123	22,140
					Oct. 21	By Purchase A/c (due on 1st Dec.)	1,000.00	62	62,000
Nov. 1	To Cash A/c	660.00	92	60,720	Dec. 5	By Purchase A/c (due on 1st Jan.)	1,000.00	31	31,000
Dec. 1	To Cash A/c	600.00	62	37,200					
1995					Dec.10	By Purchase A/c (due on 1st Jan.)	440.00	31	13,640
Jan. 1	To Cash A/c	1,200.00	31	37,200					
Jan. 9	To Sales A/c (due on 1st Feb.)	40.00	0	0	1995				
					Feb. 1	By Balance c/d	289.13	–	55,540
Feb.1	To Interest $\left(55{,}540 \times \frac{6}{100} \times \frac{1}{365}\right)$	9.13	–	–					
		2,909.13		1,84,320			2,909.13		1,84,320

Average Due Date

Average due date is an 'equated' or 'mean' date on which a single payme of a consolidated amount can be made in lieu of several payments due on differe dates.

In the normal course of business, a person may be required to pay severa amounts to another person on different future dates. It is inconvenient for both of them to settle each amount due separately. Payment of the total amount due on the average due date protects both the debtor and creditor from 'loss of interest'.

The mathematical process involved in the computation of average due date is known as "Equation of Payments". In the process of single payment on Average Due Date, certain dues are paid after their actual due dates and some other dues are paid before their actual due dates. Thus, average due date is the 'arithmetic average' of various payments, giving proper weightage to the amount and period of the dues.

Actual payment of the total amount may be made on the average due date. Payment can also be postponed or preponed, based on compensation in the form of 'interest' for the period involved.

Practical uses of Average Due Date

a) In the settlement of running accounts between traders or traders and customers.
b) In the settlement of transactions between a principal and agent.
c) In settling a series of bills of exchange or post dated cheques.
d) In the calculation of interest on drawings of partners.
e) In the computation of interest on book debts realised piecemeal during dissolution of partnership firms.

Basic types of Problems

Though Average due date concept can be used in numerous situations, the following are the two basic types of problems.

a) Average due date for amounts lent in different instalments to be repaid in a single instalment.
b) Average due date for amounts lent in one instalment, repayable in several instalments.

(a) Where amount is lent in different instalments

The following steps are necessary to find the average due date:-

(i) Selecting one of the due dates as the 'base date'. Any one of the available due dates can be taken as base date. However, it is 'preferable' to choose the earliest of the due dates as 'base date'.
(ii) Calculation of the number of days from the base date to the due date of each transaction.
(iii) Multiplication of the amount of each transaction with the number of days from the base date, as shown in step (ii) to obtain products.
(iv) Adding the amounts of all payments and all products separately.
(v) Dividing the total of the products with the total of the payments to get a number [any fraction must be approximated to the nearest digit].
(vi) If the above number is positive, the average due date is ahead of the base date by that number of days. If however the above number is negative, [this is possible only when the base date is not the earliest of the due dates] the average due date is the date obtained by subtracting the above number of days from the base date.

$$\therefore \text{ Average Due Date} = \text{Base Date} \pm \frac{\text{Total of products}}{\text{Total of amounts}} \text{ days}$$

Determination of Due Date

Due dates of transactions are essential for ascertaining number of days from base date of each transaction. The following guidelines are important for determination of due dates.

(i) In the case of running account between traders or other individuals, the date of a transaction is its due date, unless otherwise given.
(ii) In case of bills of exchange, bills payable 'on demand' or 'at sight' or 'on presentation', are due on the date they are presented for payment.
(iii) Bills of exchange payable at a predetermined time in future are due on the third day from the day they are payable. This is due to the customary 'three days of grace'.
(iv) Due date of a bill drawn in terms of days must be determined by actual count of days (adding grace days, if applicable).
(v) Due date of a bill drawn in terms of months must be computed in terms of months irrespective of actual number of days in each month.
(vi) If due date of a bill falls on a public holiday, the previous day becomes the day of due date.
(vii) Due date of bills payable *days or months after sight* should be computed from the date of acceptance, if given. Due date of bills payable *after date* should be computed from the date of drawing of the bill, if given.
(viii) While counting the number of days from base date for each transaction, the base date itself should be omitted.

