Syllabus

M.C.A. Semester-II

Accounting and Financial Management

1. Accounting process and principles, financial, cost and management accounting.
2. Elements of book keeping, Journal, cash and handbook, Book reconciliation statement, Ledger, trial balance, profit and loss accounts, final accounts of proprietary and partnership concern and balance sheet.
3. Cost accounting – Objectives, elements of cost, understanding of the different methods of costing.
4. Financial Management – Meaning, scope and role, a brief study of functional areas of financial management. Introduction to various FM tools: Ration Analysis
   - Meaning
   - Basis of comparison
   - Types of ratios
5. Working Capital Management: Theory of Working Capital Management: Introduction, Nature of Working Capital, Concepts and Definitions of Working Capital, Need for Working Capital, Permanent and Temporary Working Capital, Changes inn Working Capital, Determinants of Working Capital.
6. Budgeting – budgets, purpose, budgetary control, preparation of budgets, master budget, fixed and flexible budgeting.

Reference Books:

1. "Book Keeping and Accountancy" Choudhari, Chopde.
2. "Cost Accounting": Choudhari, Chopde.
3. "Financial Management" Text and Problems: M.Y.Khan, P.K. Jain.
4. "Financial Management Theory & Practice" Prasanna Chandra Tata McGraw Hill.
5. Managerial Economics & Financial Analysis, Siddiqui S.A. Siddiqui A.S. New Age.

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1

ACCOUNTING PROCESS AND PRINCIPLES, FINANCIAL, COST AND MANAGEMENT ACCOUNTING

Unit Structure:

1.0 OBJECTIVES

After studying the unit the students will be able to:

- Understand the meaning of Accounting.
- Explain the Accounting Principles and Concepts.
- Know the Process of Accounting.
- Understand and explain the process of Accounting.

1.1 INTRODUCTION

Every person performs some kind of economic activity. A worker daily works and get wages and he spends to buy goods, cloths and some part of earnings saves for future. A business man purchases goods and sales it. He incurred various expenses like salaries, rent etc. A partner in firm contributes towards capital in the firm which carries on business may be trading in goods. Similarly companies, Governments are also carries on some financial activities. All are carrying some kind of economic activities. Such economic activities are performed through transactions and / or events. Thus the business transactions include purchase, sale of goods, rendering various services, receipts and payments for such transactions. In a business concerns the transactions are numerous. The details of all transactions cannot be remembered by the business man. Therefore it is necessary to keep written records of all such transactions. The records of written transaction will help business to settle disputes and also possible to provide valuable information to the owner of business. Book-keeping disciple has been developed to serve this purpose. The aim of Book-keeping is to provide the information needed by the businessmen and also it helps him to take decisions.

1.2 MEANING OF ACCOUNTING

The American Institute of Certified Public Accounts (AICPA) defined Accounting as “Accountancy is the art of recording classifying and summarizing in a significant manner and in terms of money transactions and events which are in part of at least a financial characters and interpreting the result there of”.

Again in 1966, AICPA defines Accounting as “The process of identifying, measuring and communicating economic information to permit; informed judgement and decisions by the uses of accounts”.

Thus accounting may be defined as the process of recording, classifying, summarizing, analysing and interpreting the financial transactions and communicating the results. There of to the persons interested in such information.

The utility of accounting information is greatly increased when it is compiled in a systematic manner and financial statements are prepared at periodic intervals.

There is difference between the terms “Book keeping” and “Accounting”. Book keeping is merely concerned with orderly record keeping and recording business transactions and financial Accounting is border in scope than book keeping. Accounting involves analysis and judgements at different stages such as recording of transactions, classification, summarization and interpretation.

1.3 ACCOUNTING PRINCIPLES

The basis aims of book-keeping and accountancy are to record the business transactions and events in a summarised form. Transactions are recorded in chronological order in proper books of accounts book-keeping. Accountancy and science based or fundamental truth and rules or conducts or procedures which are universally accepted. These rules of conducts to record business transactions are called accounting principles. These principles are developed over long period of time.

The classification of accounting principles is as under:

Accounting Principles

Accounting Concepts

a) Business entity
b) Going Concern
c) Money Measurement
d) Cost Concept
e) Accounting period
f) Duel aspect
g) Accrual Concept
h) Matching Cost
i) Realisation

Accounting Conventions

a) Disclosure
b) Materiality
c) Consistency
d) Conservatism

1.3.1 Accounting Concepts:

Concepts mean a general idea which conveys certain meaning. Accounting concepts may be considered as basis assumption or conditions on which the science of accounting is based. Concepts are based on logical consideration. Accounts and Financial statements are always interpreted in light of concepts which govern accounting method.

Different accounting concepts are discussed as follows:

a. Business Entity Concepts

According to Entity concept, business is treated as a unit of entity form separate from its Owner, Creditors and Management etc. Accounts are kept for business entity as distinguished form a person associated with it. All business transactions are recorded in the books of Accounts from the point of view of business only. Every type of business organisation is treated as separate Accounting entity.

The failure to recognise the business as separate accounting entity would make it extremely difficult to evaluate the performance of business alone.

The overall effect of adopting this concept is –

1) Only the business transactions are reported and not the personal transactions of the owners.
2) Profit is the property of business unless distributed to the owners.
3) The personal assets of the owners are not considered while recording and reporting the assets of the business entity.

b. Going Concern

Business transactions are recorded on the assumption that the business will continue for a long time. There is neither the intention nor the necessity to liquate the particular business in near future. Therefore, it would be able to meet its contractual obligation and use its resources according to the plans and predetermined goals. Therefore, Fixed Assets are recorded at cost and depreciation is calculated on cost / written down value. Similarly prepaid expenses are treated as Assets on the presumption that the business will continue and these expenses will be utilized in future.

When an enterprise liquidates a branch or one division or one segment of its business, the ability of the enterprise to continue as a going concern is not imparted.

In case of enterprise going to liquidate or become insolvent. Then the enterprise cannot be considered as a going concern.

c. Money Measurement Concept

A unit of exchange and measurement is necessary to account for business transaction in a uniform manner. Money is common denominator in terms of which the exchange ability of goods and services are measured. Only such transactions and events as can be interpreted in terms of money are recorded.

Non monetary events like public political contract, location of business; certain disputes, efficient Sales Force etc. can not be recorded in the books of Accounts even through these have great effects.

However, a unit of money measurement over period of time has its own drawbacks. Money has time value, which can not be considered. Time value of money is affected seriously by economic differences etc. System of accountancy treats all units of money same irrespective of time of original and settlement of it say after two years. It will be the same amount. However value of Money true sense will be less. This is a great drawback. This leads to the introduction of inflation accounts.

d. Cost Concepts

According to cost concept the various assets acquired by enterprise should be recorded on the basis of actual cost incurred. The cost concept does not mean that the basis for all subsequent accounting for the assets. As per cost concept Fixed Assets are shown at cost less depreciation charged from year to year. It may be noted that if nothing has been paid for acquiring something it would not be shown/recorded in the books of accounts maintain.

Financial statement based on historical cost may not be much relevant for investors and other users because they are more interested in knowing what the business actually worth today rather than the original cost.

e. Accounting Period Concept

It is customary that the life of the business is divided into appropriate parts or segments of analysing the results shown by the business. Each part divided is known as an accounting period. It is an internal of time at end of which the income statement and balance sheet are prepared. Normally the accounting period consists of twelve months.

f. Duel Aspect Concept

This concept based on double Entry book-keeping which means that Accounting system is set up in such a way that a record is made of the two aspects of each transaction that affects the record. The recognition of the two aspects of every transaction is known as duel aspects concept. Modern Financial Accounting considers both aspects of every transaction.

One entry consists of debit to one or more accounts and another effect consist of credit to some other one or more accounts. However, the total amount debited is always equal to the total amount credited. Therefore at any point of time total assets of a business are equal to its total liabilities. Liabilities to outsider are known as liabilities, liabilities to the owner are referred to as capital.

Assets = Liabilities + Capital

Therefore, Capital = Assets – Liabilities

Assets referred to valuable things owned by the business, Capital refers to the owner’s contribution to the business.

g. Accrual Concept

This accounting concept states that revenue is recognised when they are earned and when they are not received similarly, cost are recognised as and when they are incurred and not when they are paid. This concept implies that the income should be measured as difference between revenues and expenses rather that the difference between cash received and disbursements. Therefore certain adjustments are required while preparing Final Accounts. In case of revenue accounts; prepaid expenses, out standing expenses, Income received in advance / Receivable are adjusted. These adjustments have their impact on both the income statement and the Balance sheet.

h. Matching Cost Concept

This concept is based on accounting period concept for determining accurate profit / Income has to compare the revenues of the business with the cost that is incurred to earn that revenue. The term "Matching" means appropriate association of related revenues and expenses. According to this concept adjustments should be made for all outstanding expenses, income receivable, prepaid expenses, Income received in advance, depreciation etc. While preparing final accounts at the end of accounting period.

i. Realisation Concept

This accounting concept explains that sell is supposed to be completed only when ownership of goods are passed on from the seller to the buyer. Income is considered to be earned on the date when sales take place. No profit is supposed to accrue on the acquisition of any thing, however, income earned / realised will be earn only when goods are sold at a profit. Therefore closing stock is valued at cost or market price whichever is less. It prevents business Firms from inflecting their profits by recording income that is expected in future.

1.3.2 Accounting Conventions:

The term 'Convention' denotes customs or traditions or practice based on general agreement between the accounting bodies which guide the accountant while preparing the financial statements.

a. Disclosure

According to convention of full disclosure, accounting must disclose all the material facts and informations so that interested parties after reading such accounting report can get a clear view of the state of affairs of the business. All information which are of material interest to proprietors, creditors and investors should be disclosed in accounting statement.

The Companies Act makes various provisions for disclosure of essential information that their is no chance of any material information being left out.

b. Materiality

The term material means “relative importance”, Accounting to the convention of materiality; account should report only what is material and ignore insignificant details while the preparing the final accounts. Materiality will differ or changed with nature, size and tradition of the business. What is material for one enterprise may be immaterial for another enterprise. This is because otherwise accounting will unnecessarily be overburdened with minute details. It is not possible to lay down any fixed standard by which Materiality can be judged. The decision is to be made by the accountant or the Auditor based on their professional experience.

c. Consistency

This accounting convention state that ones a particular accounting practice, method or policy is adopted to prepare accounts, statements and Reports. It should be continued for years together and should not charge unless it is forced to change it. Accounting practices should remain the same from one year to another. The results of different years will be comparable only when accounting rules are continuously adhered to from years to years i.e. Valuation of stock in trade, method of depreciation, treatment of approval sale etc. Since methods of accounting consistence the financial statements are reliable to the people who use it.

d. Conservatism

Financial Statements are usually drawn up on a conservative basis. Their are two principles which stem directly from conservatism.

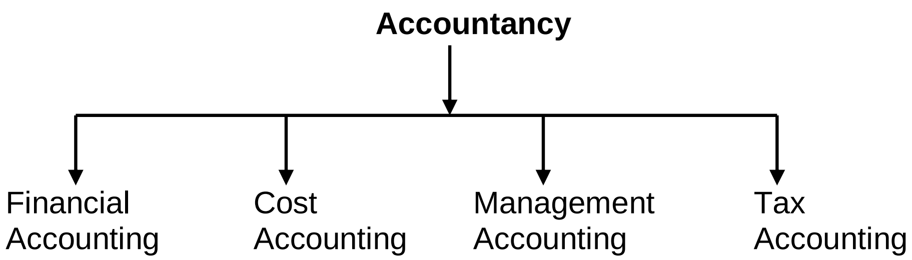
a) The accountant should not anticipate income and should provide all possible losses, and

b) Faced with the choice between two methods of valuing an asset the accountant should choose a method which leads to the lesser value.

It is also called “Principles of prudence”. Therefore, provision for bad and doubtful debts is also permitted and made every year. Accounting convention must be followed continuously. If not followed continuously it would result into understatement of incomes, assets and overstatement of liabilities and provisions and expenses.

1.4 BRANCHES OF ACCOUNTING

Accounting has forms of branches as under



1.4.1 Financial Accounting

It is concerned with record keeping directed towards the preparation of Trial balance, profit and loss account and balance sheet.

1.4.2 Cost Accounting

Cost Accounting is the process of accounting for costs. It shows classification and analysis of cost on the basis of functions process, products etc. It also deals with cost computation, cost saving, cost reduction etc. In cost accounting cost per unit of output produced or services rendered is ascertained. It helps management in the control of cost of output or services rendered.

1.4.3 Management Accounting

It deals with the processing of data sentenced in financial accounting and cost accounting for managerial decision making. It also deals with application of managerial economic concepts for decision making for the efficient running of the business and thus in maximising profits.

1.4.4 Tax Accounting

This branch of accounting is becoming important because of complex tax laws governing income-tax, Excise duty, value added tax etc. Tax planning is now a days is very important as well to save tax, Account for tax deducted at sources, payment of advance tax, Filing of various tax returns in time as well as taking Cenvat credit for various taxes whenever is available.

1.5 ACCOUNTING PROCESS

The process of accounting involves recording classifying and summarizing of past events and transactions of financial nature, with a view to enabling the user of accounts to interpret the resulting summary.

The utility of accounting information is greatly increased when it is complied in a systematic manner and financial statements prepared at periodic intervals.

The Accounting Process

STEP I	Identification of Transaction
STEP II	Preparation of Documents
STEP III	Recording of Transaction in Journal
STEP IV	Posting to ledger
STEP V	Preparation of Trial Balance
STEP VI	Passing Adjusting Entries
STEP VII	Preparation of Final A/cs

Preparation of Final A/cs:

- Profit & Loss A/c
- Balance Sheet
- Fund Flow Statement
- Cash Flow Statement

Note: As final Accounts are separately explains in subsequent chapter, here only fund flows & cash flows statements are explained.

CHECK YOUR PROGRESS

- Define the following terms:
    1. Cost Concept
    2. Business entity concept
    3. Going concern concept
    4. Duel aspect concept
- Explain the following Accounting conventions:
    1. Disclosure
    2. Consistency
- Draw the chart showing Accounting Process.

1.6 FUND FLOW STATEMENT

The fund flow statement reflects movement of fund during particular period i.e. movement of working capital. Funds means working capital and not only cash/Bank balances. Sources consider of the transactions that increases net working capital and their applications consist of transactions that decrease working capital.

Specimen of funds flow statement

Funds flow statement for the year ended.....

Sources		Applications	
Issue of Share Capital	x	Redemption of preference shares	x
Issue of Debentures	x	Redemption Debentures	x
Sale of Fixed Assets	x	Repayment of loan Term loans	x
Sale of Investments	x	Purchased of Fixed Assets	x
Long term Loans	x	Purchased of Investment	x
Decrease in working capital	x	Dividend paid	x
Funds from operations (Cash Trading Profit)	x	Income Tax paid	x
		Buy-Back of Equity shares	x
		Increase in working capital	x
	xx		**xx**

In short fund flows statement indicates various sources of working capital and its applications.

1.7 CASH FLOW STATEMENT

Cash flow statement shows inflows and outflows of cash/ cash equivalent. It is prepared as per A.S-3.

As per A.S-3, the cash flow statement should report cash flows during the period classified as operating, Investing and financing activities.

Activities that do not require use of cash / cash equivalents should be excluded from a cash flow statement. e.g. Issue of Bonus shares conversion of Debentures into new Debentures / Shares.

Cash flow statement can be prepared by Direct method or Indirect method.

Under direct method, major classes of gross cash receipts and gross cash payments are obtained for showing it in funds from operations.

Indirect method, cash flow operating activities is calculated by adjusting net profit. Net profit is adjusted, with non cash transaction such as depreciation, Goodwill w/off etc, result figure indicates cash operating profit, which further adjusted with net increases / decreases in current Assets / Current liabilities. The final amount resulted indicates cash flows operating activities.

Proforma of cash flow statement As per A.S-3 (Indirect Method)

Cash Flow statement for the year ended ....

		Rs.	**Rs.**
I)	<u>**Cash flows from operating Activities**</u>		
	Net profit before taxations	x	
	Add: Adjustment for		
	Depreciation, Goodwill w/off	x	
	Loss on sale of fixed Assets / Investment	x	
	Interest / Dividend Income	x	
	Operating profit before working capital changes	**xx**	
	Increases in working capital	(x)	
	Decreases in working capital	x	
	Cash generated from operations	**x**	
	Cash Income Tax paid	(x)	
	Net cash from operating activities		**x**

II)	**Cash flows from Investing Activities**		
	Sale of Fixed Assets / Investment	x	
	Interest / Dividend received	x	
	Purchased of fixed assets / Investment	(x)	
	Net cash flow from investing activities		**x**
III)	**Cash flows from financing Activities**		
	Proceeds from Issurance of share capital	x	
	Proceeds from Issurance of Debentures	x	
	Proceeds from long term loans	x	
	Repayment of long term loans	(x)	
	Redemption of Pref. Shares / Debenture	(x)	
	Interest / Dividend paid	(x)	
	Net cash used in financing activities		**x**
	Net increases or decreases in cash / cash equivalents		xx
	Add: Cash/ cash equivalents at the beginning of the period.		x
	Cash / cash equivalent at the end of period.		**xx**

1.8 DISTINCTION BETWEEN FUNDS FLOW STATEMENT AND CASH FLOW STATEMENT

Both the above statement are used in analysis of past performance of the business firm.

	Fund Flow Statement		Cash Flow Statement
1.	It is based on accrued accounting system	1.	All cash and cash equivalents are taken into consideration
2.	It analyses the sources & application in Long term funds affecting working capital	2.	Cash flows statements considers only the transactions affecting increases or decreases in current assets or / and current liabilities.
3.	It is more useful in Long-run planning	3.	It help form in identifying the current liquidity problems.
4.	It is broader concepts, considering short term / long term funds into accounts in analysis.	4.	It only deals with current assets/ current liabilities shown in Balance sheet.

5.	It tallies the funds generated from various sources with various uses to which they are put.	5.	It shows in increases or decreases in cash/ cash equivalent during the period, which tallies with difference in opening / closing cash / Bank balances.
6.	It shows the funds generated and applied as regards long term assets & liabilities.	6.	It shows the cash flows from operating, financing and investing activities.

1.9 EXERCISES :

1. Are the accounting concepts and conventions necessary?
2. Explain meaning of:
   a) Accounting concepts
   b) Accounting conventions
   c) Accounting principles
3. Explain accounting conventions of:
   a) Conservatism
   b) Consistency
   c) Disclosure
   d) Materiality
4. Define and explain:
   a) Concept of entity
   b) Concept of continuity
   c) Cost concept
   d) Cost attach concept
   e) Periodic matching of costs and revenues
5. Explain different branches of Accounting.

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ELEMENT OF BOOK-KEEPING, JOURNAL, CASH AND BANK BOOK-I

Unit Structure:

2.0 OBJECTIVES

After studying the unit the students will be able to:

- Know the Meaning, utility and objectives of Book keeping.
- Explain the Accounting system.
- Know the Classification of Accounts.
- Understand the rules of Debit and Credit.
- Explain the Meaning and Utility of Journal.
- Journalise the Business transactions.

2.1 MEANING OF BOOK-KEEPING

The oxford dictionary defines Book-keeping as “The activities of keeping records of financial dealings”.

J.R. Batiboi defines book-keeping as, “Book-keeping is the art of recording business dealings in set of Books”.

R.N. Carter defines book-keeping as “The science and art of correctly recording in the books of accounts. All those business transactions and events inset of books, as and when such transactions take place. It is a systematic recording interms of money in set of books.”

2.2 OBJECTIVES OF BOOK-KEEPING

The main objectives of Book-keeping are given below:

1. To maintain the permant records of the business transactions.
2. To ascertain the profit earned or loss suffered during accounting period.
3. To know various business Assets and liabilities apart from the above main objectives.
4. To know amount due to businessman from his customers.
5. To know amount payable to Suppliers.
6. To know various taxes and duties payable to government.
7. To defect and prevent errors and frauds committed by employees and other person.
8. To provide valuable informations for taking for taking various decisions.
9. To take decision on significant business matters.
10. To compare and measure the optional efficiency of his business with other firm, companies in same type of Industry.
11. To review the progress of the business from year to year.
12. To maintain permanent record of all transactions of business for future reference.
13. To excise effective control on various expenses, incomes earned over business assets, business liabilities.
14. Other firms, Companies and within the firm compare current year with previous years. Such comparison is known as infra-firm comparison.

2.3 UTILITY OF BOOK- KEEPING

Utility means usefulness. The utilities to different persons and entities are as under:

1) **Businessman:**

The owner who invest his money and assets into his business. He must know the profitabilities, financial stability. The owner can take various decisions on the basis of the valuable information obtained from books of accounts.

2) **Evidence:**

Books of Accounts can be produced as evidence in a court of law in case of disputes.

3) Book-keeping ensures proper calculation of Income Tax, Sales Tax, VAT and other tax liabilities.

4) **Lenders:**

On the basis of information from books, it is possible to obtain additional finance for business and working capital. On the basis of such information, lender can be provided any additional information along with various financial statements.

5) **Trade Union:**

On the basis of financial statement Trade union can insist like in Wages, Bonus etc.

6) **Prospective Investors:**

Prospective Investor can take investment decision by studying financial statements.

7) **Comparative Study:**

Financial statement of business enterprise may be compared over a period of years inter firm and can be compared with two or more business enterprise in same type of Business over period of years. This is known as inter firm comparison. Such comparison helps businessman to judge profitabilities and efficient of his business.

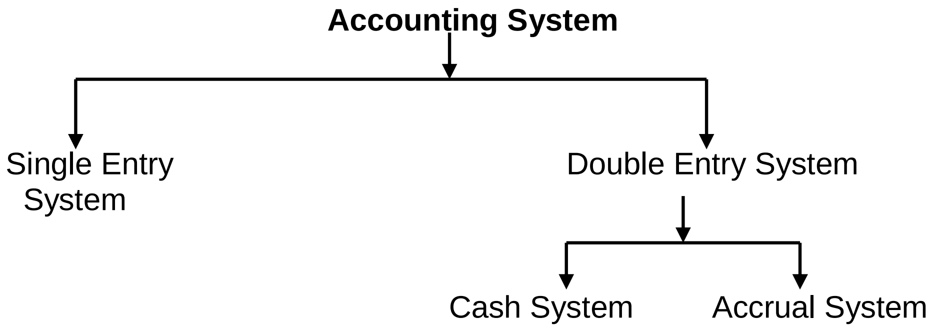
2.4 BOOK- KEEPING AND ACCOUNTANCY

Book-keeping and Accounting they are differ from each other. Book-keeping is mainly concern with recording of financial data relating to business operations in a significant and orderly manner. It is mechanical and repetitive.

Accounting is a broader and more analytical subject. It includes the design of accounting system which book-keepers use to preparation of financial statement, audit, cost studies, Income tax, value added tax etc. Analysis and interpretation of accounting information for internal and external end users as on aid to making business decision. Book-keeping provides the basis of accounting.

2.5 ACCOUNTING SYSTEM

There are two accounting system of keeping records.



2.5.1 Single Entry System:

The single entry system appears to be time saving and economical but it is unscientific, having number of defects. Under single Entry system only few personal accounts are kept, as nothings; Expenses / Income accounts are totally ignored. This system is followed by sole proprietor, having total control on cash as well as on goods. However this system is not generally followed by any trader.

2.5.2 Double Entry System:

The Double entry system is based on scientific principle and is used universally by most of business organisations. This system recognises the fact that every transaction has two aspects and records both aspects of each and every transaction. Every business transaction involves exchange of equal values or benefits. Exchange means the act of giving or receiving one thing in return of the other thing or service or benefit. Thus every transaction has two aspects i.e. receiving and giving. The receiving aspect is also known as the incoming aspect (Debit) and going aspect is known as the outgoing aspect (credit).

Under double entry system books of accounts can be maintained by either cash basis or accrual basis.

- **Cash System of Accounting**

Under cash system of accounting entries are made only when cash is received or paid. No entry is made when amount is due for receipts or payments. Income is received is accounted irrespective of period for which relates. Similarly expenses are restricted to the actual payments made in cash, during the current period is immaterial whether the payments have been made for previous year or subsequent year.

The financial statement prepare under this system do not present a true and fair view of Income, operating results of enterprise. However it is suitable in following cases.

i) For very small business organisation.

ii) For individual to record his own transactions.

iii) For professionals like Doctors, Lawyers, Chartered Accountant etc.

In cash system financial statements are prepared on the basis of Receipts and payments accounts.

- **Accrual System of Accounts**

This is also known as mercantile system of accounts. Under this system business transactions are recorded as and when it take place irrespectful of amount / cash received or paid. Income earned as well as expenses incurred are recorded related to the Particular period. The following are the essential features of accrual basis.

a) Revenue is recognised on it is earned irrespective of whether cash is received or not.

b) Costs are matched against revenues on the basis of relevant time period to determined periodic income.

c) Costs which are not charged to income are carried forward. Any cost that lost its utility is written off as a loss.

2.6 ACCOUNT

An account is summarised record or statement of all transactions relating to a particular person or to a Assets or liability or income or expense.

According to Kohler's Dictionary for accounts, An account has been defined as a formal record of a particular type of transaction expressed in money.

Each account is divided into two parts by the vertical line drawn in the middle.

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

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount

The left hand side is termed as Debit (Dr.) side and the right hand side is termed as credit (cr.) side.

In order to keep full record of all the transactions the business has to keep.

i) An account of each head of expenses or income earned by the business and

ii) An account of each property which belongs to the business and

iii) An account of each party with whom business deals.

2.7 CLASSIFICATION OF ACCOUNTS :

Accounts are classified into two classes:

- Personal Accounts
- Impersonal Accounts

Impersonal Accounts are further sub divided into

1. Real Accounts
2. Nominal Accounts
3. Valuation Accounts

Thus all accounts can be classified into Personal, Real and Nominal Accounts.

2.7.1 Personal Accounts:

These accounts show the transactions with customers, suppliers, Money lenders, the banks and the owner.
For example: Mohan's A/c, Rajesh's A/c, M/s XY and Co. Reliance Industries Ltd., Apna Bazar Co-operative Society Ltd., Mumbai University, Dena Bank etc.

2.7.2 Real Accounts:

Real accounts may be the following types.

a) Tangible real Accounts: These are accounts of such things which are tangible i.e. which can be seen touched or felt physically.
Example: Land, Building, Furniture, Cash etc.

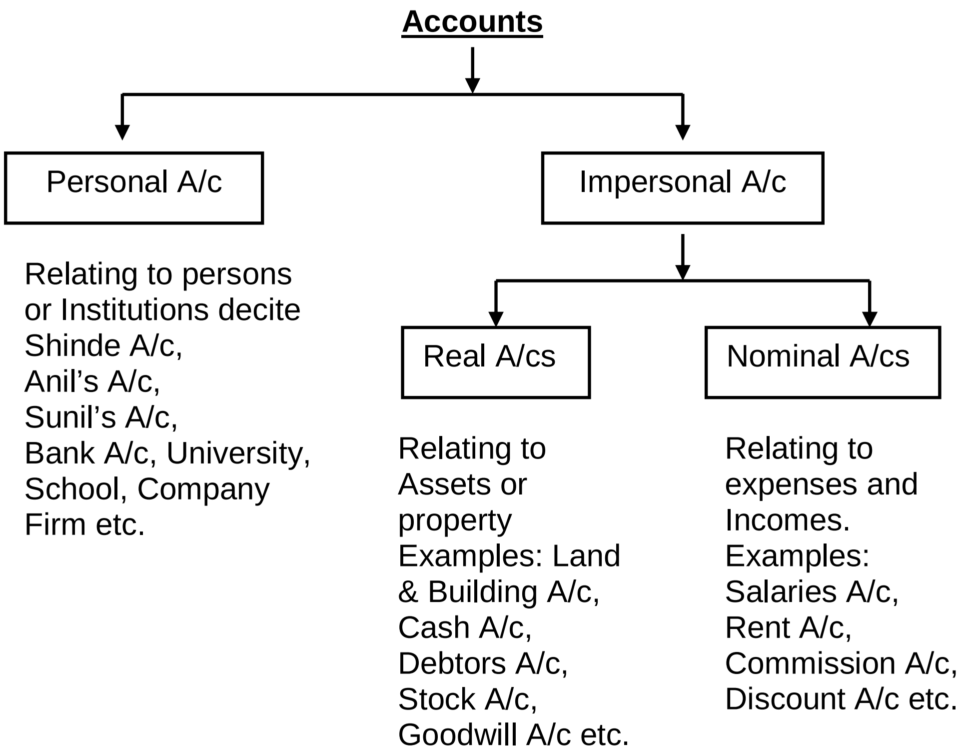
b) Intangible real Accounts: These accounts represent such things which cannot be touched, seen or felt physically.
Example: Goodwill, Trade marks, Patent right etc.

2.7.3 Nominal Accounts:

Nominal Accounts includes accounts of all expenses, losses, incomes and gains. Nominal Accounts represent only services or uses.

2.7.4 Valuation Accounts:

Valuation accounts are accounts open to adjust values of assets e.g. provision for Depreciation, Stock Reserve, Provision for doubtful debt A/c.



CHECK YOUR PROGRESS:

- Draw the chart showing the classification of Accounts.
- Define the following terms:
  1. Account
  2. Personal Accounts
  3. Tangible Real Accounts
  4. Valuation Accounts
  5. Single Entry System
  6. Accrual System of Account
  7. Book Keeping

2.8 RULES OF DEBIT AND CREDIT :

The two sides of any account are arbitrarily distinguished. The left hand side of an Account is called Debit side and Right hand side is called the Credit side.

When entry on the left side is made it is called account is debited, and an Entry made on the right hand side of account is called account is credited.

An account is capable of receiving and giving values. When an account receives a value / benefit. It is debited and when it gives a value / benefit it is credited. Each business transactions affects at least two accounts. One account receives benefit of certain value, another account would give the benefit of the same value. The difference between the total debits and total credits in the accounts is considered as balance.

Golden Rules for Debit and Credit

A Personal A/c	**B** Real A/c	**C** Nominal A/c
Debit the receiver, Credit the giver	Debit what comes in, Credit what goes out	Debit expenses or losses, Credit Incomes and gains

A) Personal Accounts

The personal Account which receives the benefit is debited, while the personal account which gives the benefit is credited. The fundamental rule of Debit and Credit regarding personal Account is

Debit the Receiver

And Credit the Giver

The rule means, if a person receives anything from the business, his account will be debited in the books of business, and if person gives anything to the business, his account will be credited.

Illustrations 1

Suppose Goods sold on credit to Sunil from the view point of business Sunil is a receiver because he receives goods and therefore Sunil's Account will be debited.

Subsequently cash is received from Sunil. Mr. Sunil becomes a giver because he gives cash and hence his account will be credited.

B) Real Accounts

As a thing either comes in into business or goes out of business.

Debit-What Comes In

Credit-What Goes Out

Real account relates to things or property. Hence the above rule says if anything is coming into business, account of thing is to be debited and anything is going out of business account of that thing is to be credited.

In the Illustration goods are sold to Mr. Sunil on credit. Goods are going out of business and therefore 'Goods A/c' is to be credited subsequently cash is received from Sunil. Cash is comes in therefore cash Account is to be debited.

C) Nominal Accounts

Being the accounts of losses and expenses or gains and incomes.

Debit Expenses and Losses
Credit Incomes and Gains.

Dr.	**Nominal Accounts** Cr.
Payment of Salary, rent loss on sale of Assets. Bad Debts etc Debit losses and expenses.	Received Commission. Interest Discount etc. Credit Incomes and Gains

The accounts of expenses or losses of the business are to be debited where as the accounts of Incomes or profits are to be credited Exp. Paid salaries.

Here Salary is on expenditure of the business and there fore Salary account is to be debited.

In the transaction "Received Interest from A & Co" Interest is an Income of the business and hence Interest Account is to be credited.

Illustration. 2

State the names of the accounts to be debited or credited in the following transactions.

No.	Transactions	Name of accounts affected	Classification of account	Application of the rules	Answers
1.	Sujit Commenced business with cash	Sujit's Capital A/c	Personal A/c	Credit the giver	Credit
		Cash A/c	Real A/c	Cash comes in Debit what comes in	Debit
2.	Purchased goods for cash	Goods A/c	Real A/c	Goods are comes in	Debit

		Cash A/c	Real A/c	Cash is goes out	Credit

3.	Sold goods on credit to Mr. Avinash	Avinash's A/c	Personal A/c	Avinash is receiver	Debit
		Goods A/c	Real A/c	Goods are goes out	Credit
4.	Cash received from Mr. Avinash	Cash A/c	Real A/c	Cash comes In	Debit
		Avinash's A/c	Personal A/c	Avinash is giver	Credit
5.	Cash deposited into the Bank	Cash A/c	Real A/c	Cash goes out	credit
		Bank A/c	Personal A/c	Bank is receiver	Debit

2.9 BOOKS OF ACCOUNTS :

A business organisations maintains three types books of Accounts; namely,

Cash Book:

To record cash receipts and payments including receipts and Payments through Bank. A separate cash book is kept to record petty expenses.

Journal:

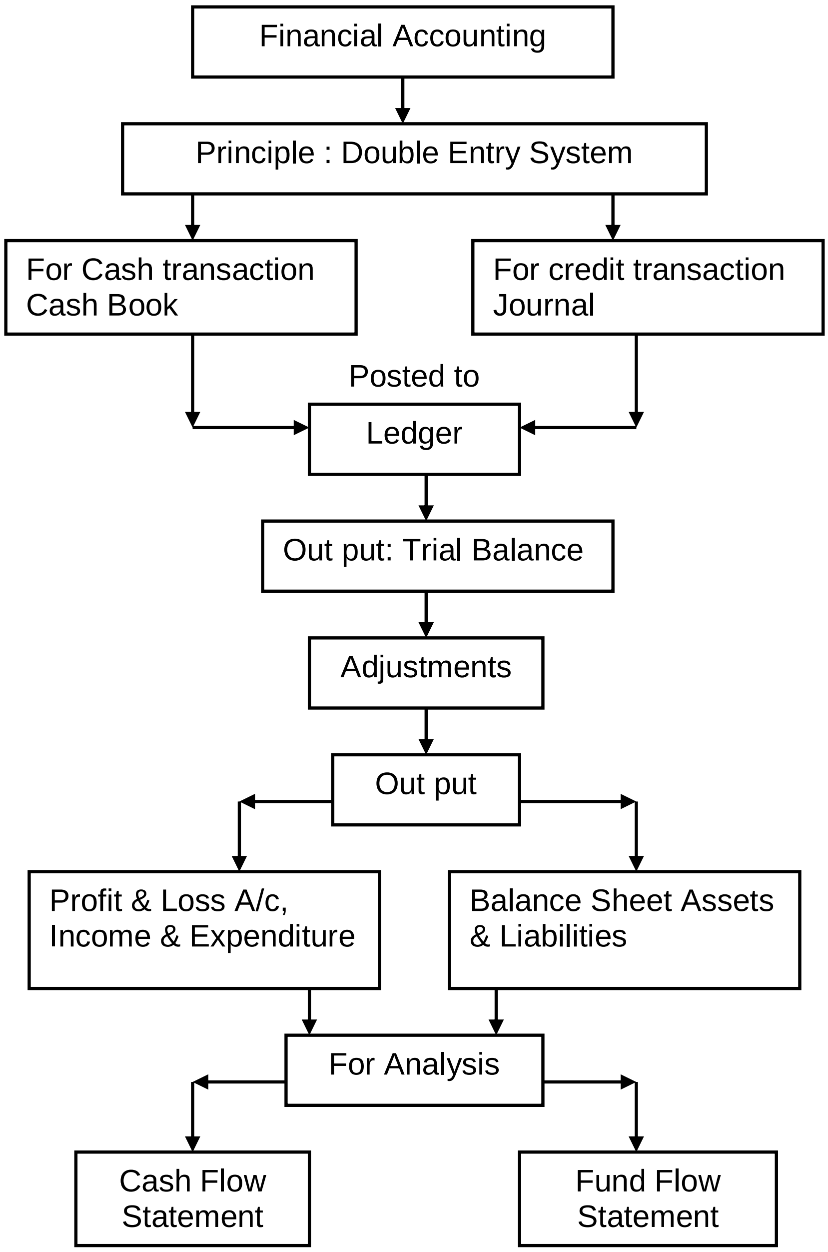
To record non cash transactions like credit sales, credit purchases, Sales Returns, Purchase Returns. These Books are called Subsidiary books.

Ledger:

Ledger contains a classified summary of all transactions recorded in cash book and journal. All personal, Real and Nominal Accounts are prepared into the ledger.

Few additional books of account may be maintained as per requirement of business organisation e.g. Stock Register, Members Register etc.

2.10 A CONCEPTUAL FRAMEWORK OF FINANCIAL ACCOUNTING :



2.11 JOURNAL :

2.11.1 Meaning:

It is essential in a business to record each and every transaction immediately after it takes place. To record credit transaction a separate book, called 'Journal' is maintain, Journal can be defined as, 'a subsidiary book in which all day-to-day monetary transactions of business are recorded first as and when they take place in chronological order (i.e. date wise), in debit and credit form and in a systematic manner. Journal is also known as ‘Prime entry’ or ‘Original entry’ book. Because transactions are first entered in this book and then they are posted in the Ledger.

As Business transactions are numerous and large in size, the Journal may be split up into number of separate Journals to record particular type of transaction. These journal are known as the subsidiary books. Some of the subsidiary books are:

i) Purchase Book
ii) Purchase Return Book
iii) Sales Book
iv) Sales Return Book
v) Bills Receivable Book
vi) Bills Payable Book
vii) Journal Proper

2.11.2 Necessity or Utility of Journal

1. Direct recording of transactions in the ledger may result in committing errors and omissions and it would be difficult to correct them later on. Hence, Journal is necessary.
2. A complete record (i.e. Debit and credit aspects of each transaction) is available at one place.
3. As the transactions are recorded date wise, it facilitates quick and easy reference to any transaction, whenever necessary.
4. Narration to Journal entry explains the purpose of the entry and helps in understanding the transaction recorded.
5. Entries in the ledger can be made at leisure by the clerk concerned according to his convenience.
6. Cross checking between Journal and Ledger is facilitated to check the accuracy.
7. As the entries in the Journal are made from basic documents like invoices. Vouchers, receipts etc. The court considers the entries in the Journal as proof of transactions.

2.11.3 Specimen of Journal:

Date	Particulars	Voucher No.	LF	Dr. Amt. (Rs.)	Cr. Amt. (Rs.)

Journalising: The act of recording a transaction in the Journal in the form required is called Journalising.

2.11.4 How to Journalise the Transactions

1. First find out the two accounts involved in a transaction.
2. Ascertain the types of those accounts and then decide by applying rules of Debit and Credit as to which account is to be debited and which account is to be credited.
3. The name of the account is to be debited is to be written first under ‘Particulars’ column. It is written close to the first margin line and the name of the account to be credited is to be proceeded by the word “To” and is to be written on the Second line.
4. The amount involved in the transactions is written under the “Dr” and “Cr” columns against the names of debit and credit accounts respectively.
5. A brief explanation of the entry is given in the bracket just below the entry. It is called “narration”.
6. A line is drawn below each Journal Entry from first margin line to the second margin line to keep the entries of the transaction separate from one another.
7. Ledger folio (L.F.): It means page number in the ledger. The page on which the particular account is opened in the “Ledger” is stated under “L.F.” column to facilite easy reference.
8. Date: The date of the transaction is written under the column “Date”.

2.11.5 Debit note and Credit note:

Debit Note:

When goods are received from the supplier, the Supplier account is credited. When goods are returned from him the supplier account is debited, so in case of purchase returns a debit note is prepared. It should contain all the details of purchase returns. Generally a debit note will be made in duplicate, one copy will be sent to the customer and other will be kept as office copy.

Credit Note:

It is a statement sent by the seller to his customer intimating that, his account has been credited with the amount of goods return by him or any other allowances granted to him.

2.12 SOLVED PROBLEMS

Illustration 1

Journalise the following transactions in the books of "Ketan".

2009

Jan. 1 Purchased goods from Nalini on Credit Rs. 1000/-.

Jan. 2 Sold goods to Mr. Sharma on credit Rs. 2,500/-

Jan. 3 Purchased furniture for cash Rs. 10,000/-

Jan. 4 Received interest Rs. 800

Jan. 5 Paid salaries Rs. 3,500/-

After deciding the accounts to be debited and accounts to be credited the Journal Entries are passed as shown below.

In the Books of Ketan
Journal Entreis

Date	Particulars	L.F.	Dr. Rs.	Cr. Rs.
2009				
Jan.1	Purchases A/c .... .Dr.		1,000	
	To Nalini's A/c			1,000
	(Being goods purchased on credit from Nalini)			
2	Mr. Sharma's A/c ....Dr.		2,500	
	To Sales A/c			2,500
	(Being goods sold on credit to Mr. Sharma)			
3	Furniture A/c ....Dr.		10,000	
	To Cash A/c			10,000
	(Being furniture purchased for Cash)			

4	Cash A/c .... .Dr. To Interest A/c (Being interest received)		800	 800
5	Salaries A/c ....Dr. To Cash A/c (Being Salaries paid)		3,500	 3,500
	Total		**17,800**	**17,800**

Illustration 2

Journalise the following transactions in the books of Shri. More.

2009

Dec. 1 Shri More started business with cash Rs. 15000.

2 Purchased goods from Mr. Singh Rs. 30,000

3 Deposited cash into the Bank Rs. 4,000

4 Sold goods to Mr. Gujar Rs. 2,500

5 Purchased furniture of Rs. 2,500 from furniture and Co.

6 Paid to Mr. Singh by cheque Rs. 1,000

7 Received a cheque from Mr. Gujar Rs. 1,200

8 Paid Interest Rs. 450

9 Withdraw cash Rs. 3,000 for personal use

10 Cheque received from Mr. Gujar Deposited into the Bank.

11 Returned goods to Mr. Singh Rs. 500

12 Received goods returned by Mr. Gujar Rs. 300

13 Paid salary by cheque Rs. 4,000

14 Received a cheque for rent Rs. 900. The cheque is deposited into the Bank.

15 Withdraw cash Rs. 3,000 from Bank for office use.

16 Returned Furniture of Rs. 400 to Furniture and company.

In the books of Shri. More.
Journal Entries

Date	Particulars	L.F.	Dr. Rs.	Cr. Rs.
2009				
Dec.1	Cash A/c . ... .Dr. To Capital A/c (Being started business with cash)		15,000	 15,000
2	Purchases A/c ....Dr To Mr. Singh's A/c (Being credit purchases from Mr. Singh)		30,000	 30,000

3	Bank A/c ....Dr. To Cash A/c (Being Cash deposited in the bank)		4,000	4,000
4	Gujar's A/c ....Dr. To Sales A/c (Being goods sold on credit to Mr. Gujar)		2,500	2,500
5	Furniture A/c ....Dr. To Furniture & Co. A/c (Being furniture purchased on credit)		2,500	2,500
6	Singh's A/c ....Dr. To Bank A/c (Being issued a cheque to Mr. Singh)		1,000	1,000
7	Cash A/c .... Dr. To Mr. Gujar's A/c (Being Cheque received from Mr. Gujar)		1,200	1,200
8	Interest A/c ....Dr. To Cash A/c (Being Interest paid)		450	450
9	Drawings A/c ....Dr. To Cash A/c (Being Mr. More withdraw cash for personal use)		3,000	3,000
10	Bank A/c ....Dr. To Cash A/c (Being cheque deposited into the Bank)		1,200	1,200
11	Mr. Singh's A/c ....Dr. To Purchase Return A/c (Being Goods returned to Mr. Singh)		500	500
12	Sales Return A/c .... Dr. To Mr. Gujar's A/c (Being Goods returned by Mr. Gujar)		300	300
13	Salaries A/c ....Dr. To Bank A/c (Being cheque issued for Salaries)		4,000	4,000

14	Bank A/c ....Dr.		900	
	To Rent A/c			900
	(Being a cheque from the subtenant in payment of Rent and the cheque is deposited into the Bank)			
15	Cash A/c ....Dr.		3,000	
	To Bank A/c			3,000
	(Being cash withdrawn from Bank for office use)			
16	Furniture and Co's A/c .....Dr.		400	
	To Furniture A/c			400
	(Being Furniture returned to Furniture and Co's A/c)			
	Total		**69,950**	**69,950**

The students will note that the total Debits is always equal to total of credits.

The entries in which there are more than one debit or more than one credit are called compound Entries.

Illustration 3

Journalise the following transactions in the books of Mr. Ashok.
March, 2009

March 1 Mr. Ashok commenced business with Rs. 10,000 of his own and Rs. 5,000 borrowed from his friend Pramod.

2 Opened a current account in the Bank of Maharashtra by depositing Rs. 4000.

3 Purchased goods worth Rs. 3,000 from Anil and Co. subject to the 2% Trade Discount.

4 Credit Sales of Rs. 4,000 to Mr. Desai.

5 Cash Sales of Rs. 6,000 to Mr. Kulkarni.

6 Purchased furniture costing Rs. 4,000 of which furniture of Rs. 600 was for residential use of Mr. Ashok.

7 Received cash from Mr. Desai Rs. 3,800 and he was allowed cash discount Rs. 200.

8 Cash purchases of Rs. 1,000 paid carriage Rs. 300.

8 Withdrew from Bank Rs. 2,000 for office use.

10 Returned goods to Anil and Co. Rs. 100.

15 Paid cash to Anil & Co Rs. 980, who allowed us discount Rs. 20.

16 Received a cheque for Rs. 300 in exchange of cash from Raju.

18 Received Interest from M/s Shah and Sons Rs. 800.

20 Sale og goods to Kadam Rs. 500.

21 Distributed goods of Rs. 500 as free samples.

22 Goods of Rs. 500 were used by Ashok for his private purposes.

25 Paid Rs. 400 to Manan on behalf of our creditor, Anil and co.

30 Our debtor Ketan paid our office Rent Rs. 800.

30 Received goods returned by Kadam Rs. 100.

31 Ashok brought into business sale proceeds of his personal Furniture Rs. 7,000.

31 Invested Rs. 10,000 in the shares of ABB Co. Ltd.

31 Received Rs. 360 in full settlement of Kadam dues.

In the Books of Ashok
Journal

Date	Particulars	L.F.	Dr. Rs.	Cr. Rs.
2009				
Mar. 1	Cash A/c . ... .Dr.		15,000	
	To Pramod Loan A/c			10,000
	To Capital A/c			5,000
	(Being Ashok Started business with cash Rs. 10,000 of his own and Rs. 5,000 borrowed from Pramod)			
2	Bank of Maharashtra A/c Dr.		4,000	
	To Cash Ac			4,000
	(Being Cash is deposited into Bank)			
3	Purchases A/c ....Dr.		2,940	
	To Anil and Co's A/c			2,940
	(Being Purchased goods from Anil & Co.)			
4	Mr. Desai's A/c ....Dr.		4,000	
	To Sales A/c			4,000
	(Being goods Sold on credit)			

5	Cash A/c ....Dr. To Sales A/c (Being goods Sold for cash)		6,000	 6,000
6	Furniture A/c ....Dr. Drawings A/c ....Dr. To cash A/c (Being Furniture purchased for office use and personal use)		3,400 600	 4,000
8	Cash A/c ....Dr. Discount A/c ....Dr. To Mr. Desai's A/c (Being cash received from Mr. Desai)		3,800 200	 4,000
8	Purchases A/c ....Dr. Carriage A/c ....Dr. To Cash A/c (Being Goods purchased for cash and carriage paid thereon)		1,000 300	 1,300
9	Cash A/c ....Dr. To Bank A/c (Being cash withdrawn from Bank)		2,000	 2,000
10	Anil and Co's A/c ....Dr. To Goods A/c (Pur. Return) (Being Goods returned to Anil and Co.)		100	 100
15	Anil and Co's A/c ....Dr. To Cash A/c To Discount A/c (Being cash paid to Anil and Co and received discount from him)		1,000	 980 20
18	Cash A/c ....Dr. To Interest A/c (Being interest received from Shah and Co.)		800	 800
20	Kadam's A/c ....Dr. To Sales A/c (Being goods sold for credit to Kadam)		500	 500

21	Advertisement A/c ....Dr. To Goods A/c (Being Goods distributed as free samples)		500	 500
22	Drawings A/c ....Dr. To Goods A/c (Being Goods withdrawn by proprietor for personal use)		500	 500
25	Anil and Co's A/c ....Dr. To Cash A/c (Being cash paid to Manan of behalf of Anil and Co's A/c)		400	 400
30	Rent A/c ....Dr. To Ketan's A/c (Being Ketan paid rent behalf of us)		800	 800
30	Goods A/c / Sales Return A/c ...... Dr. To Kadam's A/c (Being Goods returned by Kadam)		100	 100
31	Cash A/c ....Dr. To Capital A/c (Being Proprietor introduced additional capital into the business)		7,000	 7,000
31	Investment's / Shares A/c Dr. To Cash A/c (Being investment made in shares of ABB Co. Ltd)		10,000	 10,000
31	Cash A/c ....Dr. Discount A/c ....Dr. To Kadam's A/c (Being cash received from Kadam and allowed him to Discount)		360 40	 400
	Total		**65,340**	**65,340**

Note: Transaction dated 16 march, 2009 does not require Journal Entry as cash exchanged for a cheque. It is not a transaction.

Illustration 4

Journalise the following transactions in the books of Dhawal 2008.

			Rs.
Mar.	2	Commenced business with cash	2,50,000
	4	Purchased furniture for cash	20,000
	4	Cash purchases	1,45,000
	5	Deposited with bank	30,000
	6	Bought from Z	40,000
		Sold to Natu for cash	14,300
	7	Stationery purchased	1,050
	7	Bought from Mona	20,000
	7	Sold to Rakesh	8,000
	9	Rent for two years paid in advance	14,000
	9	Drawings by the proprietor for household Expenses	4,000
		Goods taken out by the proprietor for domestic use	1,500
	9	Cash withdrawn from Bank	25,000
	10	Sold to A & Co on credit	9,000
	11	Purchases made, payment through cheque	2,900
	14	Cash received from Z on account	10,000
	14	Cash paid to Mona after deduction of discount Rs. 130	3,870
	17	Cash received from A & Co. in full settlement of his account	8,750
	28	Purchase of office furniture	40,000
	30	Sold goods to Agarwal for cash	8,000
		Sold to Nana	3,000
	31	Cartage paid in cash	150

Solution:

Journal in books of Dhawal

Date	Particulars	L.F.	Dr. Rs.	Cr. Rs.
2008				
Mar. 2	Cash A/c ....Dr.		2,50,000	
	To Capital A/c			2,50,000
	(For cash brought in by proprietor as his capital)			
4	Furniture A/c ....Dr.		20,000	
	To Cash A/c			20,000
	(For purchase of furniture for cash)			

4	Purchases A/c ....Dr. To Cash A/c (For purchase of goods in trade for cash)		1,45,000	1,45,000
5	Bank A/c ....Dr. To Cash A/c (For cash deposited in bank)		30,000	30,000
6	Purchases A/c ....Dr. To Z's A/c (Goods purchased from Z on credit)		40,000	40,000
6	Cash A/c ....Dr. To Sales A/c (For cash sales made to Natu)		14,300	14,300
7	Stationery A/c ....Dr. To Cash A/c (For purchase of stationery for cash)		1,050	1,050
7	Purchases A/c ....Dr. To Mona's A/c (For credit purchases of goods to Mona)		20,000	20,000
7	Rakesh's A/c ....Dr. To Sales A/c (For credit sales of goods to Rakesh)		8,000	8,000
9	Rent paid in Advance A/c ..Dr. To Cash A/c (For rent paid in advance)		14,000	14,000
9	Drawings A/c ....Dr. To Cash A/c To Purchases A/c (For drawings in cash and goods made by the proprietor)		5,500	4,000 1,500
9	Cash A/c ....Dr. To Bank A/c (For cash withdrawn from Bank)		25,000	25,000
10	A & Co's A/c ....Dr. To Sales A/c (For sales to Mathur on credit)		9,000	9,000

11	Purchases A/c ....Dr. To Bank A/c (For purchases of goods, payment made by means of cheque)		2,900	 2,900
14	Cash A/c ....Dr. To Z's A/c (For cash received from Z)		10,000	 10,000
14	Mona's A/c ....Dr. To Cash A/c To Discount A/c (For cash paid to Mona and discount received from him)		4,000	 3,870 130
17	Cash A/c ....Dr. Discount A/c ....Dr. To A & Co. A/c (For cash received from A & Co. and discount allowed)		8,750 250	 9,000
28	Furniture A/c ....Dr. To Cash A/c (For purchase of a scooter)		40,000	 40,000
30	Cash A/c ....Dr. Nana A/c ....Dr. To Sales A/c (For sales made in cash and Nana on credit on this day)		8,000 3,000	 11,000
31	Cartage A/c ....Dr. To Cash A/c (Cartage paid)		150	 150

Illustration 5

Shri Sona started his business with cash Rs. 35,000 and furniture of Rs. 5,000 on 1st April 2009.