Average due date as basis for calculation of interest

I. Gain or loss on interest to any party can be avoided by making payment on the average due date. However, this date may be used as a 'bench mark' for several dealings.

(a) The debtor may seek extra time from the average due date for actual payment, agreeing to pay specified rate of interest.

(b) The debtor may plan to save 'interest' by agreeing to pay the aggregate sum before the due date. [Illustration 10]

(c) Both the parties may agree to settle the amount due with a new bill drawn on the average due date, adding interest for the period of the bill.

Interest is computed as follows:-

$$\text{Total Amount} \times \text{Agreed \% of interest} \times \frac{\text{Agreed period}}{\text{1 year}}$$

$$\text{For example, Rs. } 50{,}000 \times \frac{15}{100} \times \frac{73}{365} = \text{Rs. } 1{,}500.$$

II. Interest on Drawings of Partners: Partners may withdraw money for personal needs on different dates during the year. Average due date for all the drawings can be calculated in the usual manner. When final accounts are prepared, interest on the total amount withdrawn from the average due date till the date of closing of accounts can be computed at the agreed rate of interest.

(b) Where the amount is lent in a single instalment

When a single amount is borrowed which is repayable in several instalments, Average due date can be calculated, through the following steps:

(i) Calculation of the number of days / months / years from the date of lending to the date of each instalment.

(ii) Ascertaining the aggregate of days / months / years as computed in step (i).

(iii) The aggregate found in step (ii) should be divided by the number of instalments payable for complete repayment of the sum borrowed.

(iv) The result of step (iii) should be added to the date of the loan to arrive at the Average due date.

$$\text{Average Due Date} = \text{Date of Loan} + \frac{\text{Total of Days / Months / Years of various instalments}}{\text{No. of instalments}}$$

Kannan purchased goods from Raman, the due dates for payment in cash being as follows:

	Rs.	
Mar. 15	1,000	Due 18th April
Apr. 21	1,500	Due 24th May
Apr. 27	500	Due 30th June
May 15	600	Due 18th July

Raman agreed to draw a bill for the total amount due on the average due date. Ascertain that date.

Solution:

Computation of Average due date

Base date 18th April

Due date 1	*Amount* Rs. 2	*No. of days from Base date* 3	*Product* Rs. 4 (2 x 3)
18th April	1,000	0	0
24th May	1,500	36	54,000
30th June	500	73	36,500
18th July	600	91	54,600
	3,600		1,45,100

$$\text{Average due date} = \text{Base date} + \frac{\text{Total of products}}{\text{Total of amounts}} \text{ days}$$

$$= 18\text{th April} + \frac{1,45,100}{3,600} \text{days}$$

$$= 18\text{th April} + 40 \text{ days}$$

∴ Average Due Date = May 28

R owes S the following sums of money due from him on the dates stated:

Rs. 300 due on March 9. 1993.
Rs. 1,000 due on April 2. 1993.
Rs. 4,000 due on April 30. 1993.
Rs. 100 due on June 1. 1993.

He wants to make the complete payment on 30-6-93. Calculate interest at 5% p.a. with the help of Average due date method.

Solution: **Computation of Average due date**

Base date 9-3-93.

Due date	*Amount* Rs.	*No. of days from base date*	*Product* Rs.
1	2	3	4 (2 x 3)
9-3-93	300	0	0
2-4-93	1,000	24	24,000
30-4-93	4,000	52	2,08,000
1-6-93	100	84	8,400
	5,400		2,40,400

$$\text{Average due date} = \text{Base date} + \frac{\text{Total of products}}{\text{Total of amounts}} \text{ days}$$

$$= 93.93 + \frac{2,40,400}{5,400} \text{ days}$$

$$= 93.93 + 45 \text{ days}$$

$\therefore$ Average Due Date = 23.4.93

Therefore, interest is chargeable from 23-4-93 to 30-6-93 i.e., 68 days.

$$\text{Interest for 68 days} = 5,400 \times \frac{68}{365} \times \frac{5}{100}$$

Interest payable = Rs. 50.30.

UNIT – IV

DEPRECIATION

Concept of Depreciation

Depreciation is the process of spreading the cost of fixed assets over the different accounting periods which derive the benefit from their use. The cost of fixed assets apportioned to a given period forms part of the overall cost to be matched with the revenues generated in that period. So, depreciation is of great significance in the concept of income measurement. It measures the service potential of the fixed assets.