April. 4 Paid cash into Bank Rs. 10,000

6 Purchased furniture and issued a cheque Rs. 4,000.

8 Credit purchases from Ketan Rs. 20,000 less 5% trade discount.

14 Returned goods to Ketan Rs. 400

19 Cash Sales Rs. 10,000

27 Credit Sales to Natu Rs. 4,000 less trade discount 3%

29 Natu returned goods of Rs. 196

30 Distributed goods of Rs. 4,000 as free samples and Sona used goods of Rs. 1,000 for personal use.

Solution:

In books of Sona
Journal

Date	Particulars	L.F.	Dr. Rs.	Cr. Rs.
2009				
April. 1	Cash A/c ....Dr.		35,000	
	Furniture A/c ....Dr.		15,000	
	To Capital A/c			50,000
	(Sona started business by bringing cash & furniture)			
April. 4	Bank A/c ....Dr.		10,000	
	To Cash A/c			10,000
	(Paid cash into Bank)			
April 6	Furniture A/c ......Dr.		4,000	
	To Bank A/c			4,000
	(Purchased furniture by issuing a cheque in payment)			
April 8	Purchase A/c ......Dr.		19,000	
	To Ketan's A/c			19,000
	(Credit purchases from Ketan's)			
April 14	Ketan's A/c ....Dr.		400	
	To Return outwards A/c			400
	(Returned goods to Ketan)			
April 19	Cash A/c ....Dr.		10,000	
	To Sales A/c			10,000
	(Cash Sales)			
April 27	Natu's A/c ....Dr.		3,880	
	To Sales A/c			3,880
	(Credit Sales to Natu)			
April 29	Return Inwards A/c .....Dr.		196	
	To Natu's A/c			196
	(Natu Returned goods to us)			

April 30	Advertisement A/c ......Dr. Drawings A/c To Purchases A/c (Distributed goods as free samples & Madhav took goods for personal use)		4,000 1,000	 5,000

2.13 EXERCISE

2.13.1 Theory Questions

1. Explain term 'Book Keeping.
2. What is Account?
3. Distinguish between:
   a) Book-keeping and Accountancy
   b) Personal Accounts and impersonal Accounts
   c) Real Accounts and Nominal Accounts
   d) Single Entry system and Double Entry system
   e) Cash system of Accounts and Accrual system of Accounts.
4. Discuss the principles of debit and credit of Accounts.
5. Explain Journal & its utility.
6. "By sub-division of journal, there will be a division of labour". Explain.

2.13.2 Practical Problems

1) Journalise the following transactions in the books of Ram for the month of March 2010.

March 1 Ram commenced business with cash Rs. 60,000.

2 Purchased furniture for Rs. 5,000.

4 Purchased goods for cash Rs. 2,000.

7 Bought goods from M/s. Raj & Co. for Rs. 4,000.

10 Sold goods costing Rs. 3,000 on cash.

15 Purchased stationery for office use Rs. 1,000.

19 Received cash Rs. 1,250 from Mr. Ketan in full settlement of his account for Rs. 1,500.

20 Paid salaries by cheque Rs. 1,500.

25 Introduced additional capital Rs. 20,000.

27 Paid to Raj Rs. 3,250 in full settlement of Rs. 3,500

29 Sold goods for Rs. 15,000 to Mr. Dohi.

31 Deposited Rs. 3,000 into the Bank.

2) Journalise the following transactions in the books of Mr. Shiva for the month of April 2010.

April 1 Started business with cash Rs. 25,000/-

2 Purchased goods worth Rs. 10,000/-

4 Deposited cash Rs. 3,000 into the Bank.

6 Purchased goods of Rs. 6,000 from M/s. Raju Trading Company.

9 Sold goods to Mr. Ramesh for Rs. 3,000.

12 Paid to M/s. Raju Trading Company Rs. 3,000.

15 Received Rs. 1,000 from Mr. Ramesh.

20 Paid salaries Rs. 1,000/- and paid commission Rs. 1,600/- in cash.

25 Bought stationery for office use Rs. 300.

27 Withdrew Rs. 2,500 from business for personal use.

29 Withdrew Rs. 4,000 from bank for office use.

3) Journalise the following transactions in the journal of Mr. Anand for the month of February, 2010.

Feb 1 Borrowed from Bank @ 15% interest Rs. 20,000.

3 Purchased goods from Mr. Sam for Rs. 3,500.

4 Paid carriage and cartage Rs. 250

7 Sold goods on cash Rs. 3,000.

10 Paid Rs. 2,250 to Mr. Sam.

15 Purchased office furniture for Rs. 6,000.

18 Paid interest Rs. 450/- to Mr. Bank.

20 Paid salaries Rs. 6,000.

22 Cash sales Rs. 20,000.

26 Cash purchases Rs. 15,000

28 Paid Rs. 2,000 to Bank in part payment of loan.

4) Journalise the following transactions in the books of Mr. Vishal for the month of March, 2010.

Mar. 1 Vishal started business with cash Rs. 35,000, goods worth Rs. 10,000.

2 Opened bank account in the Bank of India by depositing Rs. 5,000.

4 Bought goods worth Rs. 6,000 @ 10% trade discount term.

7 Sold goods worth Rs. 3,000

9 Purchased furniture of Rs. 4,000 for office use and furniture of Rs. 1,000 for home use.

14 Withdrawn goods of Rs. 1,000 for self use.

17 Received Rs. 2,400 from Mr. Ravindra in full settlement of Rs. 2,450.

19 Paid salaries Rs. 500 to office clerk and paid electricity bill of Rs. 750 in cash.

24 Paid Mr. Raj Rs. 1,960 in full settlement of Rs. 2,000.

26 Paid insurance premium of Rs. 1,200 on the life of Mr. Vishal, a proprietor.

29 Cash sales Rs. 3,000.

30 Withdrew Rs. 4,000 from bank for office use.

5) Draft journal entries for the business transactions given below.

Apr. 1 Mr. Atul started business with cash Rs. 5,000/-, goods Rs. 7,500 and furniture Rs. 2,500/-

3 Purchased goods worth Rs. 4,500 from Mr. Kamalakar.

5 Cash sales Rs. 6,000

8 Purchased stationery for office use Rs. 500.

10 Paid to Mr. Kamalakar Rs. 4,350 in full settlement of Rs. 4,500.

13 Deposited Rs. 1,000 into the Bank.

16 Received Rs. 500 from Mr. Kiran.

19 Withdrawn Rs. 200 from business for self use.

23 Paid Rs. 150 for commission and paid Rs. 450 for rent.

27 Paid wages Rs. 600 in cash, and paid sundry expenses Rs. 200/- by cheque.

29 Borrowed Rs. 5,000 from wife for business purpose.

30 Cash purchases Rs. 1,000.

❖❖❖❖

3

ELEMENT OF BOOK-KEEPING, JOURNAL, CASH AND BANK BOOK-II

Unit Structure:

3.0 OBJECTIVES

After studying the unit the students will be able to:

- Know the Meaning of Cash book.
- Understand the meaning of Cash discount and effect of cash discount.
- Understand the types of Cash Book.
- Record the transactions in the Cash Book.

3.1 CASH BOOK

This records all receipts of and payments in cash. Usually the deposits into bank accounts maintained by the business, withdrawals from such accounts and cheques payments are also recorded in the Cash Book. Sometimes a separate book for recording receipts and payments by cheques / DDs etc., is kept known as the Bank Book. A Cash Book which is used to record both cash and bank transactions is referred to as a Two-column Cash Book. The format of this cash book is given below:

Illustration 1

Cash Book of Anand & Co.

Dr. **Cr.**

Date	Receipts	Ledger Folio	Cash	Bank	Date	Payments	Ledger Folio	Cash	Bank
2008					2008				
July					July				
1	To Balance b/f		11,500	13,000	2	By Wages		150	
6	To Sales		1,800		5	By Electricity			800
7	To Z & Co.			7,000	8	By Salaries		4,400	
11	To R.K. Corporation			2,000	15	By O Ltd			11,200
30	To Sales		2,500		22	By Plant		4,000	
					31	By Balance c/f		7,250	10,000
			15,800	22,000				15,800	22,000

3.2 CASH DISCOUNTS

Sometimes, in order to encourage early payments due from customers, a company may offer a certain percentage of the amount as a discount. For example, if a customer owes the company Rs. 11,000, the company may allow 3% discount if the payment is made before a certain date. In such a case, the customer would pay an actual cash of Rs. 10,670 only (Rs. 11000-3% of Rs. 11,000) and Rs. 330 would be treated as discount expense by the company. A cash discount may be distinguished from a trade discount which is given on the invoice price, especially when orders for large quantities are placed. The trade discount is therefore reflected as a reduction in the sale price itself. Therefore Trade discount not recorded in books of Accounts.

A cash book can also be used to record the cash discounts that are allowed to customers for prompt payments and the cash discounts that are earned on payments made to suppliers within a stipulated time period. Since discounts will be allowed to customers at the time of receipt of money and received from suppliers at the time of payment of dues, it is convenient to maintain the column for discounts allowed on the receipts side of the cash book and the column for discounts received on the payments side. A cash book in which the cash and bank transactions and the details of cash discounts are recorded is referred to as a Three-column cash book. An illustrative format of this type of cash book is given below:

Illustration 2

Cash Book of Anand & Co.

Dr. **Cr.**

Date	Receipts	Discount allowed	Cash	Bank	Date	Payments	Discount received	Cash	Bank
2010					2010				
April					April				
1	To Balance b/f		11,500	6,500	1	By Salaries			6,200
6	To Sales		8,000		3	By Wages		2,500	
7	To Z & Co.	100		10,000	5	By Printing			4,000
11	To Balu Corpn.	100	600	22,350	8	By Repairs		4,000	
20	To Sales		1,500		15	By K Ltd	100	12,700	10,900
					20	By Drawings		1,000	4,000
					30	By Balance c/f		1,400	13,750
		200	21,600	38,850			100	21,600	38,850

Illustration: 3

Enter the following transactions in simple cash book.

April, 2010

1 Started business with Cash Rs. 50,000

3 Made Cash purchases Rs. 8,000

4 Made Cash Sales Rs. 12,000

6 Purchased furniture Rs. 4,000

7 Received Cash from Mr. Kulkarni Rs. 8,000

8 Paid Salaries Rs. 5,000

Cash Book

Dr. **Cr.**

Date	Particulars	V. No.	JF No	Rs.	Date	Particulars	V. No.	JF No	Rs.
2010					2010				
April,					April,				
1	To Capital A/c			50,000	3	By Purchases A/c			8,000
4	To Sales A/c			12,000	6	By Furniture A/c			4,000
7	To Kulkarni's A/c			8,000	8	By Salaries A/c			5,000
					30	By bal. c/d			53,000
				70,000					**70,000**

Illustration: 4

From the following particulars of Kahan's. Prepare a cash book with discount and cash column only.

2010

Jan 1 Balance of cash in hand Rs. 50,000

2 Purchased goods worth Rs. 25,000 for cash and paid carriage inward Rs. 700.

5 Paid into Bank current A/c Rs. 15,000

13 Paid by cheque to Malini Rs. 4,800 infull settlement of Rs. 5,000.

13 Received for cash sales Rs. 1500 cash and cheque Rs. 5,000

14 Drew for sister's marriage Rs. 8,000/- by cheque.

16 Paid for wages Rs. 400 and salaries Rs. 2,000.

17 Received interest on investment Rs. 900 and paid the same into the Bank.

20 Paid by cheque Rs. 5,000 on account Mr. Mali and was allowed discount of Rs. 300.

25 Drew two cheques for petty cash and office use Rs. 150 and Rs. 100 respectively.

31 Received a cheque from Bharat Rs. 2,880 infull settlement of Rs. 3,000.

31 Paid in cash in excess of Rs. 4,000 into Bank.

Solution: **Cash Book**

Receipts

Payments

Date	Particulars	R. No	LF No	Dis.	Rs. Cash	Date	Particulars	R. No.
2010						2010		
Jan.1	To bal b/d			-	50,000	Jan. 2	By Purchases A/c	
13	To Sales A/c			-	6,500		By Carriage Inward A/c	
15	To Bank A/c			-	4,800	5	By Bank A/c	
14	To Bank A/c			-	8,000	13	By Malini's A/c	
17	To Interest A/c			-	900	14	By Drawings A/c	
20	To Bank A/c			-	5,000	16	By Wages A/c	
25	To Bank A/c			-	250		By Salaries A/c	
31	To Bharat's A/c			120	2,880	17	By Bank A/c	
						20	By Mali A/c	
						25	By Petty Cash	
						31	By Bank A/c	
							By Bal c/d	
				120	**73,530**			

3.3 PETTY CASH BOOK

When the petty cash fund is operated as an imprest fund, the recording of the petty expenses paid will be made in the petty cash book. This would also avoid recording too many small value transactions in the main cash book. The petty cash book would contain a number of analytical columns for grouping the various expenses under a few classifications which would facilitate subsequent posting into the General Ledger. A specimen petty cash book is given below:

Illustration 1:

Analytical Petty Cash Book of Anand & Co.

Amount Received	Date	Particulars	Total Amount paid	Postage & Telegrams	Printing & Stationery	Carriage	Traveling Expenses	Sundry Expenses
	2010							
3000	April, 1	To Bank A/c (Cheque encashed)						
	April, 7	By Postal stamps	190	190				
	April, 10	By Stationery	232		232			
	April, 15	By Carriage	616			616		
	April, 20	By Auto fare of salesman	400				400	
	April, 22	By Telegrams	10	10				
	April, 27	By Carriage	110					110
	April, 30	By Stationery	206		206			
			1764	**200**	**438**	**616**	**400**	**110**
	April, 30	By Balance c/d	1236					
3000			3000					
	2010							
1236	May, 1	To Balance b/d						
1764	May, 1	To Bank A/c (Cheque encashed)						

Separate Petty Cash A/c is open in Ledger & total Exp. credited to Petty Cash A/c. Individual expenses total is debited to concerned expenses A/c in the Ledger.

3.4 THREE COLUMN CASH BOOK

Cash book with Discount, cash and bank column is known as three column cash-book. In this cash book along with cash transactions banking transactions are also recorded.

Dr. Receipts Cash book Payments Cr.

Date	Particulars	R No.	LF No.	Disc ount	Cash Rs.	Bank Rs	Date	Particulars	R No.	LF No.	Disc ount	Cash Rs.	Bank Rs

Journal Entries for cash and Banking Transactions

	Accounting Entry
1) Investment of capital in cash by proprietor	Cash A/c ......Dr. To Capital A/c
2) Sale of goods on cash basis	Cash A/c ......Dr. To sales A/c
3) Receipt of Income in cash	Cash A/c ......Dr. To Income A/c
4) Cash deposited in to the Bank	Bank A/c ......Dr. To Cash A/c
5) Cash withdrawn from Bank for office use	Cash A/c .....Dr. To Bank A/c
6) Sale of goods and amount received by Cheque and same cheque is deposited into Bank immediately.	Bank A/c .....Dr. To Sales A/c
7) When bearer cheque is received from outside party.	Cash A/c ....Dr. To Party's A/c
8) When order or crossed cheque received from outside party.	Bank A/c ......Dr. To Party's A/c
9) When cheque received from outside Party and deposited in into the bank on the same day	Bank A/c ......Dr. To Party's A/c
10) Cheque received on earlier day and deposited to day	Bank A/c .....Dr. To Cash A/c
11) Cheque issued to other Party Dishonoured	Bank A/c .....Dr. To Party's A/c
12) When customer directly deposits the amount into the Bank	Bank A/c .....Dr. To Customers A/c

13) When bank collects our income and deposit into our account	Bank A/c ......Dr. To Incomes A/c
14) Cheque received, deposited and then dishonoured	Party's A/c ......Dr. To Bank A/c
15) Purchase of goods on cash basis / cash purchase	Purchases A/c ....Dr. To Cash A/c
16) Payment of expenses in cash	Expenses A/c ....Dr. To Cash A/c
17) Entry for Bank charges and commissions	Bank charges A/c..Dr. Commission A/c ..Dr To Bank A/c
18) Transfer of amount from current A/c to Fixed Deposit or savings A/c	Fixed Deposit A/c .Dr Savings A/c .... Dr. To Bank A/c
19) When cheque is issued to outside Party	Party's A/c ....Dr. To Bank A/c

Illustration 2:

During January 2010 Ram transacted the following business:

2010 Jan		Rs.
1.	Commenced business with cash	20,000
2.	Purchased goods on credit from Nadu.	1,00,000
3.	Purchased goods for cash	4,000
4.	Paid Gopal an advance for goods ordered	10,000
5.	Received cash from Maruti as advance for goods ordered by him	6,000
6.	Purchased furniture, office use for cash	2,000
7.	Paid Rent	1,000
8.	Received commission (in cash)	1,600
9.	Goods returned to Nadu	2,000
10.	Goods sold to Kishore	10,000
11.	Paid for postage and telegrams	200
13.	Goods returned by Kishore	2,000
14.	Purchase furniture (amount cheque paid)	16,000
15.	Paid for stationery	1,200
18.	Paid into Bank	5,000

20.	Goods sold for cash	27,750
22.	Bought goods for cash	3,000
25.	Paid salaries by cheque	3,200
28.	Paid rent	1,000
31.	Drew cash for personal use	4,000
31.	Deposited cash into Bank	12,000

Journal Entries in the books of Ram

Date	Particulars	L.F.	Dr. Rs.	Cr. Rs.
2010				
Jan. 1	Cash A/c ....Dr.		20,000	
	To Ram's Capital A/c			20,000
	(Being the cash brought into business as capital)			
Jan. 2	Purchase A/c ....Dr.		1,00,000	
	To Nandu's A/c			1,00,000
	(Being the goods purchased on credit)			
Jan. 3	Purchases A/c .....Dr.		4,000	
	To Cash A/c			4,000
	(Being the goods purchased for cash)			
Jan. 4	Gopal A/c .....Dr.		10,000	
	To Cash A/c			10,000
	(Being the amount paid to Gopal)			
Jan. 5	Cash A/c .....Dr.		6,000	
	To Maruti A/c			6,000
	(Being the cash received from Maruti)			
Jan. 6	Furniture A/c .....Dr.		2,000	
	To Cash A/c			2,000
	(Being the furniture purchased for office use for cash)			
Jan. 7	Rent A/c ......Dr.		1,000	
	To Cash A/c			1,000
	(Being the wages paid)			

Jan. 8	Cash A/c ......Dr. To Commission Received A/c (Being the commission received)		1,600	1,600
Jan. 9	Nandu A/c .....Dr. To Purchase return A/c (Being goods returned to Nandu)		2,000	2,000
Jan. 10	Kishore A/c ......Dr. To Sales A/c (Being goods sold to Kamal on credit)		10,000	10,000
Jan. 12	Postages & Telegrams A/c..Dr To Cash A/c (Being the amount paid for postages & Telegrams)		200	200
Jan. 13	Sales returns A/c ...Dr. To Kishore's A/c (Being the goods returned by Kamal)		2,000	2,000
Jan. 14	Furniture A/c .....Dr. To Bank A/c (Being cheque issued for purchase of Furniture)		16,000	16,000
Jan. 15	Stationery A/c ......Dr. To Cash A/c (Being the amount paid for stationery)		1,200	1,200
Jan. 18	Bank A/c ......Dr. To Cash A/c (Being the amount deposited into the Bank)		5,000	5,000
Jan. 20	Cash A/c ....Dr. To Sales A/c (Being the goods sold for cash)		27,750	27,750
Jan. 22	Purchases A/c .....Dr. To Cash A/c (Being the goods purchased for cash)		3,000	3,000

Jan. 25	Salaries A/c .....Dr. To Bank A/c (Being the amount paid as salaries)		3,200	 3,200
Jan. 28	Rent A/c ......Dr. To Cash A/c (Being the rent paid)		1,000	 1,000
Jan. 31	Ram Drawings A/c ..Dr. To Cash A/c (Being the cash drawn for personal use)		4,000	 4,000
Jan. 31	Bank A/c .....Dr. To Cash A/c (Being cash deposited)		12,000	 12,000

Posting in the Ledger Accounts:

Now let us prepare the ledger accounts based on the entries passed earlier. A separate account is opened in ledger for each account. All the debit entries and credit entries are duly entered. At the end, the accounts are properly balanced. In other words, the total of all debit entries is adjusted against the total of credit entries and balance is carried forward to the next accounting period.

In the Books of Ram
Cash Book, Subsidiary Books and General Ledger
Cash Book
(Three Column)

Date	Receipts	L.F.	Cash Rs.	Bank Rs.	Date	Payments	L.F.	Cash Rs.	Bank Rs.
2010					2010				
Jan.1	To Capital A/c		20,000		Jan. 3	By Purchases A/c		4,000	
Jan. 5	To Maruti's A/c		6,000		Jan. 4	By Gopal A/c		10,000	
Jan. 8	To Commission A/c		1,600		Jan. 6	By Furniture A/c		2,000	
Jan. 18	To Cash A/c	C	-	5,000	Jan. 7	By Rent A/c		1,000	
Jan. 20	To Sales A/c		27,750		Jan. 12	By Postage A/c		200	
Jan. 31	To Cash A/c	C	-	12,000	Jan. 14	By Furniture A/c			16,000
					Jan. 15	By Stationery A/c		1,200	
					Jan. 18	By Bank A/c	C	5,000	
					Jan. 22	By Purchases A/c		3,000	
					Jan. 25	By Salaries A/c			3,200
					Jan. 28	By Rent A/c		1,000	
					Jan. 31	By Bank A/c	C	12,000	
					Jan. 31	By Drawings A/c		4,000	
					Jan. 31	By Balance c/d		11,950	12,000
			55,350	17,000				55,350	17,000

Note: The letter ‘C’ in the Ledger Folio column denotes a ‘contra entry’. That is an entry for which the debit and credit aspects are found in the Cash Book itself.

Purchases Book

Date	Name of Supplier	Ledger Folio	Inward Invoice No.	Amount Rs.
2010				
Jan.2	Nandu			1,00,000
			Total	**1,00,000**

Purchase Returns Book

Date	Name of Supplier	Ledger Folio	Debit Note No.	Amount Rs.
2010				
Jan.9	Nandu			2,000
			Total	**2,000**

Sales Book

Date	Name of Customer	Ledger Folio	Outward Invoice No.	Amount Rs.
2010				
Jan.10	Kishore			10,000
			Total	**10,000**

Sales Returns Book

Date	Name of Customer	Ledger Folio	Credit Note No.	Amount Rs.
2010				
Jan.13	Kishore			2,000
			Total	**2,000**

General Ledger

Ram’s Capital A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.31	To Balance c/d		20,000	Jan.1	By Cash A/c		20,000
			20,000				**20,000**
				Feb.1	By Balance b/d		20,000

Nandus A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.9	To Purchase Returns A/c		2,000	Jan.2	By Purchases A/c		1,00,000
Jan.31	To Balance c/d		98,000				
			1,00,000				**1,00,000**
				Feb.1	By Balance b/d		98,000

Purchases A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.2	To Nandu's A/c		1,00,000	Jan.31	By Balance c/d		1,07,000
Jan.3	To Cash A/c		4,000				
Jan.22	To Cash A/c		3,000				
			1,07,000				**1,07,000**
Feb.1	To Balance b/d		1,07,000				

Sales A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.31	To Balance c/d		37,750	Jan.13	By Kishore's A/c		10,000
				Jan.20	By Cash A/c		27,750
			37,750				**37,750**
				Feb.1	By Balance b/d		37,750

Purchase Return A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.31	To Balance c/d		2,000	Jan.9	By Nandu's A/c		2,000
			2,000				**2,000**
				Feb.1	By Balance b/d		2,000

Sales Return A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.13	To Kishore's A/c		2,000	Jan.31	By Balance c/d		2,000
			2,000				**2,000**
Feb.1	To Balance b/d		2,000				

Gopal's A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.6	To Cash A/c		10,000	Jan.31	By Balance c/d		10,000
			10,000				**10,000**
Feb.1	To Balance b/d		10,000				

Rent A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.7	To Cash A/c		1,000	Jan.31	By Balance c/d		1,000
			1,000				**1,000**
Feb.1	To Balance b/d		1,000				

Commission Received A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.1	To Balance c/d		1,600	Jan.31	By Cash c/d		1,600
			1,600				**1,600**
				Feb.1	By Balance b/d		1,600

Kishore's A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.10	To Sales A/c		10,000	Jan.31	By Sales Returns A/c		2,000
				Jan.31	By Balance c/d		8,000
			10,000				**10,000**
Feb.1	To Balance b/d		8,000				

Postage & Telegram A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.12	To Cash A/c		200	Jan.31	By Balance c/d		200
			200				**200**
Feb.1	To Balance b/d		200				

Stationery A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.15	To Cash A/c		1,200	Jan.31	By Balance c/d		1,200
			1,200				**1,200**
Feb.1	To Balance b/d		1,200				

Salaries A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.25	To Bank A/c		3,200	Jan.31	By Balance c/d		3,200
			3,200				**3,200**
Feb.1	To Balance b/d		3,200				

Rent A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.28	To Cash A/c		1,000	Jan.31	By Balance c/d		1,000
			1,000				**1,000**
Feb. 1	To Balance b/d		1,000				

Drawings A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.31	To Cash A/c		4,000	Jan.31	By Balance c/d		4,000
			4,000				**4,000**
Feb.1	To Balance b/d		4,000				

Maruti's A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.31	To Balance c/d		6,000	Jan.5	By Cash A/c		6,000
			6,000				**6,000**
				Feb.1	By Balance b/d		6,000

Furniture A/c

Dr. **Cr.**

Date	Particulars	JF No	Amount Rs.	Date	Particulars	JF No	Amount Rs.
2010				2010			
Jan.6	To Cash A/c		2,000	Jan.31	By Balance c/d		2,000
			2,000				**2,000**
Feb. 1	To Balance b/d		2,000				

Illustration 3:

Enter the following transactions in Raj's Cash show 'Discount Allowed' and 'Discount Received A/c'. March 2010.

1 Cash on hand Rs. 2,400 and bank overdraft Rs. 500.

3 Atmaram bought goods from us worth Rs. 300 on credit for 2 months, but he paid cash on the spot after deducting discount Rs. 6.

5 Received a cheque for Rs. 150 and cash Rs. 100 from Govind. He was allowed discount RS. 10. The cheque was deposited into the Bank.

6 Purchased goods from Mehta and paid for same by cheque Rs. 150.

8 Cheque from Govind is returned dishonoured.

10 Deposited Rs. 1,300 into Bank.

12 Received Bank Pass Book showing interest charged by Bank Rs. 10.

13 K. Nath paid by cheque Rs. 100 in full settlement of his debt to us Rs. 105.

14 Above cheque is paid into Bank.

15 Transferred Rs. 1,000 from fixed deposit to current account.

18 Paid rent of residential quarters of Rajkumar by issuing a cheque for Rs. 75.

20 Withdrew for office use Rs. 300.

22 Received for cash sales from Manikchand a crossed cheque for Rs. 525.

25 Purchased safe from Kolhapur Steel Company for Rs. 700 and issued a cheque for the same.

26 Paid into bank a cheque on a National Bank, Bombay for Rs. 800 collection charges being charged by Bank Rs. 3.

28 Received a cheque for Rs. 200 from P. Pant in full settlement of his account for Rs. 205.

29 P. Pant's cheque was endorsed to S. Sant in full settlement of his account for Rs. 210.

30 Issued a cheque in payment of office rent Rs. 150.

31 Our cheque to Kolhapur Steel Company was returned dishonoured.

31 Cancelled the cheque issued for rent and paid the amount in cash.

31 Excess over Rs. 500 deposited into Bank.

Solution:

Date	Particulars	R. No.	L.F.	Discount Rs.	Cash Rs.	Bank Rs.	Date	Particulars	R N
2005							2005		
Mar. 1	To Balance b/d				2,400		Mar.1	By Balance b/d	
3	To Sales (Cash Sales & Cash discount)			6	294		6	By Purchases (Issue Cheque No.)	
5	To Govind (Received cheque, cash & discount, allowed, cheque is paid into Bank)			10	100	150	8	By Govind (Cheque received is dishonored, dis. Allowed cancelled).	
10	To Cash (Deposited into Bank)		C			1,300	10	By Bank (Deposited into Bank)	
13	To K. Nath (Cheque received & Discount allowed)			5	100		12	By Interest (Bank charged Interest)	
14	To Cash (Cheque deposited)		C			100	14	By Bank (Cheque deposited)	
15	To Fixed deposit (Transferred from fixed deposit).					1,000	18	By Drawings (Issued cheque No. for rent of residence.)	
20	To Bank (Withdrew for office use.)		C		300		20	By Cash (Withdrew for office use.)	

20	To Sales (A crossed cheque received from, Manikchand for Cash sales.)					525	25	By Furniture (Issued cheque No. for purchase of safe.)
26	To Cash (Paid cheque)		C			800	26	By Bank (Paid into Bank)
28	To P. Pant (Received cheque.)			5	200		26	By Bank Charges (Collection charges.)
30	To Kolhapur Steel Co. (Cheque No. dishonoured.)					700	29	By S. Sant (Cheque endorsed.)
31	To Rent (Cancelled cheque No.)					150	30	By Rent (Paid by cheque.)
31	To Cash (Paid into Bank)		C			344	31	By Rent (Paid cash in cancellation of cheque.)
							31	By Bank (Paid into Bank).
							31	By Balance c/d
				26	**3,394**	**5,069**		
1-4	To Balance b/d				500	3,031		

Illustration: 4

Enter the following transactions in a cash book with 3 columns that is Discount, Cash and Bank in the books Yashshri for the month of June, 2010.
2010

Jan	1	Cash in hand Rs. 8,000 and at Bank Rs. 10,000
	2	Sold goods to Swami and Co. for Rs. 6,000 and received a cheque of Rs. 2,000 as part payment.
	3	Purchased goods from Patel for Rs. 8,000 less trade discount 2% and paid the amount by issue of cheque.
	5	Transferred Rs. 5,000 from Private Banking A/c to Business Bank A/c.
	10	Issued a cheque for Rs. 3,000 to furniture mart for the furniture purchased for last month in full settlement of Rs. 3,200
	12	Withdrew for personal use from Bank Rs. 8,000
	14	Issued a cheque to petty cashier for Rs. 2,000
	15	Withdrew for office use Rs. 4,000
	16	Swami and Co. infored that they paid directly into our Bank A/c in; the remaining balance amounting Rs. 4,000.
	19	Bank collected Dividend and credited to our Account to Rs. 1,400.
	20	Paid Insurance premium for goods Rs. 3,000, by cheque.
	20	Cash sales Rs. 8,000.
	25	Paid Salaries by cheque Rs. 800
	30	Purchased Govt. securities of Rs. 900.

Solution:

In the books of

Yashshri

Three column

Cash Book

Receipts

Payments

Date	Particulars	R. No	LF No	Dis.	Cash	Bank	Date	Particulars	R. No.
2010							2010		
Jan. 1	To bal. b/d			-	8,000	10,000	Jan. 3	By Purchases A/c	
2	To Sales A/c			-	-	2,000	10	By furniture Mant. A/c	
5	To Capital A/c			-	-	5,000	12	By Drawings A/c	
15	To Bank A/c		C	-	4,000	-	14	By Petty Cashier A/c	
16	To Swami & Co's A/c			-	-	4,000	15	By Cash A/c	
19	To Dividend A/c			-	-	1,400	20	By Insurance A/c	
20	To Sales A/c			-	8,000	-	25	By Salaries A/c	
31	To Bank over draft c/fd			-	-	5,440	30	By Investment A/c (Govt. Securities)	
								By Balance c/d	
				-	**20,000**	**27,840**			

3.5. EXERCISES

3.5.1 Theory Questions

7. Explain term ‘Book Keeping.
8. What is Account?
9. Distinguish between:
   a) Book-keeping and Accountancy
   b) Personal Accounts and impersonal Accounts
   c) Real Accounts and Nominal Accounts
   d) Single Entry system and Double Entry system
   e) Cash system of Accounts and Accrual system of Accounts.
10. Discuss the principles of debit and credit of Accounts.
11. Explain Journal & its utility.
12. What is Ledger? What is a ledger Account?
13. Explain how a ledger account is balance? What is indicates by Debit or Credit balance?
14. “By sub-division of journal, there will be a division of labour”. Explain.
15. Which type of transactions will be recorded in sales Book and purchase Book.
16. What is cash Book? What are different types of cash book.
17. What do you mean by “Contra Entries” in the cash book with Cash & Bank columns?
18. What is the petty cash?

1) Journalise the following transactions in the books of Ram for the month of March 2010.

   March 1 Ram commenced business with cash Rs. 60,000.

   2 Purchased furniture for Rs. 5,000.

   4 Purchased goods for cash Rs. 2,000.

   7 Bought goods from M/s. Raj & Co. for Rs. 4,000.

   10 Sold goods costing Rs. 3,000 on cash.

   15 Purchased stationery for office use Rs. 1,000.

   19 Received cash Rs. 1,250 from Mr. Ketan in full settlement of his account for Rs. 1,500.

   20 Paid salaries by cheque Rs. 1,500.

   25 Introduced additional capital Rs. 20,000.

   27 Paid to Raj Rs. 3,250 in full settlement of Rs. 3,500

   29 Sold goods for Rs. 15,000 to Mr. Dohi.

   31 Deposited Rs. 3,000 into the Bank.

2) Journalise the following transactions in the books of Mr. Shiva for the month of April 2010.

April	1	Started business with cash Rs. 25,000/-
	6	Purchased goods worth Rs. 10,000/-
	4	Deposited cash Rs. 3,000 into the Bank.
	6	Purchased goods of Rs. 6,000 from M/s. Raju Trading Company.
	9	Sold goods to Mr. Ramesh for Rs. 3,000.
	12	Paid to M/s. Raju Trading Company Rs. 3,000.
	15	Received Rs. 1,000 from Mr. Ramesh.
	20	Paid salaries Rs. 1,000/- and paid commission Rs. 1,600/- in cash.
	25	Bought stationery for office use Rs. 300.
	27	Withdrew Rs. 2,500 from business for personal use.
	29	Withdrew Rs. 4,000 from bank for office use.

3) Journalise the following transactions in the journal of Mr. Anand for the month of February, 2010.

Feb	1	Borrowed from Bank @ 15% interest Rs. 20,000.
	7	Purchased goods from Mr. Sam for Rs. 3,500.
	8	Paid carriage and cartage Rs. 250
	9	Sold goods on cash Rs. 3,000.
	11	Paid Rs. 2,250 to Mr. Sam.
	16	Purchased office furniture for Rs. 6,000.
	19	Paid interest Rs. 450/- to Mr. Bank.
	20	Paid salaries Rs. 6,000.
	22	Cash sales Rs. 20,000.
	26	Cash purchases Rs. 15,000
	28	Paid Rs. 2,000 to Bank in part payment of loan.

4) Journalise the following transactions in the books of Mr. Vishal for the month of March, 2010.

Mar.	1	Vishal started business with cash Rs. 35,000, goods worth Rs. 10,000.
	4	Opened bank account in the Bank of India by depositing Rs. 5,000.
	4	Bought goods worth Rs. 6,000 @ 10% trade discount term.
	7	Sold goods worth Rs. 3,000

9 Purchased furniture of Rs. 4,000 for office use and furniture of Rs. 1,000 for home use.

14 Withdrawn goods of Rs. 1,000 for self use.

17 Received Rs. 2,400 from Mr. Ravindra in full settlement of Rs. 2,450.

19 Paid salaries Rs. 500 to office clerk and paid electricity bill of Rs. 750 in cash.

24 Paid Mr. Raj Rs. 1,960 in full settlement of Rs. 2,000.

26 Paid insurance premium of Rs. 1,200 on the life of Mr. Vishal, a proprietor.

29 Cash sales Rs. 3,000.

30 Withdrew Rs. 4,000 from bank for office use.

5) Draft journal entries for the business transactions given below.

Apr. 1 Mr. Atul started business with cash Rs. 5,000/-, goods Rs. 7,500 and furniture Rs. 2,500/-

5 Purchased goods worth Rs. 4,500 from Mr. Kamalakar.

9 Cash sales Rs. 6,000

10 Purchased stationery for office use Rs. 500.

10 Paid to Mr. Kamalakar Rs. 4,350 in full settlement of Rs. 4,500.

13 Deposited Rs. 1,000 into the Bank.

16 Received Rs. 500 from Mr. Kiran.

19 Withdrawn Rs. 200 from business for self use.

23 Paid Rs. 150 for commission and paid Rs. 450 for rent.

27 Paid wages Rs. 600 in cash, and paid sundry expenses Rs. 200/- by cheque.

29 Borrowed Rs. 5,000 from wife for business purpose.

30 Cash purchases Rs. 1,000.

6) On 1st July, 2010, Mr. X commenced business with cash Rs. 25,000, Bank balance Rs. 25,000, Stock Rs. 43,000 & Computer Rs. 18,000.

July 2 Borrowed Rs. 20,000 from Mr. Y for business purpose.

6 Sold goods to Mr. Z for Rs. 10,000 @ 5% T.D.

7 Paid for business stationery by cheque Rs. 500.

7 Sold goods to Mr. A on credit Rs. 5,000.

9 Sold goods to Mr. B on cash Rs. 10,000 and amount deposited into the bank.

11 Received cheque from Mr. Z in payment for goods sold to him on 4^{th} July less 5% C.D. and deposited into the bank.

13 Mr. A paid us cash Rs. 4,900 for goods sold to him on 7^{th} July.

15 Bought printer for Rs. 2,000 and amount paid by cheque.

18 Withdrawn Rs. 600 from Bank to pay insurance premium on the life policy.

19 Withdrawn goods of Rs. 500 from stock for private use.

22 Purchased second hand car for Rs. 15,000 for business purpose and amount paid by cheque.

25 Paid monthly wages Rs. 1,000 in cash.

26 Purchased 1,500 shares of M/s. ABC Co. Ltd. at Rs. 10 per share.

27 Transferred Rs. 10,000 from Current A/c to Fixed Deposit A/c.

28 Issued a cheque to chartered accountant for auditing Rs. 800.

30 Deposited into Bank Rs. 6,000.

You are required to prepare three columns cash book and balance the same.

7) Record the following transactions in a cash book with cash, bank and discount columns and balance the same.

Aug. 1 Mr. Arvind kumar started business with cash Rs. 30,000.

2 He opened a Current A/c into the city Co-operative Bank by depositing Rs. 20,000.

4 He received a cheque from Mr. Ram for Rs. 5,000 for goods sold to him, which was deposited in Bank.

6 Paid by cheque an amount of Rs. 11,500 to Mr. Shah for goods purchased from him for Rs. 12,000 (cheque is issued for full settlement)

11 Bank informed that Ram cheque is dishonoured, and our account is debited by Rs. 50 for bank charges.

17 Paid salaries Rs. 1,600, commission Rs. 1,000 and rent Rs. 1,000 by cheque.

18 Bank informed that our account is credited by Rs. 3,000 for receipt of dividend and debited our account for payment of insurance premium for Rs. 1,600.

23 Purchased key board for Rs. 3,000 for home use and a computer for Rs. 40,000 for office use, total amount paid by cheque.

24 Borrowed Rs. 7,500 from our business friend Mr. Sam for business purpose.

27 Bought stationery worth Rs. 500 for business purpose and fan for home use for Rs. 2,000. Both the payments were made by cheques.

28 Mr. Kishor deposited Rs. 1,750 into our bank account directly.

29 Issued a cheque to Art & Creative Co. for advertisement Rs. 12,500/-

8) Compile a Cash Book having cash, discount and bank columns from the following transactions for the month of May, 2010 and balance the same.

May. 1 Cash in Cash Box Rs. 20,000 and Bank balance Rs. 25,000.

2 Deposited into the bank Rs. 7,500.

4 Cheque of Rs. 14,000 received from Mr. Arjun in full settlement of Rs. 15,000.

6 Mr. Arjun's cheque deposited into the bank along with cash Rs. 1,500/-

7 Amount of Rs. 1,000 directly deposited into the our Bank A/c by Mr. Anu.

9 Paid to M/s. Z and sons by cheque Rs. 1,090 and earned discount of Rs. 10.

12 Cash sales Rs. 2,520 and allowed cash discount of Rs. 30.

14 Cash purchases Rs. 6,000 and amount paid by issuing across cheque for the same amount.

16 Bank informed that Mr. Arjun's cheque is dishonoured and he is paid Rs. 13,500 immediately to settle his account.

19 Purchased stationery for Rs. 250 and office furniture for Rs. 2,250.

20 Paid commission Rs. 1,000 and Staff salaries Rs. 1,000 through bank.

24 Withdrawn cash Rs. 750 from office for self use and cash Rs. 1,500 from bank for petty expenses.

26 Received a crossed cheque of Rs. 14,500 from Mr. Ashok.

28 Endorsed a cheque received from Mr. Ashok in favour of Mrs. Jani.

29 Borrowed from wife Rs. 20,000 for business purpose.

30 Mr. Ashok's cheque endorsed to Mrs. Jani was dishonoured.

31 Transferred Rs. 10,000 from Current A/c to Fixed Deposit A/c.

9) Prepare the three column cash book from the following details and balance the same.

June 1 Cash office Rs. 40,500/- and Overdraft Bank balance Rs. 16,600/-.

2 Purchased goods worth Rs. 15,000/- @ 10% T.D. and 5% C.D. from M/s. Randhir and Sons. 50% of the amount paid immediately and balance after 15 days.

4 Bought office furniture for Rs. 15,000 and paid Rs. 12,500 as first installment.

6 Purchased stationery for office use costing Rs. 400.

7 Sold goods worth Rs. 20,000 @ 2% C.D. and amount deposited into Bank.

9 Received a cheque of Rs. 12,000 from Mr. Anand on account.

11 Deposited Mr. Anand's cheque into the Bank.

13 Paid Mr. Ramesh by cash Rs. 1,500 and by cheque Rs. 750 in full settlement of his account of Rs. 2,400.

14 Gave loan of Rs. 10,000 to wife by issuing cheque.

16 Cheque issued to Mr. Ramesh returned dishonoured and cash Rs. 1,000 paid to him.

18 Transferred Rs. 20,000 from Fixed deposit A/c. to Current A/c.

20 Withdrawn from bank cash Rs. 4,000 for office use and withdrawn from office cash Rs. 10,000 for daughter's marriage.

22 Issued a cheque of Rs. 6,700 to M/s. Randhir and Sons and earned discount of Rs. 50.

25 Bank has debited our account by Rs. 550 for payment of insurance premium.

28 Issued a cheque of Rs. 2,500 for payment of salaries. Paid office rent Rs. 1,600 in cash.

29 Deposited into Bank all the cash in excess of Rs. 1,400.

10) From the following information prepare cash book with cash, bank and discount column and balance the Cash Book.

Mar.	1	Opening balance of cash Rs. 21,000 and at bank Rs. 16,000
	3	Received from Jayant Rs. 12,900 and allowed discount Rs. 100.
	5	Paid to Babar by cheque Rs. 2,910 in full settlement of their account for Rs. 2,930.
	10	Sanjay deposited directly into our bank account Rs. 3,000.
	15	Received a cheque of Rs. 2,000 for interest on investments which was deposited into the bank.
	20	Drew cheque for personal use Rs. 5,000.
	24	Paid salaries Rs. 2,250 and rent Rs. 4,000 by cheque.
	26	Sold goods costing Rs. 18,000 at 25% profit on cost and received half the amount in cash and half by cheque which is deposited into the bank.
	28	Bank pass book shows that bank has debited our account by Rs. 200 for bank charges and credited account by Rs. 1,000 for interest on investment.
	30	Transferred Rs. 5,000 from savings account to current account.

11) From the following details prepare three column cash book and balance the same.

Jan	1	Opening cash balance Rs. 20,000 and bank balance Rs. 25,000.
	5	Received cash from Kaka Rs. 9,500 and allowed discount Rs. 500.
	8	Received a cheque from Anil for Rs. 7,000 and immediately deposited into bank.
	10	Paid to Suresh by cheque Rs. 3,000 for rent.
	14	Paid salary by cash Rs. 3,000 and by cheque Rs. 10,000.
	16	Received by cheque Rs. 14,000 and cash Rs. 6,000 from Nagori and deposited the same cheque into the bank immediately.
	20	Paid to Rakesh Rs. 4,000 by cash and Rs. 1,500 by cheque on account.
	22	Paid to Narayan by cheque Rs. 4,500 and received discount Rs. 500.
	25	Cash sales Rs. 20,000 at 5% C.D.
	27	Cash purchases Rs. 20,000 at 5% C.D.

28 Paid to Nagori on account Rs. 5,000 by cheque.

29 Received from Arun Rs. 4,500 towards full settlement of Rs. 5,000.

30 Paid telephone bill by cheque Rs. 450.

12) Enter the following transactions in a three column cash book and balance the same.

May 1 Opening cash balance Rs. 30,000 and bank balance Rs. 42,500.

2 Cash purchases Rs. 20,000 at 3% C.D.

5 Cash sales Rs. 25,000 at 3% C.D.

9 Received cash from ABC Co. Rs. 5,900 and allowed discount Rs. 100.

11 Received a cheque from Delta Co. for Rs. 2,000 and deposited it into the bank immediately.

13 Paid rent by cash Rs. 1,000 and by cheque Rs. 5,000.

15 Paid to XYZ Co. Rs. 2,000 by cash and Rs. 4,000 by cheque.

18 Received cash Rs. 9,750 from Bata & Co. and allowed a discount of Rs. 250.

22 Deposited into bank Rs. 5,000.

❖❖❖❖

4

BANK RECONCILIATION STATEMENT

Unit Structure:

4.0 OBJECTIVES

After studying the unit the students will be able to:

- Define and explain bank reconciliation statement.
- Know the reasons of disagreement of the balances of cash book and bank statement.
- Prepare the format of the statement.
- Prepare bank reconciliation statement.

4.1 MEANING

A customer of the bank opens a Bank Account in his Cash book to record all his bank transactions. Similarly a bank maintains a Customer's Account in its ledger, and gives a Bank Pass Book to the customer. From the entries in the pass book a customer can have knowledge of the transactions recorded by the bank in his account. When we make entries on the debit side of Bank Account the bank makes entries on the credit side of our account for the same transactions and vice versa. As a result when the Bank Account shows debit balance, the pass book shows credit balance and vice-versa.

As a matter of fact balance shown by the Bank Account and by the bank pass book on a particular day must tally. But in actual practice they differ due to reasons given below. It is therefore, becomes necessary to reconcile the difference to ascertain that there are no mistakes committed. Thus a Bank Reconciliation Statement is a statement prepared to reconcile the difference between the balances as shown by the Bank Account in a Cash Book and by the Bank Pass Book.

4.2 REASONS FOR DIFFERENCES IN BANK BALANCE OF CASH BOOK WITH PASS BOOK

Some of the transactions are entered in the Cash Book (Bank column only) whereas some are entered only in the Pass Book. In addition to this there may be some mistakes committed, either in the Cash book or in the Pass Book.

A) Transactions entered in the Cash Book (Bank Column) or in the pass book.

i) Cheques issued: When a cheque is issued, Bank Account is at once credited, but the Customers Account is debited by the Banker only when the payment of that cheque is effected by the Bank.

ii) Cheques paid or deposited into the Bank : When a cheque is received and paid into the bank, the customer debits at once the Bank Account in his Cash Book, but the Customer's Account is credited by the Banker only when the cheque is collected by the bank.

B) Generally the following transactions are entered first in the Pass Book and subsequently they are entered in the Cash Book from the Pass Book.

1. Bank Charges
2. Interest allowed or charged by Bank
3. Dividend, Interest on Investment collected by Bank on behalf of a customer.
4. Dishonour of cheque paid into Bank and credited to Customer's Account by Bank.
5. Amount collected or paid for Bills of Exchange by Bank, Sale of Securities on behalf of a customer.
6. Payment by Bank, such as Club Subscription, Insurance Premium, Purchases of Securities on behalf of a customer.

4.3 PREPARATION OF BANK RECONCILIATION STATEMENT

In actual practice, we have both Cash Book (Bank Account) and the Bank Pass Book on hand, to compare the entries in them during a particular period. As the entries which are made in both the books do not cause the difference in balance, they are to be left out. The entries which are recorded only in one of the two books are taken into consideration.

Generally, Bank balance either as per Cash Book or as per Pass Book of a particular date is given and the balance as per other book is required to be traced out.

A) First ascertain balance that is whether a debit balance or a credit balance.

B) Out of the transactions given, those which are recorded in both the books that is Cash Book and Pass Book before the date of reconciliation are not to be considered.

C) Transaction which is recorded in only one of two books either in the Cash Book or in the Pass Book is to be considered.

Bank Reconciliation Statements helps the customer to know which cheques are yet to be realized and which cheques are not yet encashed.

It reduces the chances of misappropriation by the Bank employees.

4.4 CHART FOR SOLVING THE PROBLEMS

The following charts will help the students in solving the problems:

Transactions	Given Bank balance as per Cash Book or overdraft as per Pass Book	Given Bank balance as per Pass Book or overdraft as per Cash Book
1. Cheques issued but not encashed recorded in the Cash Book only.	Add	Less
2. Interest allowed or collected by Bank, Sale of Investments recorded in Pass Book only.	Add	Less
3. Direct payment into bank by our customer etc.	Add	Less

4. Wrong amount taken in Cash Book i) Short Amount ii) Excess Amount	 Add Less	 Less Add
5. Cheque paid into Bank but not credited by Bank.	Less	Add
6. Bank Charges, Interest charged by Bank or dishonour of cheque etc. are recorded in Pass Book only.	Less	Add
7. Bank charges, Interest charged by Bank or dishonour of cheqe etc. are recorded in Pass Book only.	Less	Add
8. Payment by bank for insurance premium, club subscription, Purchase of Securities etc. are recorded in Pass Book only.	Less	Add

4.5 SPECIMEN OF BANK RECONCILIATION STATEMENT

Particulars	Rs.	Rs.
Balance as per Cash / Pass Book given		XX
Add : The transaction that would increase the balance in the other Book.	XX	XX
Less : The transaction that would reduce the balance of the other book	XX	(XX)
Balance as per Cash / Pass Book (i.e. other book) as on		XXX

4.6 BANK OVERDRAFT

Normally, Traders keeps depositing cash into Bank Account and withdraws by issuing cheques to various parties. However, trader makes arrangement with the bank, to withdraw more than his bank balance. This is known as Bank Overdraft. The upper limit of such overdraft is fixed in advance. When there is overdraft Bank Account in trader's books shows credit balance and in the books of Bank, trader's account will show debit balance, and he is a debtor.

For preparing reconciliation statement, taking Bank overdraft as base, it will be exact opposite that of Bank Balance, add items will become Less and less items will be Add.

4.7 IMPORTANCE OF BANK RECONCILIATION STATEMENT

After getting Bank Statement / Pass Book, businessmen, compares entries in Cash Book (recorded by trader) and Bank Statement (recorded by bank in relation to businessmen) and prepare Bank Reconciliation. While preparing reconciliation statement, numbers of entries are not matching with each other these discrepancies may lead to notice frauds, errors, misappropriation of cash, by cashier. It reduces the charges of misappropriation by the employees, so timely action may be taken. At the same time, it is possible that Bank might have made wrong entry of deposit or withdrawal, businessmen can be inform bank to correct it.

It presents sinero, of e-banking of increasing use of credit card / debit card facilities / Net banking. Their may be number of transaction are not recorded in time which can be brought to notice. For wrong entry by bank, immediate action can be taken, asking bank to verify the mistake(s).

CHECK YOUR PROGRESS

- Give the examples of various transactions which are generally entered first in the Pass Book.
- If the Bank balance as per Cash Book is given, how the following transactions affect:
  1. Interest allowed or collected by Bank, Sale of Investments recorded in Pass Book only.
  2. Cheque paid into Bank but not credited by Bank.
  3. Payments by bank for insurance premium, club subscription, Purchase of Securities etc. are recorded in Pass Book only.
  4. Direct payment into bank by our customer.
  5. Bank Charges, Interest charged by Bank or dishonour of cheque etc. are recorded in Pass Book only.

4.8 ILLUSTRATIONS

Illustration 1 : On 31st December 2010, M/s. M.D. & Co.'s bank column of Cash Book showed a debit balance Rs.17,800/- from the following particulars prepare a Bank Reconciliation Statement showing the balance as per Bank Pass Book as on 31st December 2010.