Fixed Assets: They include all assets whose benefit is derived by a businessman for a long period of time, usually more than one year period. *Examples:* Machinery, furniture, buildings, leases, etc. Land is a fixed asset but not subject to depreciation because it has infinite lifetime.

Meaning and Definition of Depreciation

Depreciation is a permanent decline in the value of an asset. The gradual decrease, both in the value and usefulness, of an asset due to its nature and usage is termed as depreciation.

It is common experience that whenever an asset is used it reduces in value. The net result of depreciation is that sooner or later, the asset becomes useless. So, it can be stated that depreciation is that portion of the cost of an asset which is reduced from revenues for the services of the asset in the operation of a business.

According to Spicer and Pegler " Depreciation is the measure of the exhaustion of the effective life of an asset from any cause during a given period".

According to International Accounting Standards Committee "Depreciation is the allocation of the depreciable amount of an asset over its estimated useful life. Depreciation for the accounting period is charged to income either directly or indirectly".

According to the Institute of Chartered Accountants of India, "Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes".

The following important terms from these definitions are important.

(i) *Depreciable Assets:* The assets whose lifetime can be estimated and useful during two or more accounting periods in production or service activities of an organisation can be called depreciable assets.

(ii) *Useful life:* Useful life is the time during which the asset is helpful in the normal business activities of a firm. It can be less than the total life time of the asset. It can be exactly predetermined or it should be estimated on reasonable basis.

(iii) *Depreciable amount:* It is the cost of acquisition and installation of an asset after reducing any realisable value at the end of useful life.

(iv) *Realisable value:* This is the amount realisable at the end of the asset's useful life, either as *scrap* or as *second hand asset.*

(v) *Effluxion of time:* It is the passage of time irrespective of actual use of an asset as in the case of leased assets.

(vi) *Obsolescence:* It refers to an asset becoming out of date due to improved models or methods.

Characteristics of Depreciation

The important characteristics of depreciation are noted below:-

(i) Depreciation is a reduction in the book value of a fixed asset except land.

(ii) It is a charge against profit for a particular accounting period i.e. the true profit cannot be ascertained without charging depreciation.

(iii) It reduces the book value of the asset but not its market value.

(iv) It is a process of allocation of expired cost and not of valuation of fixed assets.

(v) It is always computed in a systematic and rational manner since it is not a sudden loss.

(vi) It may be physical and functional.

(vii) It takes place gradually unless there is a quick physical deterioration or obsolescence due to technological developments.

(viii) It is a continuing process. The book value is reduced either with the use of the asset or due to passage of time. Depreciation once charged will have to be charged in the subsequent periods also till the asset is totally exhausted or discarded.

(ix) The reduction in the book value of an asset is permanent. When the book value of an asset is reduced, it is not possible to restore it to its original cost.

(x) The exact amount of depreciation cannot calculated, whatever method of charging depreciation is followed. It can simply be estimated.

Causes of Depreciation

The following are the main causes of depreciation:-

(i) *Use:-* Wear and tear is an important cause of depreciation in the case of a tangible fixed asset. It is due to use of the asset.

(ii) *Lapse of time:-* Assets such as, lease, copyright, patent etc. have a fixed number of years of legal life, after the expiry of which, they are rendered useless. As such, their cost is written off over their legal life and the amount charged against revenue every year is known as depreciation. This is true of acquired goodwill also. In these cases, depreciation is known as "amortisation".

(iii) *Obsolescence:-* Loss of usefulness occasioned by improved production methods is known as obsolescence. For example, an old machine which is still workable may have to be replaced by a new one because the latter may be more efficient and economical.

(iv) *Accidents:-* An asset may reduce in value because of an accident. Accidental loss may be permanent but it is not continuing and gradual.

(v) *Disuse:-* A machine remaining continuously idle becomes potentially less and less useful with the passage of time. In fact, certain machines like farm implements and machinery used in farming kept in the open, may depreciate more rapidly from disuse than from use.

(vi) *Inadequacy:* It refers to the termination of the use of an asset because of growth and changes in the size of the firm.

(vii) *Depletion:-* An asset may get exhausted through working as in the case of mines, quarries, oil fields and forests etc. The natural resources such as minerals, granite, oil and timber get exhausted because of extraction and exploitation, and the asset becomes useless. As such, these assets are known as *wasting assets*. The term 'depletion' is correctly used to refer to the expired utility of wasting asset.