1. Cheques deposited into the Bank but not cleared and credited before 31st December amounted to Rs.8,950/-.
2. Cheques issued on 31st December but presented for payment on the 7th January 2011 amounted to Rs.6,750/-.
3. Purchases of securities of Rs.4,000/- by the Bank on behalf of M/s. M.D. & Co. appeared in Pass Book only.
4. Interest Rs.95/- was credited in the Pass Book but was entered in the Cash Book as Rs.59/-.
5. Bank charges Rs.45/- were recorded in the Pass Book but no entry was made in the Cash Book.

Bank Reconciliation Statement as on 31-12-2010

Particulars	Rs.	Rs.
Balance at the bank as per Cash Book as on 31-12-2010.		17,800
Add :		
(i) Cheques issued on 31st December but not cashed upto 31st December 2010.	6,750	
(ii) Interest recorded in the Cash Book as Rs.59/- instead of Rs.95/-, hence the difference.	36	6,786
		24,586
Less :		
(i) Cheques paid into Bank but not cleared upto 31st December 2010.	8,950	
(ii) Payment made by Bank for purchase of securities not entered in the Cash Book.	4,000	
(iii) Bank charges appearing in the Pass Book.	45	(6,390)
Balance as per Pass Book as on 31st December 2010.		8,710

Illustration 2 : On 30th June, 2010 the Cash Book of M/s. Patil & Co. showed a Bank balance of Rs.12,000/-.

1. Cheques sent to Bank for collection of Rs.10,000/- before 30-06-2010 but only one cheque of Rs.4,000/- is credited in June 2010.
2. Cheque issued for Rs.5,000/- in the month of June, but cheques of Rs.2,500/- presented for payment in July 2010.

3. The following entries were passed in the Pass Book before 30th June, 2010 but no corresponding entry was made in the Cash Book.
   a) Rs.320/- paid a Insurance Premium.
   b) Interest on Investment collected by the Bank Rs.600/-.
   c) Bank has charged Rs.50/- as interest and commission Rs.20/-.

Prepare a Bank Reconciliation Statement as on 30th June, 2010 from the above particulars.

Solution :

Bank Reconciliation Statement as on 30-06-2010

Particulars	Rs.	Rs.
Balance as per Cash Book as on 30-06-2010.		12,000
Add :		
(i) Cheques issued but not encashed before 30th June 2010.	2,500	
(ii) Interest collected by Bank.	600	3,100
		15,100
Less :		
(i) Cheques paid in to Bank but not credited by Bank.	6,000	
(ii) Insurance Premium paid by Bank.	320	
(iii) Interest and Commission charged by Bank.	70	(6,390)
Balance as per Pass Book as on 3-06-2010.		8,710

Illustration 3 : Bank Account as per Bank Pass Book of Mr. Kant showed Credit Balance of Rs.20,168/- on 31-03-2010. From the following particulars prepare Bank Reconciliation Statement arriving at the balance as per Cash Book as on 31st March, 2010.

1. Two cheques for Rs.458/- and Rs.760/- were paid into the Bank in March 2010 but they were not credited in the Pass Book by the Bank till 31-03-2010.
2. Three cheques for Rs.1,065 Rs,545/- and 335/- were issued on 28-03-2010 out of which (i) the cheque for Rs.335/- was presented to the bank on 30-03-2010. (ii) the cheque for Rs.545/- was presented on 2-04-2010 and (iii) the cheque for Rs.1,065/- was lost and not presented at all.

3. The Bank has charged Rs.5/- as Bank charges and has credited interest of Rs.30/-. The bank has also collected interest on investment on behalf of Mr. Kant Rs.100/-. These are not recorded in the Cash Book.
4. A customer of Mr. Kant has paid Rs.500/- directly in the Bank Account of Mr. Kant has paid Rs.500/- directly in the Bank Account of Mr. Kant on 31-03-2010 of which Mr. Kant has no intimation.

Solution :

Bank Reconciliation Statement as on 31-03-2010

Particulars	Rs.	Rs.
Balance as per Pass Book as on 31-03-2010.		20,168
Add :		
(i) Cheques paid into Bank but to credited by Bank upto 31-03-2010.	1,218	
(ii) Bank charges entered in Pass Book.	5	1,223
		21,391
Less :		
(i) Cheques issued but not presented for payment upto 31-03-2010.	1,610	
(ii) Interest credited by Bank.	30	
(iii) Interest on investments collected & credited by Bank.	100	
(iv) Direct payment into Bank by a customer.	500	(2,240)
Balance as per Cash Book as on 31-03-2010.		19,151

Illustration 4 : On 31st December 2010 the Pass Book of Dr. Raj showed a credit balance of Rs.11,000/-. On comparing it with Cash Book, following differences were discovered.

(i) Cheaues deposited with Bank before 31-12-2010, but not yet collected Rs.1,400/-.

(ii) Cheque issued upto 31-12-2010 but not yet presented for payment Rs.450/-.

(iii) The Bank has collected dividend Rs.250/- and has charged Rs.15/- as collection charges. Entries of these transactions do not appear in Cash Book.

(iv) The Bank has paid his electricity bill Rs.410/- for the month of November 2010. This transaction appears only in Pass Book.

(v) The debit column of Bank Account in Cash Book is added shorted by Rs.40/-.

Prepare Bank Reconciliation Statement.

Solution :

Bank Reconciliation Statement as on 31-12-2010

Particulars	Rs.	Rs.
Balance as per Pass Book as on 31-12-2010.		11,000
Add :		
(i) Cheques paid into Bank but to collected and credited by Bank.	1,400	
(ii) Bank Charges not entered in Cash Book.	15	
(iii) Payment of electricity bill by Bank not entered in Cash Book.	410	1,825
		12,825
Less :		
(i) Cheques issued but not encashed	450	
(ii) Collection of dividend by bank not entered in Cash Book.	250	
(iii) Undercasting of debit column of Bank Account in Cash Book.	40	(740)
Bank Balance as per Cash Book as on 31-12-2010.		12,085

Illustration 5 : On 31st December 2010 the Bank Pass Book of a company showed an overdraft of rss.12,060/-. Comparison of the Pass Book and the Cash Book showed the following.

a) The company had sent to the Bank three cheques on 28th December 2010. The cheques were for Rs.4,100/-, Rs.900/-, and Rs.560/- of these only the cheque for Rs.4,100/- was credited by the Bank before 31st December 2010.

b) The company had issued on 27th December, 2010 cheques for Rs.800/-, Rs.500/- and Rs.1,760/-. The cheque for Rs.1,760/- was paid before 31st December, 2010. The other cheques were paid on 3rd January, 2011.

c) The Bank had debited the company with Rs.120/- as Bank charges and with Rs.5,120/- as interest. The entries had not yet been made in the Cash Book.

d) A customer had deposited in Company's Account Rs.1,500/- but the fact was not recorded in the Cash Book.

Prepare Bank Reconciliation Statement as on 31st December, 2010.

Solution :

Bank Reconciliation Statement as on 31-12-2010

Particulars	Rs.	Rs.
Balance as per Pass Book as on 31-12-2010.		12,060
Add :		
(i) Cheques issued but not encashed before 31-12-2010 (Rs.800/- + Rs.500/-)	1,300	
(ii) Direct payment into Bank by the customer not recorded in Cash Book.	1,500	2,800
		14,800
Less :		
(i) Cheques paid into Bank but not credited by Bank before 31-12-2010 (Rs.560/- + Rs.900/-).	1,460	
(ii) Bank charges and interest not recorded in Cash Book as on 31-12-2010 (Rs.120/- + Rs.5,120/-)	5,240	(6,700)
Balance as per Cash Book as on 31-12-2010.		8,160

Illustration 6 : On 1st January, 2010 the Cash Book of Dayand showed a Bank balance overdrawn to the extent of Rs.3,117/-. On comparing his Cash Book with the Pass Book he finds that :

1. A Cheque for Rs.125/- sent to Shah has not been entered in the Cash Book.
2. Bank charges of Rs.47/- at 31st December, 2010 were not entered in the Cash Book at all.
3. The Bank has debited Dayand's Account with a cheque for Rs.410/- received from Damodar which had been returned dishonoured. The fact of dishonour was not shown in the Cash Book.
4. The Bank column on the receipt side of the Cash Book was found to be under cast by Rs.70/-.
5. Unpresented cheques amounted to Rs.1,450/-.

Prepare a Bank Reconciliation Statement of Doyand as on 1st January 2010.

Solution :

Bank Reconciliation Statement as on 1-1-2010

Particulars	Rs.	Rs.
Overdraft as per Pass Book as on 1-1-2010.		3,117
Add :		
(i) Bank charges not entered in Cash Book	47	
(ii) Entry for dishonour of cheque not recorded in Cash Book	410	
(iii) Cheque issued to Shah and encashed is not entered in the Cash Book.	125	582
		3,699
Less :		
(i) Undercasting of the debit side of Bank column.	70	
(ii) Cheques issued but not presented for payment till 01-01-2011.	1,450	(1,520)
Bank Balance as per Pass Book as on 1-1-2011.		2,179

- **Different Periods:**

Sometimes entries in the Pass Book and in the Cash Book (Bank Account) are given. But they are not for the same month but they are two different months. In such a case following entries only in the Cash Book are to be considered for preparation of Reconciliation Statement.

Cash Book entries which appear also in the Pass Book; common entries in the both Books are to be consider for preparation of Reconciliation.

Illustration 7 Prepare Bank Reconciliation Statement as on 30-04-2010 from the following.

Cash Book (Bank Column)

2010 April	Receipts	Rs.	2010 April	Payments	Rs.
1	To Balance b/d	500	5	By Wages A/c	100
10	To Kasab A/c	100	15	By Shanti A/c	200
15	To Interest	50	20	By Pawar A/c	150
20	To Sales A/c	200	25	By Purchases A/c	100
22	To Ashok A/c	300	30	By Balance c/d	600
		1,050			**1,050**

Pass Book

2010 May	Particulars	Rs.	2010 May	Particulars	Rs.
	To Shanti A/c	200	1	By Balance b/d	550
	To Pawar A/c	150	2	By Kasab A/c	100
	To Charges A/c	25	3	By Sales A/c	200
	To Kulkarni A/c	100	10	By Jani A/c	1,100
	To Mane A/c	1,010			

Common entries in both book are consider in reconciliation. Uncommon month, common entries appear in Reconciliation.

Solution

Bank Reconciliation Statement as on 30th April 2010

Particulars	Rs.	Rs.
Bank balance as per Cash Book		600
Add :		
(i) Cheques issued but not presented		
Shanti	200	
Pawar	150	350
		950
Less :		
(i) Cheques deposited but not cleared		
Kasab	100	
Sales	200	
(ii) Cash Book payment total over casted	100	(400)
Bank Balance as per Pass Book as on 1st May 2010.		550

Illustration 8 :

Cash Book (Bank column only)

Dr. **Cr.**

Date	Receipts	Rs.	Date	Payments	Rs.
2010			2010		
Mar 2	To Sales A/c	6,200	Mar 1	By Balance b/d	6,010
4	To A & Co. A/c	1,200	2	By Salaries A/c	7,200
6	To Data’s A/c	3,000	4	By Wages A/c	2,100
10	To Moti’s A/c	6,300	10	By Zandu A/c	4,200

14	To Cash A/c	7,000	15	By Commission A/c	1,400
19	To Malini's A/c	3,000	19	By Drawings A/c	6,100
24	To Sales A/c	1,200	24	By Furniture A/c	3,000
26	To Ketan's A/c	7,000	29	By Purchases A/c	6,750
			30	By Balance c/d	7,160
		43,940			**43,940**

Pass Book (Extract only)

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2010			2010		
Apr 1	To Balance b/d	9,630	Apr 1	By A & Co. A/c	1,200
6	To Rakesh A/c	1,000	2	By Z & Co. A/c	3,100
7	To Joshi A/c	620	4	By RK & Co. A/c	1,420
9	To Salaries A/c	7,200	9	By Moti's A/c	6,300
10	To Wages A/c	15,000	10	By Ketan's A/c	7,000
16	To Furniture A/c	3,000	20	By Plant A/c	7,950
19	To Purchase A/c	6,750	25	By Drawings A/c	1,650
20	To Suresh A/c	1,350			

Bank Reconciliation Statement as on 31.03.2010

Particulars	Rs.	Rs.
Bank balance as per Cash Book		7,180
Add :		
(ii) Cheques issued but not presented		
Salaries	7,200	
Furniture	3,000	
Purchases	6,750	16,950
		24,130
Less :		
(ii) Cheques deposited but not cleared		
A & Co.	1,200	
Moti	6,300	
Ketan	7,000	(14,500)
Bank Balance as per Pass Book as on 1st April 2010.		9,630

Note : When Cash Book & Pass Book are different month, common entry should be taken in Reconciliation Statement.

Illustration 9 : Following information is supplied by Chitra and she ask you to prepare B.R.S.

Cash Book (Bank column)

Dr. **Cr.**

Date	Receipts	Rs.	Date	Payments	Rs.
2010			2010		
May 2	To Balance b/d	2,100	May 1	By Salaries A/c	9,210
4	To Sales A/c	3,000	4	By Printing A/c	6,200
10	To P's A/c	1,450	6	By Purchases A/c	7,500
12	To T's A/c	1,900	10	By Plant A/c	16,000
16	To R's A/c	2,000	21	By Travelling A/c	600
18	To RK's A/c	4,100	24	By Office Exp. A/c	1,250
21	To Sales A/c	3,600	26	By Drawings A/c	14,000
22	To Fixed Deposit A/c	11,000	29	By Purchases A/c	6,000
29	To Interest A/c	1,150	30	By Fixed Deposit A/c	15,000
31	To Balance c/d	55,460	31	By Audit Fees A/c	10,000
		85,760			**85,760**

Bank Pass Book for the month ended 31st May 2010

Date	Particulars	Withdrawal	Deposits	Balance
2010				
May 1	Balance b/d	-	2,100	2,100 CR
2	Salaries	9,210		7,110 DR
4	Sales		3,000	4,110 DR
6	Purchases	7,500		11,810 DR
10	T's A/c		1,900	9,710 DR
24	Office Expenses	1,250		10,960 DR
25	RK's A/c		4,100	6,860 DR
29	Purchases	6,000		12,860 DR
30	Sales		3,600	9,260 DR
31	OT & Co.	6,000		15,260 DR
31	Commission		7,500	7,760 DR
		29,960	**22,200**	**7,760 DR**
				Bank Overdraft

Solution :

Chitra

Bank Reconciliation Statement as on 31st May 2010

Particulars	Rs.	Rs.
Bank overdraft as per Cash Book as on 31st May 2010.		55,460
Add :		
(i) Cheques deposited but not presented		
P	1,450	
R	2,000	
Fixed Deposit	11,000	
Interest	1,150	
(ii) Cheques issued to OT & Co. not accounted in Cash Book.	6,000	21,600
		77,060
Less :		
(i) Cheques issued but not presented		
Printing	6,200	
Plant	16,000	
Travelling Expenses	600	
Drawings	14,000	
Transferred to Fixed Deposits	15,000	
Audit Fees	10,000	
Commission received but not accounted in Cash Book	7,500	(69,300)
		7,760

4.9 EXERCISES

4.9.1 Theory Questions :

i) What is Bank Reconciliation Statement?

ii) What are different reasons for disagreement between Bank balance as per Cash Book & Pass Book / Bank Statement?

iii) Discuss procedure for preparation of Bank Reconciliation Statement.

iv) A Trader feels that it is not necessary to prepare Bank Reconciliation Statement, do you as Finance Manager agrees with trader? Why?

v) Discuss need of preparing Bank Reconciliation Statement.

4.9.2 Practical problems:

1) The Cash Book of Mr. Raj shows a balance of Rs.26,700/- on 31st October, 2011. From the following information you are required to prepare a Bank Reconciliation Statement as on 31st October, 2010.

   i) A cheque of Rs.5,000/- received from Miss Varma, deposited into the Bank but not yet credited in the Pass Book by the bank.

   ii) A cheque of Rs.6,000/- drawn in favour of Miss Meena, had not been presented into the Bank.

   iii) As per our instruction the bank had a promissory note of Rs.1,000/-. It is not yet recorded in the Cash Book.

   iv) A cheque of Rs.7,500/- received from Mr. Madhu recorded in the Cash Book, but the same cheque was sent to the bank on 1st November, 2010.

   v) Bank collected proceeds of Bill Receivable amounted to Rs.5,500/- and credited in the Pass Book but not yet recorded in the Cash Book.

   vi) Post dated cheque amounted to Rs.10,500/- issued to Mr. Shanti, recorded in the Cash Book but not yet presented to the bank.

   vii) Pass Book shows credit entries in respect of Rs.4,500/- as interest collected on investment and Rs.2,000/- as dividend collected by bank. These were not recorded in the Cash Book.

2) Prepare Bank Reconciliation Statement as on 31st January, 2011 from the following particulars.

   i) Bank balance as per Cash Book Rs.22,510/-.

   ii) Cheque amounted to Rs.13,500/- sent to the bank for collection as on 28th January, 2010 but collected by the bank as on 2nd February, 2010.

   iii) Bank column of Cash Book credit side cast short by Rs.2,250/-.

   iv) Cheques of Rs.7,500/- deposited into the bank and collected by the bank and credited in the Pass Book but recorded twice in the Cash Book.

   v) Cheques of Rs.16,000/- issued in favour of Mr. Rane returned dishonoured for lack of fund. Dishonour of cheque not yet recorded in the Cash Book.

vi) Proprietor has closed his savings account and transferred the balance of Rs.9,500/- to current account, not recorded in Cash Book.

vii) Bank Pass Book shows debit entry for payment of electricity charges of Rs.1,800/- and credit entry of Rs.9,500/- for collection of salaries. Corresponding entries were not found in the Cash Book.

3) On 31st December, 2010 the Cash Book showed an overdraft of Rs.16,600/-. From the following particulars, prepare Bank Reconciliation Statement as on 31st December, 2010.

i) Cheques paid into the bank but not cleared Rs.4,040/-.

ii) Cheques drawn but not cashed for Rs.3,100/-.

iii) A Bill Receivable for Rs.1,500/- previously discounted with the bank had been dishonoured and debited in the Pass Book along with bank charges Rs.100/-.

iv) Pass Book debit total undercasted by Rs.100/- whereas credit total of Cash Book under.

v) Interest on Bank overdraft amounting Rs.6,750/- not accounted in Cash Book.

vi) ECS claring for telephone charges Rs.710 not accounted in Cash Book.

vii) Debit total of Cash Book Page No. 11 = Rs.3,100/- wrongly carried on credit side of Cash Book.

4) Prepare a Bank Reconciliation Statement from the following particulars as on 31st March 2010.

i) Cash Book showed an overdraft of Rs.41,000/- as on 31st March, 2010.

ii) Cheques deposited worth Rs.6,500/- into the bank out of which only Rs.5,500/- were credited.

iii) Cheques issued worth Rs.3,000/- were not presented until 4th April, 2010.

iv) The bank has entered in the Pass Book the interest collected on investment Rs.2,500/- and bank charges Rs.400/-, but same were not entered in the Cash Book.

v) Rs.1,050/- in respect of dishonour of issued cheques appears in the Pass Book and not in the Cash Book.

5) Prepare Bank Reconciliation Statement as on 28th February, 2010.

   i) Credit balance as per Cash Book was Rs.10,000/- on 28th February, 2010.

   ii) Interest charged by bank Rs.125/- was recorded in the Pass Book only.

   iii) Dividend on shares Rs.1,750/- was collected by bank but not recorded in cash.

   iv) Cheques paid into the bank Rs.2,000/- but cheques of Rs.1,000/- were only cleared and credited by the bank.

   v) Two cheques of Rs.4,000/- and Rs.4,200/- were issued, but only the cheque of Rs.4,100/- was presented for payment before the end of month.

6) The Cash Book of Mr. Kamat shows a credit balance of Rs.10,350/-. Prepare the Bank Reconciliation Statement as on 30th April, 2010.

   i) Cheques of Rs.4,250/- received and deposited in the bank, but same were not collected upto 30th April, 2010.

   ii) Cheques of Rs.850/- issued, but not presented for payment.

   iii) Interest on investment Rs.275/- and dividend of Rs.510/- collected by the bank and recorded only in the Pass Book.

   iv) Cheques of Rs.2,250/- deposited in the bank and collected by the bank but recorded twice in the Cash Book.

   v) Cheques of Rs.1,502/- issued and presented for payment, but entered in the Pass Book as Rs.1,052/-.

7) Cash Book of Mr. Dinesh shows a credit balance of Rs.30,000/- on 31st January, 2010. However, his Pass Book shows a different balance. You are therefore, requested to prepare a Bank Reconciliation Statement as on 31st January, 2010 from the following information :

   i) Cheques amounting to Rs.15,000/- issued to supplier Mr. Rane, not yet presented for payment.

   ii) Cheques amounting to Rs.14,000/- deposited into the bank but not yet collected by the bank.

   iii) Bank has charged Rs.450/- as interest on overdraft for six months ending 31st December, 2010 and also charged Rs.100/- as bank charges for above period. Same were not recorded in the Cash Book.

   iv) Total of Cash Book at credit side cast short by Rs.520/-.

v) Cheque amounted to Rs.10,525 issued and presented into the bank for payment but recorded in the Pass Book as Rs.10,652/-.

vi) Transfer of Rs.15,000/- from fixed deposit account to current account, not recorded in the Cash Book.

8) The following are the extracts given from the Cash Book (Bank column only) and bank Pass Book of Mr. V. S. K. You are required to prepare a Bank Reconciliation Statement as on 31st December, 2010.

Cash Book (Bank column only)

Dr. **Cr.**

Date	Receipts	Rs.	Date	Payments	Rs.
2010			2010		
Dec16	To Interest A/c	900	Dec15	By Wages A/c	4,400
19	To Vichare & Sons	7,800	18	By Interest A/c	2,700
25	To D.D. Sharma A/c	2,200	22	By Sunder & Sons	1,500
30	To Mukesh's A/c	2,600	31	By Kishore & Sons	2,100
			31	By Balance c/d	2,800
		13,500			13,500
2011					
Jan 1	To Balance b/d	2,800			

Pass Book (Extract only)

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2010			2010		
Dec18	To Wages A/c	2,400	Dec19	By Interest A/c	900
21	To Interest A/c	1,700	22	By Vichare A/c	7,800
25	To Sunder & Sons	1,500	28	By D.D. A/c	2,200
27	To Janata Trader	400	29	By Jaya A/c	2,020
29	To Service Charges	20			
31	To Balance c/d	6,900			
		12,920			12,920
			2011		
			Jan 1	By Balance c/d	6,900

9) From the following extracts of Cash Book and Pass Book, prepare a Bank Reconciliation Statement as on 30.06.2010.

Cash Book (Bank column only)

Dr. **Cr.**

Date	Receipts	Rs.	Date	Payments	Rs.
2010			2010		
June 1	To Balance b/d	1,070	June 3	By Keshav & Sons	1,400
5	To Madhav A/c	1,650	9	By Drawing	150
7	To White & Co. A/c	1,340	12	By Lala & Sons	1,810
14	To M/s. Ram Ratan & Sons A/c	180	19	By Nutan Stores	360
			20	By Salary	1,350
17	To Commission A/c	2,250	23	By Vivek & Co.	1,150
22	To Bhave & Sons	1,985	29	By Shinde	600
26	To Govind A/c	1,000	30	By Balance c/d	2,655
		9,475			9,475

Bank Pass Book (Extract only)

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2010			2010		
Jun 1	To Keshav & Sons	1,400	Jun 1	By Balance b/d	1,070
9	To Drawings A/c	150	9	By Madhav A/c	1,650
18	To Lala & Sons A/c	1,810	11	By Dividend A/c	175
25	To Nutan Stores A/c	360	17	By Commission A/c	2,250
27	To Salary A/c	1,350	23	By White & Co. A/c	1,340
29	To Bank Charges	16	29	By Interest A/c	78
30	To Balance c/d	2,477			
		6,563			6,563

10) From the following extracts of Cash Book and Pass Book prepare a Bank Reconciliation Statement as on October 31, 2010.

Cash Book (Bank column)

Dr. **Cr.**

Date	Receipts	Rs.	Date	Payments	Rs.
2010			2010		
Oct 1	To Balance b/d	4,250	Oct 3	By Salary A/c	2,600
6	To Mr. A A/c	2,000	7	By Commission A/c	175
9	To Mr. B A/c	1,200	10	By Mr. Pal A/c	1,930
16	To Mr. C A/c	2,000	17	By Mr. Bal A/c	1,190
28	To Mr. D A/c	1,600	29	By Mr. Lal A/c	2,500
29	To Mr. E A/c	1,075	30	By Mr. Jal A/c	1,300
31	To Mr. F A/c	1,300	31	By Mr. Dal A/c	1,150
			31	By Balance c/d	**1,705**

Bank Pass Book

Dr. **Cr.**

Date	Particulars	Debit Rs.	Credit Rs.	Balance Rs.
2010				
Oct 1	By Balance	2,600		1,250
4	To Salary	175		1,350
8	To Commission		2,000	1,525
9	By Mr. A		1,200	475
12	By Mr. B			1675
13	To Mr. Pal	1,930		255
18	By Mr. C		200	55
19	To Mr. Bal	1,190		1,245
26	By Interest		145	1,100
28	By Dividend on Share		12,200	11,100
29	To Subscription to a Club	450		10,650
30	To Life Insurance Premium	450		10,200

11) Prepare a Bank Reconciliation Statement for the month of September i.e. as on 30.09.10 from the following.

Cash Book (Bank column)

Dr. **Cr.**

Date	Receipts	Rs.	Date	Payments	Rs.
2010			2010		
Sep 1	To Balance b/d	400	Sep 2	By Wages A/c	900
	To PZ A/c	300		By Purchases A/c	300
	To Sales A/c	800		By MO A/c	200
	To Interest A/c	150		By KT A/c	250
	To Commission A/c	50		By Rent A/c	200
	To IT A/c	200	29	By Drawings A/c	100
30	To Balance c/d	50			
		1,950			1,950

Bank Pass Book

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2010			2010		
Sep 2	To Wages A/c	900	Sep 1	By Balance b/d	300
	To N Cheque			By S A/c	100
	dishonoured A/c	90		By Interest A/c	150
	To KT A/c	250		By B/R	550
	To MO A/c	200	28	By Sale of	
	To Charges A/c	10	29	Investment A/c	300
30	To Drawings A/c	100		By T A/c	200
	To Balance c/d	50			
		1,600			1,600

12) Set out below are extracts from Cash Book (Bank column) & Bank Pass Book of A. Prepare Bank Reconciliation Statement as on 31st March, 2010.

Cash Book

Date	Receipts	Rs.	Date	Payments	Rs.
2010			2010		
Mar 1	To Balance b/d	500	Mar 5	By Salaries A/c	100
5	To Kaju A/c	100	8	By S. A/c	200
10	To Interest A/c	50	11	By S. Pawar A/c	50
15	To Sales A/c	200	12	By Purchases A/c	100
			15	By Balance c/d	400
		850			**850**

Bank Pass Book (A's A/c)

Dr. **Cr.**

Date	Payments	Rs.	Date	Receipts	Rs.
2010			2010		
Mar 5	To Salaries A/c	100	Sep	By Soman A/c	400
9	To S. A/c	200	1	By Balance b/d	200
12	To Purchases A/c	100	6	By Kaju A/c	100
13	To Commission A/c	25	9	By Interest A/c	50
15	To Insurance Premium A/c	775	12	By Kulkarni A/c	50
			15	By Balance c/d	400
		1,200			**1,200**

13) Given below are the extracts from the Cash Book (Bank columns) and the Bank Pass Book of Shri. Vora. Prepare a Bank Reconciliation Statement as on 31-12-2010.

Cash Book (Bank Column)

Dr. **Cr.**

Date	Payments	Rs.	Date	Receipts	Rs.
2010			2010		
Dec 1	To Balance b/d	1,600	Dec 5	By Wages A/c	100
8	To Ramkant A/c	700	10	By Nair A/c	250
12	To Ram Prasad A/c	1,400	15	By Furniture A/c	200
13	To Sales A/c	500	20	By Drawings A/c	450
15	To Interest A/c	100	25	By Salaries A/c	175
20	To S. Suresh A/c	2,350	31	By Commission A/c	125
			31	By Balance c/d	5,350
		6,650			**6,650**
2010					
Jan 1	To Balance b/d	1,200			

Pass Book

Date	Particulars	Rs.	Date	Particulars	Rs.
2010			2010		
Jan 2	To Wages A/c	150	Jan 1	By Balance b/d	825
4	To Commission A/c	125	2	By Ram Prasad A/c	1,400
5	To Nair A/c	250	5	By Interest A/c	100
6	To Drawings A/c	450	8	By S. Suresh A/c	2,350
6	To Kulkarni A/c	150			

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5

LEDGER AND TRIAL BALANCE

Unit Structure:

5.0 OBJECTIVES

After studying the unit the students will be able to:

- Know the meaning of Ledger.
- Understand the process of opening a Ledger Account.
- Prepare a Ledger Account from the given information.
- Explain the types of Trial Balance.
- Prepare the Trial Balance from the balances given.

5.1 MEANING

The ledger is the principal book of accounts relating to a particular person or property or revenue or expenses are recorded in summarized form. It is a set of accounts. It contains all accounts of the business enterprise whether real, nominal or personal. The main function of a ledger is to classify or sort out all items appearing in the journal or other subsidiary books under their appropriate accounts & that at the end of the accounting period each account will contain the entire information of all the transactions relating to in a summarized or condensed form.

All the transactions are recorded first in the journal and then from the journal they are posted in the respective accounts in the ledger. Ledger is a book where in all the transactions would ultimately find their place under the respective heads of accounts. Ledger is a book of final entry.

5.2 HOW TO OPEN AN ACCOUNT IN THE LEDGER :

The pages of all books of accounts must be numbered to facilitate reference. The page is divided into two parts by vertical line in between. The left hand side is used as a debit side of an account and the right hand side is used as a credit side.

_____________ Name (Account)

Dr. **Cr.**

Date	Particulars	J.F.	Amt.	Date	Particulars	J.F.	Amt.

5.3 POSTING :

Every transaction is first recorded in the book of original entry and then it is posted into the ledger. Posting is made to the debit side account which is debited in the journal entry and to the credit side of an account which is credited in the journal entry. Name of the credit account is written on the debit account and the name of debit account is written on the credit side of account. Entry on the debit side of an account starts with “To” whereas on the credit side starts with “By”.

5.4 BALANCE AND BALANCING OF ACCOUNTS :

The object of recording the business transactions in various ledger accounts to enable a trader to ascertain balance in account easily at any time. For the preparation of Trial balance all accounts are to be closed.

Each account in the ledger may have same entries on the debit side and some entries on the credit side of an account. Find out difference between totals of each side. The difference in the total of both the side is termed as Balance of an account. The process of extracting the balance and inserting it on lesser side of an account is called balancing or closing of an account.

Types of Balances

A) **Debit Balance :** If the debit side of an account is heavier than its credit side, the balance is called debit balance.

B) **Credit Balance :** If the credit side of an account is heavier than its debit side, the balance is called credit balance.

5.5 MEANING OF BALANCES :

5.5.1 Personal Accounts : Personal Accounts may have debit or credit balance.

Debit balance shows that person owes to the firm. He is debtors.
Credit balance shows that persons owed to him. He is creditor.

5.5.2 Real Accounts : Real accounts always have debit balance. These are value of Assets, properties owned by businessmen.

5.5.3 Nominal Accounts : Nominal Account may have debit or credit balance debit balances shows total expenses / losses for the period. Credit balances shows total income / gain for the period.

At the end of accounting period balances of nominal accounts transferred to Trading, Profit & Loss Account, whereas balances shown of Personal Accounts & Real accounts in the Balance Sheet, and next year these balances considered as opening balances.

CHECK YOUR PROGRESS

- Fill in the blanks:
  1. If the debit side of an account is heavier than its credit side, the balance is called---------------------------.
  2. The left hand side of a Ledger Account is used as a -------------- and the right hand side is used as a --------------------.
  3. -----------------and ---------------- Accounts may have debit or credit balance.

4. Debit balance of the -----------Account shows that person owes to the firm. It means he is the ------------of the firm.
5. Credit balances of the Nominal Account shows total --------------------------for the period.
6. Real accounts always have -------------- balance.

- Define Ledger and draw the proforma of Ledger Account.

5.6 ILLUSTRATIONS-1 :

Illustration 1: Enter the following transactions in the proper subsidiary books and post them to the Ledger Accounts and balance the Account 30 June 2010.

1 Commenced business with Cash Rs.5,000/- (of which Rs.2,000/- borrowed from friend Ram) and furniture Rs.1,400/-

2 Purchased goods from Kanta Rs.1,800/- less 5%. Trade Discount.

6 Sold goods to Ketual costing Rs.400/- at 10% Profit.

7 Cash purchases Rs.500/-.

8 Cash sales – Rs.1,200/-.

9 Purchased goods from Baba Rs.500/-.

9 Paid into Bank Rs.2,000/-.

10 Returned to Kanta goods worth Rs.150/-.

11 Purchased office furniture for Rs.1,200/- and paid for same by cheque.

16 Issued a cheque to Kanta for Rs.910/-.

21 Invoiced goods to Ketual Rs.5,000/- less 2% Trade discount.

23 Ketual paid cash Rs.400/- and returned goods of Rs.140/-.

24 Purchased goods from Kanta Rs.1,300/-.

28 Returned damaged goods to Janta Rs.160/- & to Baba Rs.150/-.

28 Sold goods to Kant Rs.1,200/-.

29 Received a cheque for Rs.1,100/- from Kant and banked the same.

30 Kant, who owes us Rs.100/- pays rent Rs.100/- to our landlord on our behalf.

30 We paid Rs.75/- to Raju on instructions from our creditor Kanta on his behalf.

Solution :

Journal

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2010 June 1	Furniture A/c ……………….. …… Dr.		1,400	
	To Capital A/c			1,400
	(Furniture brought in by Proprietor.)			
30	Rent A/c …………………………. Dr.		100	
	To Kant A/c			100
	(Rent paid by Kant on our behalf.)			

Purchases Book

Date	Name of Supplier	Inward Invoiced No.	L.F.	Amount Rs.
2010				
June 2	Kanta	-	-	1,710
9	Baba	-	-	500
24	Kanta	-	-	1,300
		Total		**3,510**

Returns Outward Book

Date	Particulars	Debit Note No.	L.F.	Amount Rs.
2010				
June 10	Kanta	-	-	150
28	Kanta	-	-	160
28	Baba	-	-	150
		Total		**460**

Sales Book

Date	Particulars	Debit Note No.	L.F.	Amount Rs.
2010				
June 6	Ketual	-	-	440
21	Ketual	-	-	4,900

28	Kant	-	-	1,200
		Total		**6,540**

Returns Inward Book

Date	Particulars	Credit Note No.	J.F.	Amount Rs.
2010 June 23	Ketual	-	-	140
		Total		**140**

Cash Account

Dr. **Cr.**

Date	Particulars	L.F.	Bank	Cash	Date	Particulars	L.F.	Bank	Cash
2010					2010				
June 1	To Capital A/c			3,000	June 7	By Purchases			
1	To Ram Loan				9	A/c			500
8	A/c			2,000	11	By Bank A/c	C		2,000
9	To Sales A/c			1,200	16	By Furniture A/c		1,200	
23	To Cash A/c	C	2,000		30	By Kanta A/c		910	
29	To Ketual A/c			400	30	By Kanta A/c			75
	To Kant's A/c		1,100			By Balance c/d		990	4,025
			3,100	**6,600**				**3,100**	**6,600**
July 1	To Balance b/d		990	4,025					

Capital Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
June 30	To Balance c/d		4,400	June 1	By Cash A/c		3,000
					By Furniture A/c		1,400
			4,400				4,400
				July 1	By Balance b/d		4,400

Furniture Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
June 30	To Capital A/c		1,400	June 30	By Balance c/d		2,600
11	To Bank A/c		1,200				

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
			2,600				2,600
July 1	To Balance b/d		2,600				

Purchases Account

Dr. Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
June 7	To Cash A/c		500	June 30	By Balance c/d		4,010
30	To Sundries A/c (as per purchase Book)		3,510				
			4,010				4,010
July 1	To Balance b/d		4,010				

Sales Account

Dr. Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
June 30	To Balance c/d		7,740	June 8	By Cash A/c		1,200
				30	By Sundries A/c		6,540
			7,740				7,740
				July 1	By Balance b/d		7,740

Return Outward Account

Dr. Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
June 30	To Balance c/d		460	June 30	By Sundries A/c (as per R. O. Book)		460
			460				460
				July 1	By Balance b/d		460

Return Inward Account

Dr. Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
June 30	To Balance c/d		140	June 1	By Balance c/d		140
			140				140

July 1	To Balance b/d		140				

Ram's Loan Account

Dr. Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
June 10	To Balance c/d		2,000	June 1	By Cash A/c		2,000
			2,000				2,000
				July 1	By Balance b/d		2,000

Kanta's Account

Dr. Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
June 10	To Return Outward A/c		150	June 2	By Purchases A/c		1,710
19	To Bank A/c		910	24	By Purchases A/c		1,300
28	To Returns Outward A/c		160				
30	To Cash A/c		75				
30	To Balance c/d		1,715				
			3,010				3,010
				July 1	By Balance b/d		1,715

Ketual's Account

Dr. Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
June 6	To Sales A/c		440	June 23	By Return Inward A/c		140
21	To Sales A/c		4,900		By Cash A/c		400
					By Bal. c/d		4,800
			5,340				5,340
July 1	To Balance b/d		4,800				

Rent Account

Dr. Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
June 30	To Kant A/c		100	June 30	By Balance c/d		100
			100				100

Baba's Account

Dr. Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
June 28	To Return Outward A/c		150	June 9	By Purchases A/c		500
30	To Balance c/d		350	30			
			500				500
				July 1	By Balance b/d		350

Kant's Account

Dr. Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
June 28	To Sales A/c		1,200	June 29	By Bank A/c		1,100
					By Rent A/c		100
			1,200				1,200

Illustration 2 :

M. D. as on 1st March 2010

Debit Balance	Rs.	Credit Balance	Rs.
Cash A/c	15,000	Capital A/c	60,000
Bank A/c	12,000	Mr. Chandra A/c	9,000
Stock A/c	14,000		
ZaCo A/c	28,000		

2010

March 2 Borrowed Rs.30,000/- from sister Maya for business purpose.

4 Bought goods from Mr. Chandra for Rs.6,000/- @ 5% trade discount.

7 Sold goods worth Rs.15,000/- to Mr. ZaCo @ 2% trade discount.

9 Received Rs.7,000/- from Mr. ZaCo.

10 Cash deposited into Bank Rs.7,000/-.

12 Paid Rs.5,000/- to Mr. Chandra by issuing a cheque.

15 Paid for new equipment of office Rs.4,000/-.

17 Purchased new furniture for Rs.2,500/- for personal use.

19 Cash purchases Rs.15,000/- and cash sales Rs.27,100/-.

22 Paid salaries Rs.1,700/-, rent Rs,1,250/-, commission Rs.800/- by cash.

26 Withdrew Rs.8,500/- from the business for daughter's marriage by a cheque.

27 Goods worth Rs.1,000/- withdrawn from the business for house use, out of opening stock.

31 Paid interest Rs.300/- to sister Maya on borrowings.

You are required to journalise the above transactions including Cash / Bank and post them to the ledger and balance the same.

Solution :

In the books of M.D.

Date	Particulars	L. F.	Debit Rs.	Credit Rs.
2010 March 2	Cash A/c ………………... ………… Dr. To Maya's Loan A/c (Being amount borrowed.)		30,000	 30,000
4	Purchase A/c ……………………… Dr. To Chandra's A/c (Being goods purchased.)		5,700	 5,700
7	ZaCo A/c …………………………… Dr. To Sales A/c (Being cash received from ZaCo.)		14,700	 14,700
9	Cash A/c …………………………… Dr. To ZaCo A/c (Being cash received from ZaCo.)		7,000	 7,000
10	Bank A/c …………………………… Dr. To Cash A/c (Being cash deposited into Bank.)		7,000	 7,000
12	Chandra's A/c ……………………… Dr. To Bank A/c (Being cheque issued.)		5,000	 5,000
15	Office Equipment A/c ……………… Dr. To Cash A/c (Being office equipment purchased.)		4,000	 4,000
17	Drawing A/c …………………………Dr.		2,500	

	To Cash A/c (Being furniture purchased for personal use.)			2,500

19	Purchases A/c ……………………….Dr. To Cash A/c (Being goods purchased.)		15,000	 15,000
19	Cash A/c …………………………… Dr. To Sales A/c (Being goods sold.)		27,100	 27,100
22	Salaries A/c …………………………Dr. Rent A/c ……………………………. Dr. Commission A/c ……………………Dr. To Cash A/c (Being Salaries, Rent & Commission paid.)		1,700 1,250 800	 3,750
26	Drawing A/c ……………………….. Dr. To Bank A/c (Being amount withdrawn by cheque for personal use.)		8,500	 8,500
27	Drawing A/c …………………………Dr. To Stock A/c (Being goods taken for personal use.)		1,000	 1,000
31	Interest A/c ………………………… Dr. To Cash A/c (Being interest paid on Maya's loan.)		300	 300

Ledger Accounts
Cash Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
Mar 1	To Bal b/d		15,000	Mar 10	By Cash A/c		7,000
2	To Maya's		30,000	15	By Office		
	Loan A/c			17	Equipment A/c		4,000
	To ZaCo A/c		7,000	19	By Drawings A/c		2,500
19	To Sales A/c		27,100	22	By Purchases A/c		15,000
				22	By Salaries A/c		1,700
				22	By Rent A/c		1,250
				31	By Commission A/c		800
				31	By Interest A/c		300
					By Balance c/d		46,550
			79,100				79,100
Apr 1	To Balance b/d		46,550				

Bank Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
Mar 1	To Bal b/d		12,000	Mar 12	By Chandan's A/c		5,000
10	To Cash A/c		7,000	26	By Drawings A/c		8,500
				37	By Balance c/d		5,500
			19,000				19,000
Apr 1	To Balance b/d		5,500				

Stock Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
Mar 1	To Bal b/d		14,000	Mar 27	By Drawings A/c		1,000
				31	By Balance c/d		13,000
			14,000				14,000
Apr 1	To Balance b/d		13,000				

Purchase Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
Mar 1	To Chandra's A/c		5,700	Mar 31	By Bal c/d		20,700
19	To Cash A/c		15,000				
			20,700				20,700
Apr 1	To Bal b/d		20,700				

Sales Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
Mar 31	To bal c/d		41,800	Mar 1	By ZaCo A/c		14,700
				31	By Cash A/c		27,100
			41,800				41,800
				Apr 1	By Balance b/d		41,800

Salaries Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
Mar 22	To Cash A/c		1,700	Mar 31	By Balance c/d		1,700
			1,700				1,700
Apr 1	To Balance b/d		1,700				

Rent Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
Mar 22	To Cash A/c		1,250	Apr 1	By Balance c/d		1,250
			1,250				1,250
Apr 1	To Balance b/d		1,250				

Commission Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
Mar 22	To Cash A/c		800	Apr 1	By Balance c/d		800
			800				800
Apr 1	To Balance b/d		800				

Interest Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
Mar 31	To Cash A/c		300	Apr 1	By Balance c/d		300
			300				300
Apr 1	To Balance b/d		300				

ZaCo's Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
Mar 1	To Balance b/d		28,000	Mar 9	By Cash A/c		7,000
7	To Sales A/c		14,700	31	By Bal c/d		35,700
			42,700				42,700
Apr 1	To Balance b/d		35,700				

Capital Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
Mar 31	To bal c/d		60,000	Mar 1	By Balance b/d		60,000
			60,000				60,000
				Apr 1	By Balance b/d		60,000

Mr. Chandra's Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
Mar 12	To Bank A/c		5,000	Mar 1	By Balance b/d		9,000
31	To Balance c/d		9,700	2	By Purchase A/c		5,700
			14,700				14,700
				Apr 1	To Balance b/d		9,700

Maya's Loan Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
Mar 31	To Balance c/d		30,000	Apr 1	By Cash A/c		30,000
			30,000				30,000
				Apr 1	To Balance b/d		30,000

Office Equipment Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
Mar 15	To Cash A/c		4,000	Mar 31	By Balance c/d		4,000
			4,000				4,000
Apr 1	To Balance b/d		4,000				

Drawings Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2010				2010			
Mar 17	To Cash A/c		2,500	Mar 31	By Balance c/d		12,000
26	To Bank A/c		8,500				
27	To Goods A/c (stock)		1,000				
			12,000				12,000
Apr 1	To Balance b/d		12,000				

5.7 TRIAL BALANCE

5.7.1 Introduction :

The fundament principle of double entry book keeping is that debit must be equal to credit. In other words, debit aspect of any transaction is always equal to its credit aspect.

All ledger accounts are balances. A debit balance in a general ledger account indicates an excess of debit side over credit side of the account. A credit balance in a ledger account indicates the excess of credit side over debit side of the account. A trial balance is a summary of all the ledger balances outstanding as on particular date. List of debit balances and credit balances should be equal. It said that Trial balance is tallied. When trial balance tallies is establishes the arithmetical accuracy of record. It is a statement prepared before preparing the final accounts. It is a link between books of account and final accounts i.e. the Trading & Profit & Loss A/c and Balance Sheet.

5.7.2 Types of trial balances

Trial balances are of two types.

1) Gross Trial Balance
2) Net Trial Balance

1 Gross Trial Balance :

Gross Trial Balance is prepared by taking all ledger account debit total and credit total, instead of considering ledger balances, as on a particular date.

Illustration 3 : Gross Trial Balance can be as under –

Sr. No.	Name of Account		Total debit side (Rs.)	Total credit side (Rs.)
1	Ketan's Capital		5,000	76,000
2	Opening Stock		10,000	-
3	Purchases		2,10,000	2,000
4	Sales		2,000	3,05,000
5	Sales Return		18,000	-
6	Expenses		27,000	-
7	Customers		1,20,000	26,000
8	Suppliers		12,000	80,000
9	Cash		6,000	-
10	U. C. Bank		96,000	17,000
			5,06,000	**5,06,000**

2 Net Trial balance :

Net trial balance is list of debit & credit balance, taken from ledger accounts on particular date. Normally, net trial balance is prepare, since it is transferred to final accounts and personal and real accounts balance are carried forward from current year to subsequent year.

Illustration 4 : Trial Balance as on 31st March 2010.

Sr. No.	Name of Account		Total debit side (Rs.)	Total credit side (Rs.)
1	Opening Stock		12,000	-
2	Capital		-	1,02,000
3	Purchases		2,10,000	-
4	Purchase Return		-	6,000
5	Sales		-	3,11,000
6	Sales Return		4,000	-
7	Expenses		28,000	-
8	Plant & Machinery		1,20,000	-
9	Customers		80,000	-
10	Suppliers		-	62,000
11	Cash		6,000	-
12	Bank balance		21,000	-
			4,81,000	**4,81,000**

5.8 SOME IMPORTANT ITEMS AND THEIR BALANCES

1.	Capital	:	Credit balance
2.	Drawings	:	Debit balance
3.	Purchases	:	Debit balance
4.	Expenses	:	Debit balance
5.	Incomes	:	Credit balance
6.	Carriage Inwards	:	Debit balance
7.	Carriage Outwards	:	Debit balance
8.	Stock (opening)	:	Debit balance
9.	Loan taken	:	Credit balance
10.	Interest paid	:	Debit balance
11.	Loan given	:	Debit balance
12.	Interest received	:	Credit balance
13.	Assets	:	Debit balance
14.	Suppliers	:	Credit balance
15.	Sales Return	:	Debit balance
16.	Purchases	:	Debit balance
17.	Return Outwards	:	Credit balance
18.	Investments	:	Debit balance
19.	Goodwill	:	Debit balance
20.	Cash	:	Debit balance

Note : Closing stock should not be taken in trial balance. However, it Gross Profit is given in trial balance then it should be taken as Debit balance.

5.9 ILLUSTRATIONS-2

Illustration 5 : From the following prepare Gross Trial balance and net Trial balance as on 31st March 2010.

Particulars	Totals
Cash (Dr.)	21,500
Bank (Dr.)	13,000
Furniture (Dr.)	21,000
Creditors (Dr.)	13,700
Debtors (Dr.)	22,000
Rent (Dr.)	5,500
Salaries (Dr.)	2,900
Cash (Cr.)	14,300

Capital (Cr.)	10,000
Bank (Cr.)	2,900
Furniture (Cr.)	400
Creditors (Cr.)	14,000
Debtor (Cr.)	4,800
Rent (Cr.)	900

Solution :

(A) Gross Trial Balance as on 31.03.2010

Particulars (i.e. Names of Accounts)	**Debit Total (Rs.)**	**Credit Total (Rs.)**
Cash	21,500	14,300
Bank	13,000	2,900
Furniture	21,000	400
Creditors	13,700	14,000
Debtors	22,000	4,800
Rent	5,500	900
Salaries	2,900	-
Capital	-	62,300
	99,600	**99,600**

(B) Net Trial Balance

Particulars	**Debit Balance (Rs.)**	**Credit Balance (Rs.)**
Cash (Dr. – Cr.)	7,200	-
Bank (Dr. – Cr.)	10,100	-
Furniture (Dr. – Cr.)	20,600	-
Creditors (Cr. – Dr.)	-	300
Debtors (Dr. – Cr.)	17,200	-
Rent (Dr. – Cr.)	4,600	-
Salaries	2,900	-
Capital	-	62,300
	62,600	**62,600**

Illustration 6 : Prepare a Trial Balance from the following items :

Particulars	Totals
Capital	7,63,050
Furniture & Fixture	40,000
Land & Building	4,03,000
Plant & Machinery	2,00,000
Drawings	60,000
Patents	20,000
Stock	4,00,000
Purchases	9,50,000
Wages	50,000
Salaries	72,000
Sundry Debtors	3,50,000
Sales	13,20,000
Sales Returns	61,000
Purchases Returns	10,000
Loan from Ketan	4,00,000
Rent, Rates & Taxes	48,000
Bad Debts	4,000
Sundry Creditors	2,24,000
Discount received	9,000
Trade Expenses	700
Interest on Loan	4,500
Insurance	6,500
Traveling Expenses	3,000
Cash in Hand	2,100
Cash at Bank	51,250

Solution :

Trial balance

Particulars	Debit (Rs.)	Credit (Rs.)
Capital	-	7,63,050
Furniture & Fixture	40,000	-
Land & Building	4,03,000	-
Plant & Machinery	2,00,000	-
Drawings	60,000	-
Patents	20,000	-

Stock	4,00,000	-
Purchases	9,50,000	-
Wages	50,000	-
Salaries	72,000	-
Sundry Debtors	3,50,000	-
Sales	-	13,20,000
Sales Returns	61,000	-
Purchases Returns	-	10,000
Loan from Ketan	-	4,00,000
Rent, Rates & Taxes	48,000	-
Bad Debts	4,000	-
Sundry Creditors	-	2,24,000
Discount received	-	9,000
Trade Expenses	700	-
Interest on Loan	4,500	-
Insurance	6,500	-
Traveling Expenses	3,000	-
Cash in Hand	2,100	-
Cash at Bank	51,250	-
	27,26,050	**27,26,050**

Illustration 7 : Prepare Trial balance from ledger Account open in Illustration No. 1.

Solution :

Trial balance as on 31st June 2010

Sr. No.	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
1	Cash		990	-
2	Bank		4,025	-
3	Capital		-	4,400
4	Furniture		2,600	-
5	Purchases		4,010	-
6	Sales		-	7,740
7	Return Outwards		-	460
8	Return Inwards		140	-
9	Ram’s Loan		-	2,000
10	Kanta’s A/c		-	1,715

11	Ketual's A/c		4,800	-
12	Rent A/c		100	-
13	Baba's A/c		-	350
			16,665	**16,665**

Illustration 8 : Prepare Trial balance from ledger accounts opened in illustration No. 2.

Solution :

Trial balance as on 31st March 2010

Sr. No.	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
1	Cash		46,550	-
2	Bank		5,500	-
3	Stock		13,000	-
4	Purchases		20,700	-
5	Sales		-	41,800
6	Salaries		1,700	-
7	Rent		1,250	-
8	Commission		800	-
9	Interest		300	-
10	ZaCo		35,700	-
11	Capital		-	60,000
12	Chandras		-	9,700
13	Maya's Loan		-	30,000
14	Office Equipment		4,000	-
15	Drawings		12,000	-
			1,41,500	**1,41,500**

5.10 EXERCISES :

5.10.1 Theory questions :

1. What is ledger?
2. How entries from Journal posted to Ledger?
3. Why Real Account have always debit balance or nil balance.
4. What are different types of Trial Balance?

5. Why Trial Balance tallies?
6. Distinguish between Gross Trial Balance and Net Trial Balance.
7. Why Trial Balance prepared?

5.10.2 Practical Problems :

Q.1 Prepare a Trial balance from the following as on March 31st, 2010.