Objectives of and Necessity for Providing Depreciation

The primary objects of and necessity for providing depreciation on fixed assets are given below:-

1. *Ascertainment of true profits:-* When a particular asset is used for earning income of the business, the reduction in the value of asset should be provided from the income in order to calculate the correct and real income of the business. Depreciation is an invisible expense. So, it must be charged to the profit & loss account.
2. *Presentation of true financial position:-* If depreciation is not provided for, the balance sheet will not disclose a true and fair view of the firms, state of affairs, since the assets will be shown at figures which are in excess of their true value.
3. *Replacement:-* The amounts debited in the profit & loss Account are retained in the business. These are available for replacement of the asset when its life is over. So, by making an annual charge for depreciation, a concern would be accumulating enough resources to enable it to replace an asset when necessary.

4. *No distortion of divisible profits:* If depreciation is not charged to profits, trading results are vitiated and divisible profits are distorted. Hence, the joint stock companies must have to provide for depreciation before declaring dividends according to the Companies Act 1956.

Basic Factors affecting the amount of Depreciation

For calculating the amount of depreciation, the following three major factors are to be considered:-

(i) *Original cost of the asset:-* The cost of asset includes the invoice price of the asset less any trade discount plus costs essential to bring the asset to a usable condition, such as freight, insurance and installation charges.

(ii) *Estimated scrap or Residual value:-* Residual value is the estimated sale value of the asset at the end of its economic life to the firm. In determining the residual value, the cost to be incurred in the disposal or removing of the asset, should be deducted out of the total realisable value.

(iii) *Estimated Effective or Commercial or Legal life whichever is shorter:-* This may be calculated in terms of years, months, hours, units of output or by other operating measures such as kilometres in case of a taxi or truck. Physical life is not important. An asset may exist physically but it may not be capable of producing goods at a reasonable cost. *For example,* if an asset can work for 20 years but is likely to lose its commercial value within 10 years, life for the purpose of accounting should be considered as only 10 years.

A company purchased a plant for Rs. 50,000. The useful life of the plant is 10 years and the residual value is Rs. 10,000. Find out the rate of depreciation under the straightline method.

Solution:

$$\text{Amount of Depreciation} = \frac{\text{Cost} - \text{Estimated Scrap Value}}{\text{No. of years of expected life}}$$

$$= \frac{50{,}000 - 10{,}000}{10 \text{ years}} = \text{Rs. } 4{,}000$$

$$\text{Rate of Depreciation} = \frac{\text{Depreciation}}{\text{Original cost of Plant}} \times 100$$

$$= \frac{4{,}000}{50{,}000} \times 100 = 8\%$$

Illustration 2

A machine purchased on 1st July 1983 at a cost of Rs. 14,000 and Rs. 1,000 was spent on its installation. The depreciation is written off at 10% on the original cost every year. The books are closed on 31st December each year. The machine was sold for Rs. 9,500 on 31st March 1986. Show the machinery account for all the years.

[Madras, B.Com(CS) Nov. 2008; 2 Times; BCS(SY1A) April 2007; B.Com., Nov. 2004; Nov. 2003] [Bharathiar, B.B.M. Nov. 2003]

Solution:

Machinery A/c

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
1983 July 1	To Bank [14,000 + 1,000]	15,000	1983 Dec. 31	By Depreciation $\left[15{,}000 \times 10\% \times \frac{6}{12}\right]$	750
				By Balance c/d	14,250
		15,000			15,000
1984 Jan. 1	To Balance b/d	14,250	1984 Dec. 31	By Depreciation	1,500
				By Balance c/d	12,750
		14,250			14,250
1985 Jan. 1	To Balance b/d	12,750	1985 Dec. 31	By Depreciation	1,500
				By Balance c/d	11,250
		12,750			12,750
1986 Jan. 1	To Balance b/d	11,250	1986 Mar. 31	By Bank (Sale)	9,500
				By Depreciation (for 3 months)	375
				By P&L A/c (Bal.fig.) (Loss on sale)	1,375
		11,250			11,250

A company acquired a machine on 1.1.88 at a cost of Rs. 40,000 and spent Rs. 1,000 on its installation. The firm writes off depreciation at 10% on the diminishing balance. The books are closed on 31st December of each year. Show the Machinery A/c for 3 years. **[Madras, B.Com., Sept. 1991]**

Solution:

Machinery A/c

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
1.1.88	To Bank (40,000+1,000)	41,000	31.12.88	By Depreciation (41,000 × 10%)	4,100
			"	By Balance c/d	36,900
		41,000			41,000
1.1.89	To Balance b/d	36,900	31.12.89	By Depreciation (36,900 × 10%)	3,690
			"	By Balance c/d	33,210
		36,900			36,900
1.1.90	To Balance b/d	33,210	31.12.90	By Depreciation (33,210 × 10%)	3,321
			"	By Balance c/d	29,889
		33,210			33,210
1.1.91	To Balance b/d	29,889			

UNIT – V

INSURANCE CLAIM

Need for Fire Insurance

Fire, in the business premises of any firm, can damage a number of assets like stock, buildings, furniture, fixtures, machinery etc. In addition, the normal working of a firm is affected for a number of days or months, resulting in loss of sales and loss of profits.

It is very difficult for a business to replace all the destroyed assets and normalise its working without affecting its working capital position and cash position. During such difficult times, external help is like a boon to the business.

All prudent business firms insure their stock and also other assets against the risk of fire. They take appropriate *Insurance Policy* from a recognised company by paying required premium. This enables the business to lodge claim against insurance company and receive sufficient funds to replace the lost assets.

Insurance companies investigate any claim made through experienced assessors. They evaluate the causes for fire and the actual loss through the damage. Based on the assessor's report, insurance company settles the claim made against it for loss due to fire.

Types of Fire Insurance Policies

There are two major types of policies issued by insurance companies – loss of stock policies and loss of profits or consequential loss policies.

Loss of Stock Claims

Business units who have insured their godown or store against the risk of loss of stock by fire are eligible to lodge loss of stock claims when a fire causes loss of their stock.

Salvage:- Fire may destroy some items of stock completely. Some other portion of stock may be damaged and some items of stock may not be affected at all.

The damaged stock and undamaged stock are separately valued and are called *salvage Value* or *Stock Salvaged.*

When claim is lodged for loss of stock, stock salvaged is subtracted from *Stock on the date of fire* and claim is made for the balance amount.

(A) Computation of claim to be lodged for loss of stock

The following are the major points to be noted for calculating claim for loss of stock.

(1) If a separate stock account is maintained by the firm, (which is possible if a Cost Accounting department exists), stock on the date of fire can be taken from the ledger account of stock. After subtracting *Salvaged stock*, claim can be lodged for the balance.

(2) In majority of firms, no ledger account is maintained for stock. So, value of *stock on the Date of Fire* must be found indirectly using *Gross Profit Ratio* as basis.

If the normal gross profit percentage of the firm to its sales is available, a *Memorandum Trading Account* can be prepared for the period from the beginning of the accounting year till the date of fire. Gross profit is shown as a percentage of sales. The balancing figure in the Memorandum Trading Account is *Stock on the date of fire*.

Memorandum Trading Account for the period.....

Particulars	Amount Rs.	Particulars	Amount Rs.
To opening stock	xxxx	By sales	xxxx
- purchases	xxxx	- stock on the date of fire (balancing figure)	xxxx
- gross profit c/d (Sales × Gross profit ratio)	xxxx		
Total	xxxx		xxxx

3) Gross Profit Ratio

When ledger account for stock is not maintained, gross profit ratio to sales is the vital link to compute the claim. The following relevant points for this ratio are to be noted:

(a) Gross profit ratio $= \frac{\text{Gross profit}}{\text{Sales}} \times 100$

(b) Previous accounting year's gross profit and sales can be used for gross profit ratio.

(c) If information about two or more previous years is given, the average gross profit ratio of all the years has to be taken.

(d) If gross profit of previous years is not directly given, previous year's trading account has to be prepared to find gross profit.

(e) Abnormal practices followed in the previous years like undervaluation of stocks or overvaluation of stocks must be adjusted to find normal gross profit.

(f) Any samples given out of purchases, goods drawings, suppression of sales etc., must be adjusted.