Particulars	Totals
Stock	60,000
Purchases	1,50,000
Capital	70,000
Drawings	22,000
Sales	2,50,000
Traveling Expenses	1,320
Salaries	11,200
Rent, Taxes & Insurance	5,600
Returns Outwards	2,600
Advertising	840
Wages	7,000
Bank Overdraft	20,000
General Trade Expenses	1,350
Returns Inwards	5,400
Discount allowed	600
Interest & Commission paid	430
Bad Debts	800
Sundry Creditors	60,000
Cash in hand	2,060
Sundry Debtors	92,000
Furniture	10,000
Plant & Machinery	20,000
Buildings	12,000

Q.2 Following are the balances extracted from the ledger of Shri. Ketan. Prepare a Trial Balance as on 31st Dec. 2010.

Particulars	**Rs.**	**Particulars**	**Rs.**
Capital A/c	40,000	Purchases	26,500
Drawings A/c	4,000	Printing & Stationery	3,000
Sundry Creditors	18,440	Rent & Taxes	2,500
Motor Car Expenses	3,000	Office Expenses	7,000
Sales	29,560	Commission paid	5,000
Trade Expenses	8,500	Sundry Debtors	18,000
Insurance	1,030	Discount Allowed	2,970
Opening Stock	8,500	Interest Received	2,000

Q.3 The following balances appeared in the ledger of M/s. Tata Traders as on 1st July 2010.

Debit Balance	**Rs.**	**Credit Balance**	**Rs.**
Cash A/c	35,000	Capital A/c	80,000
Bank A/c	30,000	Kamath's A/c	5,000
Goods A/c	35,000	10% Term Loan	20,000
Mehta's & Son's A/c	15,000		
	1,05,000		1,05,000

2010

July1 Borrowed Rs.25,000/- from wife for expansion of the business and deposited Rs.20,000/- in Bank.

4 Deposited Rs.15,000/- into the Bank.

6 Received from Mr. Mehta and Sons Rs.9,550/- in part payment of Rs.10,000/-.

8 Paid Rs.1,900/- to Mr. Kamath in part payment of Rs.2,000/-.

20 Withdrew from bank Rs.5,000/- for office use and Rs.4,000/- for private use.

24 Cash sales Rs.20,000/-.

25 Paid Salaries Rs.1,250/-, rent Rs.1,400/- and received commission Rs.2,600/- in cash.

28 Paid Rs.20,000/- for part payment of wife's loan. Also interest of Rs.1,250/- due on loan.

31 Deposited Rs.11,500/- into the Bank.

From the above transactions, draft journal entries, post them to respective ledger accounts and balance them, also prepare Trial Balance.

Q.4 The following balances appeared in the ledger of Shri as on 1st March 2010.

Debit Balance	Rs.	Credit Balance	Rs.
Cash A/c	25,000	Capital A/c	60,000
Bank A/c	10,000	Mr. Nair A/c	16,000
Goods A/c	35,000		
Govinda's A/c	6,000		

2010

Mar.1 Introduced further capital in cash Rs.25,000/-.

2 Deposited Rs.15,000/- into the bank.

4 Received Rs.3,000/- from Mr. Govind.

7 Paid Rs.4,000/- to Mr. Nair.

9 Bought goods costing Rs.17,500/- on credit from Nair.

15 Sold goods to Mr. Govind for Rs.16,000/-.

20 Bought goods from Mr. Nair for Rs.40,000/-.

24 Withdrew Rs.12,000/- from bank for office use.

25 Good costing Rs.20,000/- sold @ 25% Profit.

26 Rent paid by cheque Rs.6,000/-.

27 Salaries paid Rs.10,000/- a wages Rs.2,000/-.

29 Received cash from Govind Rs.9,000/- and allowed him discount Rs.100/-.

30 Withdrawn cash Rs.4,000/- and Rs.6,000/- by cheque for personal use.

You are required to journalise above transaction and prepare necessary ledger accounts and prepare trial balance.

Q.5 Following balances appeared in the ledger of Mr. Raman as on 1st March, 2010.

Debit Balance	**Rs.**	**Credit Balance**	**Rs.**
Cash A/c	15,000	Capital A/c	60,000
Goods A/c	10,000	M/s. Godreja Co.	14,000
Bank A/c	30,000		
Mr. H.O.'s A/c	5,000		
Furniture A/c	14,000		

Transactions during the month ending 31.03.2010.

2010

Mar.1 Introduced cash Rs.40,000/- into the business as capital.

6 Bought goods worth Rs.15,000/- from Mr. Ketan @ 5% trade discount.

14 Cash purchases Rs.10,500/-.

20 Sold goods worth Rs.10,500/- to Mr. H.O. @ 2% trade discount.

21 Paid carriage Rs.100/-.

22 Cash sales Rs.35,000/-.

24 Paid Rs.7,000/- to Mr. Godreja Co. and earned discount Rs.100/-.

27 Received Rs.6,900/- from H.O. in full settlement of Rs.7,200/-.

29 Purchase goods from David costing Rs.25,000/-.

30 Half of goods purchased were return to David.

31 Balance due to David paid @ 10% discount.

Pass necessary journal entries, open necessary ledger accounts & prepare Trial balance as on 31st March 2010.

❖❖❖❖

6

FINAL ACCOUNTS OF A SOLE TRADER

Unit Structure:

6.0 OBJECTIVES

After studying the unit the students will be able to:

- Know the meaning of Final Accounts and proforma of Final Accounts.
- Explain the Classification of Assets and Liabilities.
- Make the adjustment entries.
- Prepare Final Accounts from the given Trial Balance.

6.1 INTRODUCTION

The transactions of a business are first recorded in Journal / subsidiary books, then posted there form to the Ledger and at the end of accounting year, Trial balance is prepare to test accuracy, both the aspects of the transactions have been correctly recorded in the books of accounts of original entry as well as in the Ledger. The last stage in accounting process is the preparation of final Accounts.

From given trial balance a Trading, Profit & Loss A/c & Balance Sheet is prepared.

A Trading, Profit & Loss A/c is prepared to determine the Profit or Loss made during a particular year, and Balance Sheet is prepare which consists of all assets, Liabilities and Capital of proprietor.

For preparing Final Accounts from Trial Balance following procedure should be followed.

i) Debit Account balances :-

Balances appearing on the debit column of the trial balance may represent - (a) assets (b) Expenses and Losses. Assets are shown on right hand side of the balance sheet while expenses and loss are debited either to the Trading A/c or to the Profit & Loss A/c, depending upon nature of expenditure or loss.

ii) Credit Account balances :-

Credit items in the trial balance represents (a) Capital, Liabilities, expenses. These items are entered on the left hand side of the balance sheet (b) Income and gains. These are either credited to Trading A/c or Profit and Loss A/c.

6.2 TRADING ACCOUNT :-

Trading A/c is prepared to ascertain the Gross Profit. Gross Profit is difference between net sales and cost of goods sold. A specimen of Trading Account is given below:

Trading A/c for the year ended…

Dr. **Cr.**

Particulars		**Rs.**	**Particulars**		**Rs.**
To Opening Stock		X	By Sales	X	X
To Purchases	X		Less: Returns	(X)	
Less: Returns	(X)	X	By Closing Stock		X
To Carriage Inwards		X			
To Wages		X			
To Direct Expenses		X			
To Gross Profit		X			
		XX			**XX**

However, Gross Profit is the balancing figure, in case debit side total exceeds the credit side, then balance will be Gross Loss, it is shown on credit side of Trading A/c as ‘By Gross Loss’.

6.3 PROFIT AND LOSS ACCOUNT

Profit and Loss A/c is prepared to calculate the net profit or net loss. The balance of Trading A/c i.e. Gross profit / Gross loss is transferred to the Profit and Loss Account. Therefore, all those expenses and Losses are debited to the Profit and Loss A/c. Other income / gains are credited to this A/c e.g. commission received, discount earn etc.

The Profit and Loss accounts measures net profit by matching revenues and expenses according to the accounting principles, Net profit is the excess of revenue over total expenses. It should be kept in mind that all expenses / incomes must be adjusted in respect of outstanding / prepaid / paid or received in advance. Expenses or incomes are considered on mercantile basis. At end Net Profit or Net Loss transferred to Capital Account in the balance sheet.

A specimen of Profit & Loss Account is given below :

Profit & Loss Account for the year ended…

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To Salaries	X	By Gross Profit b/d	X
To Rent, Rates & Taxes	X	By Discount earned	X
To Insurance	X	By Commission received	X
To Printing & Stationery	X	By Interest earned	X
To Legal Exp	X	By Profit on sale of assets	X
To Audit Fees	X		
To Discount allowed	X		
To Interest paid on Loans	X		
To Bad debts	X		
To Carriage outwards	X		
To Advertising expenses	X		
To Depreciation on assets	X		
To Loss due to fire	X		
To Net Profit [transferred to capital]	X		
	XX		**XX**

It may be noted that:

1) Direct Expenses which are debited to Trading A/c are not debited again to Profit & loss A/c.
2) Personal expenses are not debited to this account.
3) Income Tax, Wealth Tax or Life insurance premium paid are personal expenses of proprietor / partners.
4) Items shown in Trial Balance should be given one effect and adjustment given below Trial Balance should be given two effects.
5) It should be noted that:

   Trading Account and Profit & Loss Account are not prepares separately as shown above but they are prepared as one account split up into two sections. As such the combined heading is given as 'Trading and Profit & Loss A/c for the year ended…'

6.4 BALANCE SHEET

Balance Sheet is a statement which shows the financial position of a business entity on a given date. It is prepared from trial balance, after all nominal accounts and accounts relating to Trading, Profit & Loss account. Accounts left out are Real accounts and personal accounts. Accounts having debit balances transferred to Assets side of balance sheet and account having credit balance transferred to Liabilities side of Balance Sheet, in some cases credit balances may be deducted from particular asset. e.g. provision for depreciation deducted from Fixed Asset; Reserve for bad & doubtful, is deducted from sundry debtors. Balances shown in Balance Sheets are carried forward for next year.

The Balance Sheet has also two sides. The Left hand side is headed as 'Liabilities' and Right hand side is headed as 'Assets'. It is not an account, therefore in no 'To' or 'By' proceeding the names of the Account recorded in the Balance Sheet.

Balance Sheet shows financial position as on a particular date and not for the year. Therefore the heading of Balance Sheet is worded as

"Balance Sheet of ….. as on ….."

6.5 MARSHALLING OF BALANCE SHEET

[Order of Assets and Liabilities]

1) Assets are arranged in order of their Liquidity i.e. in order in which they can be converted into cash and Liabilities they are

payable. As assets which can be immediately converted into cash will be taken first and then in order will follow the others. Similarly, Liability which is to be paid off immediately will be taken first and then next and so on.

2) The assets & liabilities are arranged in exactly the reverse order of the above arrangement.

A specimen of Balance Sheet is given below :

Balance Sheet of ….. as on …..
[According to Liquidity order]

Liabilities	Rs.	Assets	Rs.
Outstanding Expenses	X	Cash in hand	X
Sundry Creditors	X	Bank Balance	X
Bills Payable	X	Investments	X
Bank Overdrafts	X	Sundry Debtors	X
Loans	X	Bills Receivable	X
Capital	X	Outstanding Income	X
		Stock in trade	X
		Loose tools	X
		Prepaid Expenses	X
		Patents, Trade Marks	X
		Furniture	X
		Plant & Machinery	X
		Building	X
		Land	X
		Goodwill	X
	XXX		**XXX**

The totals of the two sides of the balance sheet must agree because of the equation

Assets = Liabilities + Capital

6.6 CLASSIFICATION OF ASSETS

6.6.1 Fixed Assets :-

These assets are acquired for long use in the business itself and not for sale. e.g. Building, Plant & Machinery etc.

6.6.2 Current or Floating Assets :-

These assets are to be converted into cash as soon as possible. e.g. stock of goods, Sundry Debtors, Bills Receivable.

6.6.3 Liquid / Quick Assets :-

These assets can be converted into cash as quickly as possible, without undue Loss. e.g. Sundry Debtors, Bank Balance, short term govt. securities.

6.6.4 Wasting Assets :-

Are those fixed assets which have fixed content like coal in coal mine.

6.6.5 Intangible Assets :-

Are those Fixed Assets which can not be seen or touched or felt, i.e. having no physical existence, e.g. Goodwill.

6.6.6 Fictitious Assets :-

Are worthless assets but shown as assets in the Balance Sheet. E.g. preliminary expenses, Discount on issue of debentures.

6.7 CLASSIFICATION OF LIABILITIES

6.7.1 Fixed and Long-term Liabilities :-

Are those Liabilities which are payable after a long period of time e.g. Bank Loan, Debentures.

6.7.2 Current Liabilities :-

These are short term Liabilities payable usually with in year e.g. sundry creditors, Bills Payable, outstanding expenses.

6.7.3 Contingent Liabilities :-

These are not actual Liabilities as on date of Balance Sheet, which may or may not be payable in future, depend on the happening of certain events. In future, however due present circumstances; whether to pay or not, depends upon further happenings. Therefore existence of contingent liabilities shown below total liabilities by way of note for the sake of information and disclosure. e.g. investment in partly paid shares, compensation suit pending in court, Bills discounting but not matured, such Liabilities are shown as a foot note in the Balance Sheet on liabilities side.

6.8 LIMITATIONS OF BALANCE SHEET

- Balance sheet is considered to be a static document. The real position of the concern keeps on changing.

- Stock valuation / method of depreciation are different, which affects on financial position.
- Change in accounting policy may not followed consistally.
- Window-dressing is accomplished in general ways, e.g. not making adequate provisions.
- Fixed assets are shown at historical cost less depreciation. However, actual value of fixed assets, like Land might have appreciated much more.

6.9 ADJUSTMENTS

Before an accountant can proceeds to prepare the Final Accounts from trial balance, he has to process some additional information, which is not consider in trial balance.

The following are a few examples showing where adjustment entries would required :

1 Closing Stock / Inventory :-

Unsold goods in stock at the end of the period. Closing stock is valued at cost or market value which ever is lower. For accounting following entry is pass

Closing Stock A/c…………………...Dr	XX	
To Trading A/c		XX

While closing stock appears on credit side of Trading A/c and it also appears on an assets, in the Balance Sheet.

2 Outstanding Expenses :-

The nominal accounts records the actual expenses paid during the period, However some expenses are incurred, (due) but not paid, hence it is not accounted, are also brought into the books to help in proper matching of revenues and expenses. e.g. Firm pays wages on 10th of the subsequent mouth. These for at the end of the year say 31st march '10, wages account is debited up to Feb. 10; since March wage not paid. These unpaid / outstanding expenses must also be included. This is done by passing following adjustment entry.

Wages A/c…………………………….Dr	XX	
To outstanding wages A/c		XX

The above entries increases wages in Trading A/c and it is since not paid shown a Liability in the balance sheet.

3 Prepaid Expenses :-

Certain expenses paid may relate to more than one accounting period. It is necessary to ascertain that portion of expense which the benefit is not yet received by the concern. e.g. In such premium paid Rs. 6000, for the year ended 31st march 2010. Prepare Final Accounts for the ended 31st Dec 2009. Hence Jan to March, three month insurance premium benefit to the subsequent three month. Such expenses paid in a advance are called 'pre-paid expenses'. Adjustment entry pass as under :

Prepaid Expenses A/c………….……...Dr	XX	
To Expenses A/c		XX

Prepaid expenses deducted from concern period and shown in the balance sheet an assets.

4 Depreciation :-

It is the reduction or fall in the value of a Fixed Assets due to its use. Thus, the depreciation is loss to the business, to account for following adjustment entry is passed.

Depreciation A/c……………………...Dr	XX	
To Fixed Assets A/c		XX

Depreciation is debited to Profit & Loss A/c and it is deducted from concerned Fixed Assets in the Balance Sheet.

5 Outstanding / Accrued Income :-

Income earned during the period but not received, Entry-

Outstanding Income A/c……………..Dr	XX	
To Income A/c		XX

It added to Income in Profit & Loss A/c and shown as assets in the Balance Sheet.

6 Income Received in Advance :-

Income received, however it relate to subsequent year; Entry-

Income A/c…………………………....Dr	XX	
To Income Received in Advance A/c		XX

Advance income deducted from income on credit side of Profit & Loss A/c and shown it on Liability side of Balance Sheet.

7 Bad debts :-

When goods are sold on credit the amount is recoverable from customer. However amount receivable is not possible to recover, then such debts is to be written off, as Loss to business; Entry-

Bad debts A/c………………………..Dr XX
To Customer A/c XX

It is debited to Profit & Loss A/c as bad debts and deducted from sundry Debtors in the balance sheet.

These are money adjustment, however, only few basis adjustment discuss above:

8 Hidden Adjustment in Trial Balance :-

These adjustments not directly however from Trial Balance, these are apparent, and hence must be consider.

	Trial Balance On 31-03-2010	**Trading, Profit & Loss A/c**	**Balance Sheet**
1.	Rent paid (Including Rs.400/- for April)	Deduct Rs.400/- from Rent Paid A/c	Show Rs.400/- as Rent Prepaid on Assets side
2.	Rent paid (upto Feb.) Rs.2,200/-	Add Rs.200/- to Rent Paid A/c	Show Rs.200/- as O/S Rent on Liability side
3.	Rent Received (upto Feb.)	Add Rs.300/- to Rent Received A/c	Show Rs.300/- as Rent Due on Assets side
4.	Rent Received (incl. Rs.500/- for April)	Deduct Rs.500/- from Rent Received A/c	Show Rs.500/- as Advance Rent on Liability side
5.	Leasehold Land : Rs.1,00,000/- (for 10 years from 01-04-2010)	Write off Rs.10,000/- on Dr. side	Deduct Rs.10,000/- form Leasehold Land on Assets side
6.	(a) Loan from ABC Rs.20,000/- (b) Interest to 10% p.a. Rs.1,500/-	Add Rs.500/- to Interest Paid A/c	Show Rs.500/- as Interest Due on Liabilities side
7.	(a) Machinery (W.D.V.) : Rs.7,500/- (b) Machinery sold for Rs.9,000/-	Show Profit Rs.1,500/- on Cr. side	Deduct Rs.7,500/- from Machinery A/c in Balance Sheet

CHECK YOUR PROGRESS

- Give the effects of the following adjustments:
  1. Salary Rs. 4000 is Outstanding.
  2. Prepaid rent Rs.1000.
  3. Wages included Rs.4000 which is used for installation of Machinery.
  4. Interest on Investment Rs.3000 received in advance.

6.10 ILLUSTRATIONS

Illustration 1:

From the following Trial Balance of Shri - Atul Sheth prepare Trading and Profit and Loss A/c for the year ended 31st March, 2010 and a Balance Sheet on that date.

Trial Balance as on 31st March, 2010

Particulars	Dr. Rs.	Cr. Rs.
Machinery	90,000	
Building	50,000	
Stock (01-04-09)	10,200	
Purchases	80,800	
Wages & Salaries	17,000	
Carriage Outwards	3,000	
Sundry Debtors	50,000	
General expenses	9,100	
Rent	1,700	
Bad Debts	650	
Income Tax	600	
Legal Charges	800	
Atul Sheth's Drawing	18,000	
Cash In hand	24,000	
Cash at bank	18,000	
Atul Sheth's Capital		1,20,200
Sundry Creditors		18,000
Bills Payable		23,000
Returns Outwards		1,800
Interest		3,300
Sales		2,07,550
	3,73,850	**3,73,850**

Adjustments :-

The following adjustments should be taken into consideration :-

1) Stock on 31st March,2010 was Rs.70,000/- valued at cost and market price Rs.82,000/-.
2) Depreciate Machinery at 10% and Building @ 5%.
3) Rent Outstanding Rs.800/-.

Solution :-

Shri Atul Sheth's

Trading and Profit & Loss Account for the year ended as on 31st March 2010

Dr. **Cr.**

Particulars		Rs.	Particulars	Rs.
To Opening Stock		10,200	By Sales	2,07,550
To Purchases	80,800		By Closing Stock	70,000
(-) P. Return	1,800	79,000		
To Wage and Salaries		17,000		
To Gross Profit c/d		1,71,350		
		2,77,550		2,77,550
To Carriage Outward		3,000	By Gross Profit b/d	1,71,350
To General Expenses		9,100	By Interest	3,300
To Rent	1,700			
(+) Outstanding	800	2,500		
To Bad Debts		650		
To Legal Charges		800		
To Depreciation				
On Machinery		9,000		
On Building		2,500		
To Net Profit c/d		1,47,100		
		1,74,650		1,74,650

Shri Atul Sheth's
Balance sheet as on 31/03/2010

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital balance	1,20,200		Machinery	90,000	
(+) Net Profit	1,47,100		(-) Depreciation	(9,000)	81,000
(-) Drawings	(18,000)		Building	50,000	
(-) Income Tax	(600)	2,48,700	(-) Depreciation	(2,500)	47,500
Sundry Creditors		18,000	Sundry Debtors		50,000
Bills Payable		23,000	Cash in hand		24,000
O/s Rent		800	Cash at Bank		18,000
			Closing Stock		70,000
		2,90,500			**2,90,500**

Illustration 2:

From the following Trial balance extracted from the books of Shri Sunit as on 31st December 2009. Prepare his final accounts as on 31st December 2009 after taking into consideration following adjustments.

Trial balance as on Dec. 31, 2009

Particulars	Dr. Rs.	Cr. Rs.
Sundry Creditors		28,000
Rent	5,000	
Cash at Bank	42,000	
Cash in hand	28,000	
Stock as on 1 Jan. 2009	18,000	
Bad debts	900	
Discounts	1,800	1,200
Purchase and Sales	65,000	1,08,000
Carriage on Sales	3,500	
Plant and Machinery	48,000	
Sales Return	1,200	
Purchase Return		1,800
Carriage on Purchases	7,500	
Furniture and Fixtures	80,000	
Insurance	8,000	
Salaries	9,000	
Bills Receivable	18,000	
Drawings	22,000	

Wages	6,000	
Capital		3,50,000
Sundry Debtors	1,20,900	
Commission	4,200	
	4,89,000	**4,89,000**

Adjustments –

1) Depreciate Plant and Machinery 10%.
2) Insurance prepaid Rs.1,500/-.
3) Outstanding Salaries Rs.1,200/-.
4) Closing Stock Rs.81,000/-.

Solution :

Shri Sunit's Final Accounts
Trading and Profit and Loss Account for the year ended as on 31st December 2009

Dr. **Cr.**

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		18,000	By Sales	1,08,000	
To Purchases	65,000		(-) Sales Return	(1,200)	1,06,800
(-) Purchase Return	(1,800)	63,200	By Closing Stock		81,000
To Carriage on Purchases		7,500			
To Wages		6,000			
To Gross Profit c/d		93,100			
		1,87,800			1,87,800
To Rent		5,000	By Gross Profit b/d		93,100
To Insurance	8,000		By Discount		1,200
(-) Prepaid	(1,500)	6,500			
To Bad Debts		900			
To Discount		1,800			
To Salaries	9,000				
(+) Outstanding	(1,200)	10,200			
To Carriage on Sales		3,500			
To Commission		4,200			
To Depreciation on Plant & Mach.		4,800			
To Net Profit [transferred to Capital]		57,400			
		94,300			**94,300**

Shri Sunit's
Balance Sheet as on 31st December 2009

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital balance	3,50,000		Plant & Mach.	48,000	
(+) Net Profit	57,400		(-) Depreciation	(4,800)	43,200
(-) Drawings	(22,000)	3,85,400	Cash at Bank		42,000
Sundry Creditors		28,000	Cash in hand		28,000
O/s Salaries		1,200	Furniture & Fixtures		80,000
			Sundry Debtors		1,20,900
			Closing Stock		81,000
			Prepaid Insurance		1,500
			Bills Receivable		18,000
		4,14,600			4,14,600

Illustration 3:

From the following Trial Balance and additional information prepare Profit and Loss Account for the year ended 31/03/2008 and Balance Sheet as on that date of Shri Ankur.

Trial Balance as on 31/03/2008

Particulars	Dr. Rs.	Cr. Rs.
Sundry Debtors	88,000	
Capital		3,16,300
Salaries	9,000	
Commission	800	
Furniture	90,000	
Creditors		81,000
Dividend		4,000
Machinery	1,56,000	
Bad debts	2,250	
Advertisement	1,000	
Investments	38,000	
Bills Payable		18,000
Opening Stock (01/04/07)	32,000	
Insurance	11,000	
Drawings	17,000	
Cash in hand	35,000	
Cash at Bank	51,000	

Interest		900
Purchases	1,34,500	
Sales Returns	1,800	
Wages	6,500	
Bills Receivable	32,000	
Purchase Return		2,300
Sales		2,10,000
Carriage Inward	2,100	
Octroi	1,500	
Bank Overdraft		76,950
	7,09,450	**7,09,450**

Adjustments –

1) Closing Stock Rs.33,000/-.
2) Wages Outstanding Rs.2,000/-.
3) Insurance prepaid Rs.2,500/-.
4) Depreciate Machinery at the rate of 10% and Furniture 15%.

Solution :

Shri Ankur's Final Account
Trading Account for the year ended 31st March 2008

Dr. **Cr.**

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		32,000	By Sales	2,10,000	
To Purchases	1,34,500		(-) Sales Return	(1,800)	2,08,200
(-) Purchase Return	(2,300)	1,32,200	By Closing Stock		33,000
To Wages	6,500				
(+) Outstanding	2,000	8,500			
To Carriage Inward		2,100			
To Octroi		1,500			
To Gross Profit c/d		64,900			
		2,41,200			**2,41,200**

Profit and Loss Account for the year ended 31st March 2008

Dr. **Cr.**

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Insurance	11,000		By Gross Profit		64,900
(-) Prepaid	2,500	8,500	By Dividend		4,000
To Salaries		9,000	By Interest		900
To Commission		800			
To Bad Debts		2,250			
To Advertisement		1,000			
To Depreciation					
On Machinery		15,600			
On Furniture		4,500			
To Net Profit		28,150			
[carried to Capital]					
		69,800			69,800

Balance sheet as on 31st March, 2008

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital balance	3,16,300		Machinery	1,56,000	
(+) Net Profit	28,150		(-) Dep^n 10%	(15,600)	1,40,400
(-) Drawings	(17,000)	3,27,450	Sundry Debtors		88,000
O/s Wages		2,000	Bills Receivable		32,000
Creditors		81,000	Closing Stock		33,000
Bills Payable		18,000	Prepaid Insurance		2,500
Bank Overdraft		76,950	Furniture	90,000	
			(-) Dep^n 5%	(4,500)	85,500
			Investments		38,000
			Cash in hand		35,000
			Cash at Bank		51,000
		5,05,400			**5,05,400**

Illustration 4:

Following is the trial balance of Amir Khan as on 31st March, 2010.