(4) Abnormal items and gross profit ratio

Some items of stock might have been considered as poor selling line either in the current year or in the previous years. A part of them might have been written off. Later on such goods might have been sold, partly or fully, at a loss or at low and also in the memorandum trading account. Normal gross profit and stock used for gross profit ratio in relation to previous years. In the Memorandum Trading Account gross profit is calculated on normal sales alone. For this purpose, separate columns are opened showing, normal, abnormal and [Refer Illustrations 10, 11, 12]

(5) Average Clause

Insurance policies for loss of stock may include average clause. This clause is needed to discourage under insurance.

If stock on the date of fire is more than the insured stock, average clause may be applied to compute claim.

Actual loss of stock = stock on the date of fire – salvage value.

$$\text{Claim to be lodged} = \frac{\text{Insured stock}}{\text{Stock on the date of fire}} \times \text{Actual loss of stock}$$

(B) Claim for loss of profits

Insurance policies taken for loss of profits are also called consequential policies. Under a consequential policy, the insurer indemnifies the policy holder against losses arising from the suspension, wholly or partly, of the activities of the business caused by fire. Claim can be made for loss of gross profit which is the total of net profit and insured standing charges (fixed costs) and also the increase in the cost of working which is consequential.

Important Terms

Some important terms used in computation of loss of profits claims are briefly explained below :

(1) *Indemnity Period*:- This is the period for which insurance policy is taken against the risk of fire. The Insurance policy is always taken for a period of one year. Indemnity period refers to the length of period which may be affected by fire. During the indemnity period, normal working is expected.

(2) *Affected Period*:- This is the period for which normal working is affected because of fire.

(3) *Turnovers*:-

(a) *Affected Period Turnover*:- This is the actual sales made during the period in which work is affected by fire.

(b) *Standard Turnover:-* This is the sales during the same months as the affected period, in the previcus year.

(c) *Accounting year Turnover:-* This is the sales in the last accounting year for which accounts were prepared.

(d) *Annual Turnover:-* This is the sales during the twelve months exactly before fire.

(e) *Saved Turnover:-* This is the sales achieved due to spending additional amounts during the affected period. This may be less than or equal to affected period turnover.

(4) *Standing Charges:-* These are the fixed expenses which have to be paid whether work is carried on or not, like salaries, rent, directors' fees, postage etc.

(5) *Insured Standing Charges:-* Fixed expenses which are mentioned in the policy taken by the insured firm.

(6) *Uninsured Standing Charges:-* These are the fixed experses which are not mentioned in the insurance policy, but still incurred by the insured firm.

(7) *Short Sales:-* This is the difference between standard turnover and affected period turnover.

(8) *Saving in standing charges:-* Due to fire, some fixed costs need not be paid. The total of such costs is called 'Saving in standirg charges'.

(9) *Special Circumstances Clause:-* If any increasing or decreasing trend is observed in sales, adjustment has to be made. The increasirg or decreasing trend as a percentage should be found. Then the standard turnover and annual turnover should be increased or decreased, proportionate to the trend.

Computation of claims for loss of profits:-

Step 1: ***Claim for reduction in turn over:-***

	Rs.
Standard Turnover	xxxx
Add: Increase for trend	
or	
Less: Decrease for trend	xxxx
	xxxx
Less: Affected period turn over	xxxx
Short Sales	xxxx

$$\text{Gross profit ratio} = \frac{\text{Net profit + Insured standing charges}}{\text{Accounting year Turnover}} \times 100$$

Claim for Reduction in Turnover = Short Sales × Gross profit ratio

Step: 2 ***Claim for increased cost of working:-***

Lowest of the following three items can be claimed for increased cost of working.

(a) Actual increased cost of working

(b) If all standing charges are not insured

$$\frac{\text{Net profit + Insured standing charges}}{\text{Net profit + All insurable standing charges}} \times \begin{bmatrix}\text{Actual increased}\\ \text{cost of working}\end{bmatrix}$$

(c) Saved turnover × Gross profit ratio

Amount to be claimed for increased cost of working (lowest of A, B and C)

Step: 3 ***Total claim for loss of profits:-***

	Claim for Reduction in Turnover (as per Step I)
Add:	Claim for increased cost of working (as per Step II)
Less:	Saving in standing charges
	Total claim for loss of profit

Step: 4 ***Application of average clause:***

If the policy amount is less than gross profit on annual turnover, then clause applies.

	Annual turnover
Add:	Increase for trend
	or
Less:	Decrease for trend
	Adjusted annual turnover

$$\text{Claim to be made} = \text{Total claim} \times \frac{\text{Policy amount}}{\text{Gross profit on adjusted annual turnover}}$$

Note: Some experts use gross profit on 'Annual turnover' in Step 2 also to determine net profit + insured standing charges. But this is not a widely used method.

Accounting Entries for fire claims:-

The following are the specimen journal entries to be passed in relation to loss of stock and loss of profits:-

(1) Loss of stock

Distinction has to be made between stock fully destroyed without recovery value and stock damaged with recovery value.

(a) When claim is admitted by the insurance company:

Insurance Company A/c	Dr.	xxxx	
(Amount of claim admitted)			
To Stock destroyed A/c			xxxx
To Stock damaged A/c			xxxx
(Being claim admitted for stock destroyed and damaged)			

(b) For actual cost of the stock destroyed and damaged.

Stock destroyed A/c	Dr.	xxxx	
Stock damaged A/c	Dr.	xxxx	
To Trading A/c			xxxx
(Being cost of stock destroyed and damaged due to fire)			

(c) When damaged goods are sold

Bank A/c	Dr.	xxxx	
To Stock damaged A/c			xxxx
(Being sale of damaged goods)			

Any balance in the stock destroyed and stock damaged accounts has to be transferred to profit and loss A/c

(d) Profit and Loss A/c	Dr.	xxxx	
To Stock destroyed A/c			xxxx
To Stock damaged A/c			xxxx
(Being net loss due to fire)			

(e) For receiving cash from insurance.

Bank A/c	Dr.	xxxx	
To Insurance Company's A/c			xxxx
(Being amount of claim received)			

(2) Loss of Profit

(a) When claim is admitted by insurance company:

Insurance Company A/c	Dr.	xxxx	
To P & L A/c			xxxx
(amount of loss of profit relating to current year)			
To P & L Suspense A/c			xxxx
(amount of loss of profit relating to next year)			
(Being claim receivable)			

P & L Suspense A/c is closed by transferring to the credit of P & L A/c at the end of next year.

(b) For any expenses incurred to put out fire

(i) At the time when expenses were paid:

Fire expenses A/c	Dr.	xxxx	
To Bank A/c			xxxx
(Being expenses paid to put out fire)			

(ii) At the time of claim being admitted:

Insurance company A/c	Dr.	xxxx	
To Fire expenses A/c			xxxx
(Being expenses payable admitted by insurance company)			

Note:- It may be assumed in the absence of details that claims admitted include fire expenses also.

(c) For receiving cash from insurance co.,

Bank A/c	Dr.	xxx
To Insurance Co.		xxx
(Being the amount of claim received)		

A fire occurred at the premises of a trader on 31.5.94 destroying his goods. His stock at 1.1.94 was Rs. 60,000. The value of stock salvaged was Rs. 13,500. The gross profit on sales was 30% and sales amounted to Rs. 1,53,000 from January to date of fire, while for the same period the purchases amounted to Rs. 103 500. Prepare a statement of claim.

(Madras, B.Com., BRA etc. Nov. 2006; B.A. eco. Nov. 2006; B.Com., Sep. 19

Solution:

Memorandum Trading A/c for the period ended 31.5.94

Particulars	Amount Rs.	Particulars	Amount Rs.
To Opening Stock	60,000	By Sales	1,53,0
- Purchases	1,03,500	- Stock on the date of fire	56,4
- Gross profit c/d (1,53,000 x 30%)	45,900	(Bal. fig)	
	2,09,400		2,09,4

Statement of claim:

	Stock on the date of fire	56,400
Less:	Stock salvaged	13,500
	Claim to be lodged	42,900

Illustration 2

Calculate insurance claim from the following facts assuming that he insurer met their liability under the policy on 'average basis'

A trader's stock valued at Rs. 40,000 was totally destroyed. The stock in the godown was insured for Rs. 30,000 subject to average clause. The balance of stock, left after fire, appeared in the books at Rs. 24,000.

(Madras, B.Com.(CS) Nov. 2008; B.Com., Nov. 20

Solution:

$$\text{Amount of claim} = \frac{\text{Amount of policy}}{\text{Stock on the date of fire}} \times \text{Actual loss of stock}$$

$$= \frac{30,000}{64,000} \times 40,000 = \text{Rs. } 18,750$$