Particulars	Dr. Rs.	Cr. Rs.
Capital Account		80,000
Drawing Account	6,000	
Stock (01/04/2009)	45,000	
Purchases	2,60,000	
Sales		3,10,000
Furniture	10,000	
Sundry Debtors	40,000	
Freight and Octroi	4,600	
Trade Expenses	500	
Salaries	5,500	
Rent	2,400	
Advertisement Expenses	5,000	
Insurance Premium	400	
Commission		1,300
Discount	200	
Bad debts	1,600	
Creditors		20,900
Cash in hand	5,200	
Bank	5,800	
Goodwill (at cost)	20,000	
	4,12,200	**4,12,200**

Adjustments –

a) Stock on 31st March, 2010 was valued at Rs.53,000/-.

b) Salaries have been paid only for 11 months.

c) Unexpired insurance included in the figure of Rs.400/- appearing in trial balance is Rs.100/-.

d) Commission earned but not yet received amounting to Rs.422/- is to be recorded in books of account.

e) Furniture is depreciated @ 10% per annum.

f) Only 1/4th of advertising expenses are to be written off.

Prepare Trading and Profit and Loss Account for the year ended 31st March, 2010 and balance sheet as on that date.

Solution :

Trading and Profit and Loss Account for the year ended 31st March, 2010

Dr. **Cr.**

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Stock (01.04.09)		45,000	By Sales		3,10,000
To Purchases		2,60,000	By Stock (31.03.10)		53,000
To Freight & Octroi		4,600			
To Gross Profit transferred to P&L Account		53,400			
		3,63,000			3,63,000
To Trade Exp.		500	By Gross Profit transferred from Trading Account		53,400
To Salaries	5,500				
(+) O/s Salaries	500	6,000			
To Rent		2,400	By Commission	1,300	
To Advertising Exp	5,000		(+) Commission earned but not received	422	1,722
(-) Amount c/f (3/4)	(3,750)	1,250			
To Insurance Premium	400				
(-) Unexpired Ins.	(100)	300			
To Discount		200			
To Bad Debts		1,600			
To Depreciation		1,000			
To Net Profit transferred to Capital Account		41,872			
		55,122			**55,122**

Amir Khan
Balance sheet as on 31st March, 2006

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital :			**Fixed Assets :**		
Opening Balance	80,000		Goodwill (at cost)		20,000
(+) Net Profit	41,872		Furniture	10,000	
	1,21,872		(-) Depreciation	(1,000)	9,000
(-) Drawings	(6,000)	1,15,872	**Current Assets :**		
O/s Salary		500	Unexpired Insurance		100
Creditors		20,900	Unexpired Advt.		
			Expenses		3,750
			Commission earned		
			but not received		422
			Stock		53,000
			Sundry Debtors		40,000
			Cash at Bank		5,800
			Cash in hand		5,200
		1,37,272			**1,37,272**

6.11 EXERCISES

6.11.1 Theory Questions

1) Explain what is Final Account?
2) Distinguish between Trial balance and Balance sheet
3) Write short notes on
   a) Adjustment
   b) Outstanding Expenses
   c) Gross Profit
   d) Prepaid Expenses
   e) Fixed Assets
   f) Floating Assets
4) What are the limitations of Balance Sheet.

6.11.2 Practical Problems

Q.1 Below is the trial balance of Suresh as at 31st March, 2010

Debit balance	Rs.	Credit balance	Rs.
Suresh's Current A/c	1,500	Capital Account	50,000
Purchases	7,60,450	Loan from Mohan @ 9%	20,000
Salaries	4,200	(taken on 1st October, 09)	
Carriage on Purchases	400	Sales	7,20,000
Carriage on Sale	500	Discount	500
Lighting	300	Sundry Debtors	20,000
Rates and Insurance	400		
Buildings	27,000		
Sundry Debtors	8,000		
Furniture	6,000		
Cash in hand	250		
Cash at bank	1,500		
	8,10,500		8,10,500

Rates have been prepaid to the extent of Rs.175/-, Bad debts totaling Rs.500/- have to be written off. Buildings have to be depreciated at 2% and Furniture @ 10%.

You are required to prepare the Profit and Loss Account for the year ended 31st March, 2010 and the balance sheet as on that date.

Q.2 From the following prepare Trading Account Profit and Loss Account and Balance Sheet.

Trial Balance as 31st March, 2011

Sr. No.	Name of the Account	L.F.	Debit (Rs.)	Credit (Rs.)
1	Sundry Debtors		15,000	-
2	Buildings		40,000	-
3	Goodwill		30,000	-
4	Bills Payable		-	45,000
5	Sundry Creditors		-	25,000
6	Plant & Machinery		1,60,000	-
7	Opening Stock		35,000	-
8	Sales		-	1,40,000

9	Bank Overdraft		-	1,25,000
10	Bills Receivable		40,000	-
11	Purchases		1,25,000	-
12	Sales Returns		1,000	-
13	Wages		45,000	-
14	Purchase Returns		-	1,500
15	Carriage Inwards		600	-
16	Carriage Outwards		300	-
17	Office Salaries		12,000	-
18	Office Rent		500	-
19	Commission		600	-
20	Postage & Telegram		100	-
21	Depreciation		500	-
22	Printing & Stationery		45	-
23	Bad Debts		200	-
24	Prepaid Insurance		150	-
25	Cash in hand		6,000	-
26	Cash at Bank		9,000	-
27	Income Receivable		400	-
28	Capital Account		-	1,90,000
29	Drawings		5,105	-
			5,26,500	**5,26,500**

Closing stock valued at Rs.1,10,000/-.

Q.3 Prepare Trading and Profit and Loss Account from the following trial balance and adjustments for the year ending 31st December, 2008. Prepare Balance sheet as at that date.

Trial balance as on 31st December, 2008

Name of the Account	L.F.	Debit (Rs.)	Credit (Rs.)
Capital Account		-	2,00,000
Drawings Account		86,000	-
Stock (01/01/2008)		75,000	-
Bills Receivable		15,000	-
Sales		-	1,62,350
Purchases		50,000	-
Returns		2,000	3,000
Salaries & Wages		12,000	-

Creditors		-	15,000
Insurance		3,500	-
Carriage Inwards		1,500	-
Carriage Outwards		850	-
Debtors		68,000	-
Commission		3,000	2,000
Interest		4,500	3,000
Discount		3,500	3,000
Bills Payable		-	12,000
Printing & Stationery		2,500	-
Trade Expenses		1,500	-
Furniture & Fixtures		11,000	-
Cash in hand		46,000	-
Cash at bank		12,000	-
Rent & taxes		2,500	-
		4,00,350	**4,00,350**

Adjustments –

1) Closing Stock was valued at Rs.1,05,000/-.
2) Furniture valued at Rs.10,000/-.
3) Outstanding Expenses : Salaries at 1,200/-, Rent & Taxes Rs.600/- and prepaid insurance Rs.650/-.

Q.4 Following is the trial balance of M/s. Anjali. You are required to prepare Trading Account, Profit and Loss Account and Balance Sheet for the year ended 31st December, 2010, after considering the adjustment given below.

Sr. No.	Name of the Account	Debit (Rs.)	Credit (Rs.)
1	Stock on 01-01-2010	60,000	-
2	Purchases & Sales	80,000	1,00,000
3	Returns	1,500	2,500
4	Drawings	2,400	-
5	Wages – productive	3,000	-
6	Wages – unproductive	2,000	-
7	Salaries	4,000	-
8	Rent, rates & insurance	1,500	-
9	Bad debts	1,000	-
10	Discount	600	1,000
11	Machinery	20,000	-

12	Buildings	60,000	-
13	Sundry Debtors & Creditors	16,000	18,000
14	Cash	12,000	-
15	Capital	-	1,17,200
16	Bank Overdraft	-	40,000
17	Furniture	7,500	-
18	Carriage Inward	1,250	-
19	Carriage Outward	1,450	-
20	Interest	4,000	16,000
21	Commission	750	11,000
22	Goodwill	25,000	-
23	Gas & Fuel	1,750	-
		3,05,700	1,05,700

Adjustments –

1) On 31st December, 2010 the cost price of closing stock was Rs.51,000/- and its market price was Rs.52,000/-.
2) Goods worth Rs.6,000/- taken over by the proprietor for the his personal use, were not entered in the books of accounts.

Q.5 From the following Trial balance, you are required to prepare Trading and Profit and Loss Account for the year ended 31st December, 2010 and the Balance Sheet as on that date, after taking into consideration the additional information.

Trial balance (31-12-2010)

Sr. No.	Name of the Account	L.F.	Debit (Rs.)	Credit (Rs.)
1	Drawings		23,800	-
2	Capital		-	1,95,000
3	Opening Stock		50,000	-
4	Creditors		-	1,75,000
5	Purchases		60,000	-
6	Sales		-	1,55,000
7	Royalties		6,000	-
8	Trade Expenses		8,000	-
9	Returns Outwards		-	1,000
10	Advertisement		1,500	-
11	Bills Payable		-	2,000
12	Wages and Salaries		4,800	-
13	Reserve Fund		-	6,000

14	Cash in hand		8,500	-
15	Debtors		68,000	-
16	Bad debts		4,400	-
17	Investments		1,30,000	-
18	Bills Receivable		12,000	-
19	Discount		2,500	2,500
20	Motor Van		15,000	-
21	Furniture		8,000	-
22	Office Rent		3,000	-
23	Plant & Machinery		25,000	-
24	Freehold Property		1,30,000	-
			5,36,500	**5,36,500**

Q.6 The following figures were taken from the books of Ashok on 31st March, 2010.

Particulars	**Rs.**	**Particulars**	**Rs.**
Cash at bank	26,400	Royalties received	400
Cash in hand	30	Trade and General	
Sales	2,61,230	Expenses	5,020
Stock (1st April, 2009)	27,410	Reserve on Patents	5,000
Sales Returns	3,300	Interest on Loan	1,240
Discount (Dr.)	6,380	Repairs	840
Bills Receivable	1,820	Sundry Debtors	20,780
Sundry Debtors	52,720	Buildings	95,820
Depreciation	4,780	Patent rights	50,000
Purchases	1,84,030	Loan (raised on	45,000
Discount on Purchases	3,900	mortgage of buildings)	
Wages	14,040	Agent's Commission	6,500
Provision for bad debts	5,400	Bad Debts	1,900
Provision for discounts		Plant and Machinery	30,000
on Debtors	1,970	Capital	2,00,000
		Drawings	30,000
		Advertising	1,000
		Carriage	450

In addition, the following information is given.

a) Stock on 31st March, 2010 was Rs.82,500/-.

Prepare Trading and Profit and Loss Account of Ashok for the year ended 31st March, 2010 and his balance sheet as on that date.

❖❖❖❖

7

PARTNERSHIP FINAL ACCOUNTS

Unit Structure:

7.0 OBJECTIVES

After studying the Unit the students will be able to:

- Define partnership and explain the characteristics of Partnership.
- Explain the types of Partners.
- Understand the methods of maintaining Capital accounts
- Make the adjustment entries and prepare the Final accounts of a partnership firm.

7.1 INTRODUCTION

In small business, sole trader can manage business. He can himself provide the capital and supervise the work. However, there are numbers of limitations : To over come limitations, businessmen may convert his business into Partnership. Each partner contribute capital and in return each partner get a share in the profits of the firm.

7.2 DEFINITION :

As per Indian Partnership Act 1932, "Partnership is the relation between persons who have agreed to share the Profit / Loss of a business carried on by all or any of them acting for all."

7.3 CHARACTERISTICS OF PARTNERSHIP

a) It is a voluntary association of persons.

b) The relations among them are contractual.

c) Each partner is <u>Principal</u> as well as <u>Agent</u>.

d) All the partners can take active part in business.

e) Profit / Loss are shared by the partners as per Partnership Deed.

f) Minimum two and maximum 10 partners are allowed for banking business, however maximum 20 partners are all for the general business.

g) The liability of the partners is unlimited.

7.4 TYPES OF PARTNERS

i)	Active Partner	:	taking active part in firm business
ii)	Sleeping / Dormant Partner	:	Not taking active part in business, provides capital.
iii)	Nominal Partner	:	Only he lends his name in firm.
iv)	Partners by holding out / by Estoppel	:	He represents himself as partner, even though he is not a partner.
v)	Minor Partner	:	He is less than 18 year old, shares in only Profit of business.
vi)	Limited Partner	:	His liabilities is limited to the extent, the capital contributed by him.

7.5 PARTNERSHIP DEED

It is much agreement, in writing between the partners of the firm. The terms of contracts are written in Deed. It is prepared on stamp paper and signed by all partners. Copy partnership deed are submitted to the Bank, Income Tax Departments, Sales Tax Departments etc. Deed indicates the rights, duties and liabilities of the partner. Partnership Deed contents various term, conditions, Profit / Loss sharing, Interest on Capital and drawings, method of valuation of Goodwill etc.

7.6 PROVISION OF PARTNERSHIP ACT 1932

Normally all terms and condition are stated in Partnership Deed. In case of deed is silent on certain matters, provision of Partnership Act, 1932 are applicable;

1. Profit and Losses shares by all partners equally.
2. No interest on capital and drawings.
3. No salary commission etc. payable to partner.
4. Interest @ 6% p.a. can be paid on Loan from partner.
5. Every partner can take active part in the Partnership business and can inspect the books of accounts.
6. Partner cannot start any parallel business in competition.

7.7 METHODS OF MAINTAINING CAPITAL ACCOUNT

There are two methods of maintaining Partner's Capital Accounts.

a) Fixed Capital Method

b) Fluctuating Capital Method

7.7.1 Fixed Capital Method :

Under this method, capital contributed by partners remain fixed forever. Capital balances are not changed. Partners Current Account are open for recording transactions like interest on capital, drawing in cash or kind, share in Profit or Loss etc. Therefore Partners Current Account may have debit balance or credit balance. Debit balances of Current Account are shown on assets side of the Balance Sheet and vice versa.

7.7.2 Fluctuating Capital Method :

Under this method Capital Account of partner always fluctuates. It do not remains fixed as internal transactions of partner with firm are recorded in Capital Account only. Due to recording of internal transactions, capital balance fluctuates / changes.

7.8 PARTNERSHIP FINAL ACCOUNTS

Partnership Final Accounts consist of :

i) Trading Account
ii) Profit & Loss Account
iii) Profit and Loss Appropriation A/c
iv) Balance Sheet of Firm

7.8.1 Trading, Profit & Loss Account

Partnership Trading, Profit and Loss A/c are prepared on same line as Sole Proprietor. As these are discuss earlier, so not explain again.

7.8.2 Profit & Loss Appropriation Account

Net Profit or Net Loss from business is ascertain in Profit & Loss Account. This Net Profit / Net Loss transferred to Profit & Loss Appropriation A/c. Internal amount payable to partners like partner Salaries, Commission, Interest on Partners Capital, Interest on drawings etc. are charges against Net Profit. Balance Net Profit / Net Loss is transferred to Partners Current Account / Capital Account as the case may be, specimen of Profit & Loss Appropriation is as under –

Profit & Loss Appropriation Account
for the year ended ______

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To Partner's Salaries A/c	XX	By Net Profit (transferred from Profit and Loss A/c)	XX
To Partner's Commission A/c	XX	By Interest on Drawings A/c	XX
To Interest on Partners Capital A/c	XX		
To Interest on Partner's Loan A/c	XX		
To Transferred to Reserves A/c	XX		
To Net Profit transferred to partners Capital A/c (in their Profit sharing ratio)	XX		
A XX	XX		
B XX			

	XX		**XX**

7.8.3 Balance Sheet of Partnership Firm :

Balance Sheet of Partnership Firm is also like a Balance Sheet of Sole Proprietor only differ is that instead of sole proprietor capital alone, there will be each partners capital balances, may have Partners Current Account balances, Specimen of Balance Sheet as under.

Balance Sheet as on ________

Liabilities	Rs.	Assets	Rs.
Partner's Capital A/c		Cash on hand	XX
R XX		Bank balance	XX
K XX		Sundry Debtors	XX
G XX	XX	Bills Receivable	XX
Partners Current A/c		Prepaid Expenses	XX
R XX		Income receivable	XX
G XX	XX	Investments	XX
Sundry Creditors	XX	Office Equipments	XX
Bank Loan	XX	Plant & Machinery	XX
Outstanding Expenses	XX	Patents	XX
Income received in		Land & Building	XX
advance	XX	Goodwill	XX
Provident Fund	XX	Partners Current A/c	
Reserve Fund	XX	K XX	XX
	XX		**XX**

Balance Sheets Liabilities side total must be equal to total Assets.

7.9 ADJUSTMENTS

In addition to normal adjusts discuss in Final Accounts of Sold Trader, there may few more adjustment in respects of firm as under.

7.9.1 Interest on Capital :

Calculate interest on Capital @ rate given,

Profit & Loss Appropriation A/c …………………… Dr. XX

To Interest on Partners Capital A/c XX
(Being interest on partners' capital provided.)

Interest on Capital A/c ……………………………. Dr. XX
To Partner Capital A/c XX
(Being interest on Capital transferred.)

7.9.2 Interest on Partners drawings :

Interest may be charged on drawings made by Partner to make distribution of Profit more equitable. Since drawing are made through the year it is calculated as under –

If amount are withdrawn equally every month.

a) Middle of each month = Int. for 6 months

b) On 1st Day of month = Int. for 6½ month

c) On Last Day of month = Int. for 5½ month

Entry :

a) Interest on drawing A/c …………………… Dr. XX
To Profit & Loss Appropriation A/c XX

b) Partners Capital A/c ………………………. Dr. XX
To Interest on drawings A/c XX

7.9.3 Salaries to Partners :

Profit & Loss Appropriation A/c ……………… Dr. XX
To Partner's Capital A/c XX

Remaining balance in Profit & Loss Appropriation Account indicates distributable Profit / Loss which should be transferred to Partner's Capital Account.

In case of Profit

Profit & Loss Appropriation A/c ……………….. Dr. XX
To A's Capital A/c XX
To B's Capital A/c XX
(Being Net Profit transferred to partners in their Profit / Loss sharing ratio.)

Note : 1) If Partners Capital are fixed, then instead of Capital Account, all above i.e. Interest, Salary, Net Profit etc. are transferred to Partner's Current Account.

2) Profit adjustment due to Guarantee etc. are not specially covered in syllabus & hence not considered.

7.10 LIMITED LIABILITY PARTNERSHIP ACT (L.L.P.)

The Act called Limited Liability Partnership Act (L.L.P.) extended scope and working of Partnership. A present partnership firm can also be converted into L.L.P. It has number of advantages over Partnership Firm or Private Ltd. Company. Number of partners limits not applicable to L.L.P. Here are number of advantages over Partnership Firm mainly liabilities of partners rusticated to capital contribution by partners. L.L.P. enjoys more or less advantages like in private limited company.

7.11 ILLUSTRATIONS

Illustrations 1: From the following trial balance of Neela and Sheela. You are required to prepare Trading and Profit & Loss Account for the year ended 31st March 2007 and Balance sheet as on that date after considering the following adjustments.

Trial Balance as on 31st March 2007

Particulars	Rs.	Rs.
Opening Stock	17,500	-
Salaries and Wages	4,600	-
Cash in hand	6,000	-
Purchase and Sales	1,12,600	2,65,000
Office Expenses	4,300	-
Productive Wages	7,000	-
Bills Receivable	4,000	-
Legal Expenses	3,300	-
Bad debts	1,900	-
Works Managers Salary	5,600	-
Commission	1,800	2,500
Investments	42,000	-
Debtors	67,500	-
Creditors	-	92,000
Bank overdraft	-	88,000
Patents	38,000	-
Loose Tools	28,000	-
Furniture	65,000	-
Goodwill	80,000	-
Interest	-	1,600
Land & Building	1,25,000	-
Capital Accounts :		
Neela	-	1,10,000
Sheela	-	1,05,000
Drawings :		

Neela Sheela	20,000 30,000	- -
	6,64,100	**6,64,100**

Adjustments :

1) Partners shares Profit and losses equally.
2) The Closing Stock cost Rs.25,000/- market value Rs.19,000/-.
3) Neela has withdrawn goods worth Rs.800/- for personal use.
4) Depreciate Land and Building at 10% p.a. and Loose Tools 15% p.a.

Trading Account for the year ended 31st March 2007

Particulars	Rs.	Particulars	Rs.
To Opening Stock	17,500	By Sales	2,65,000
To Purchases	1,12,600	By Goods withdrawn	
To Productive Wages	7,000	by Neela	800
To Works Manager's Salary	5,600	By Closing Stock	19,000
To Gross Profit	1,42,100		
	2,84,800		**2,84,800**

Profit & Loss Account for the year ended 31st March 2007

Particulars		Rs.	Particulars	Rs.
To Salaries & Wages		4,600	By Gross Profit	1,42,100
To Office Expenses		4,300	By Commission	2,500
To Legal Expenses		3,300	By Interest	1,600
To Bad Debts		1,900		
To Commission		1,800		
To Depreciation				
Loose Tools		4,200		
Land & Building		12,500		
To Net Profit				
Neela	56,800			
Sheela	56,800	113600		
		1,46,200		**1,46,200**

Balance Sheet as on 31st March 2007

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital Accounts			Cash in hand		6,000
Neela : balance	1,10,000		Bills Receivable		4,000
(+) Net Profit	56,800		Investments		42,000
(–) Drawings	20,000		Sundry Debtors		67,500
(–) Goods taken	800	1,46,000	Stock		19,000
			Patents		38,000
Sheela : balance	1,05,000		Loose Tools	28,000	
(+) Net Profit	56,800		(–) Dep^n 15%	4,200	23,800
(–) Drawings	30,000	1,31,800	Furniture		65,000
			Goodwill		80,000
Bank Overdraft		88,000	Land & Building	1,25,000	
Sundry Creditors		92,000	(–) Dep^n 10%	12,500	1,12,500
		4,57,800			**4,57,800**

Illustration 2 : From the following Trial balance of Ram and Shyam. You are required to prepare Trading and Profit & Loss Account for the year ending 31st Dec. 2006 and balance sheet as on that date after consideration the adjustments given below.

Trial Balance as on 31st March, 2006

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
Stock (01.04.05)	35,000	Sales	3,30,000
Salary and Wages	9,200	Discount	4,800
Cash	10,000	Creditors	20,000
Purchases	2,25,200	Bank Overdraft	10,000
Sundry Expenses	8,600	Interest on Investments	7,200
Productive Wages	14,000	Capital Accounts	
Bills Receivable	8,000	Ram	60,000
Law charges	3,000	Shyam	40,000
Bad Debts	1,000		
Works Expenses	6,000		
Commission	3,000		
Investments	20,000		
Debtors	40,000		
Trade Marks	8,000		
Tools and Equipments	6,000		
Furniture	12,000		

Goodwill	13,000		
Building	50,000		
	4,72,000		**4,72,000**

Adjustments :

1) Partners shares Profit and Losses in the equal ratio.
2) Closing Stock cost price Rs.40,000/- market value Rs.45,000/-.
3) Uninsured goods worth Rs.10,000/- were lost by fire.
4) Unpaid Salary and Wages Rs.2,100/-.

Trading Account for the year ended 31st December 2006

Particulars	Rs.	Particulars	Rs.
To Opening Stock	35,000	By Sales	3,30,000
To Purchases	2,25,200	By Uninsured Goods	
To Productive Wages	14,000	lost by fire	10,000
To Works Expenses	6,000	By Closing Stock	40,000
To Gross Profit c/d	99,800		
	3,80,000		**3,80,000**

Profit & Loss Account for the year ended 31st December 2006

Particulars		Rs.	Particulars	Rs.
To Sundry Expenses		8,600	By Gross Profit	99,800
To Law Charges		3,000	By Discount	4,800
To Bad Debts		1,000	By Interest on	
To Commission		3,000	Investment	7,200
To Salaries	9,200			
(+) Outstanding	2,100	11,300		
To Uninsured Goods				
lost by fire		10,000		
To Net Profit				
Ram	37,450			
Shyam	37,450	74,900		

	1,11,800		**1,11,800**

Balance Sheet as on 31st December 2006

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital Accounts			Cash		10,000
Ram : balance	60,000		Bills Receivable		8,000
(+) Net Profit	37,450	97,450	Investments		20,000
			Debtors		40,000
Shyam : balance	40,000		Trade marks		8,000
(+) Net Profit	37,450	77,450	Tools and		
			Equipments		6,000
Creditors		20,000	Closing Stock		40,000
Bank Overdraft		10,000	Furniture		12,000
Outstanding			Goodwill		13,000
Salaries & Wage		2,100	Building		50,000
		2,07,000			**2,07,000**

Illustration 3 : (Goods withdrawn, Loss by Fire)
From the following Trial Balance of Jagan and Magan, you are required to prepare a Trading and Profit and Loss Account for the year ended 31st March 2010 and the Balance Sheet as on that date, after taking into the consideration the additional information :

Trial Balance as on 31st March 2010

Particulars	Debit (Rs.)	Credit (Rs.)
Opening Stock	17,500	-
Salaries and Wages	4,600	-
Cash in hand	5,000	-
Purchases and Sales	1,12,600	1,65,000
Office Expenses	4,300	-
Productive Wages	7,000	-
Bills Receivable	4,000	-
Legal Expenses	1,500	-
Bad Debts	500	-
Works Manager’s Salary	3,000	-
Commission	1,500	2,400
Investments	10,000	-
Debtors and Creditors	20,000	10,000
Bank Overdraft	-	5,000

Patents	4,000	-
Loose Tools	3,000	-
Furniture	6,000	-
Goodwill	6,500	-
Interest on Investment	-	3,600
Land and Building	25,000	-
Capital Accounts :		
Jagan	-	30,000
Magan	-	20,000
	2,36,000	**2,36,000**

Adjustments :

1. Partners share Profits and Losses in their capital ratio.
2. The Closing Stock – Cost Rs.20,000/- Market Value Rs.22,500/-
3. Jagan has withdrawn goods worth Rs.600/- for his personal use.
4. Uninsured goods worth Rs.5,000/- were destroyed by fire.
5. Rs.225/- written off as bad debts from Debtors.
6. Outstanding Salaries and Wages Rs.400/-.
7. Depreciation on Land and Building at 7½ %.

Solution :

M/s. Jagan and Magan

Trading, Profit & Loss Account for the year ended 31-03-2005

Dr. **Cr.**

Particulars		Rs.	Particulars	Rs.
To Opening Stock		17,500	By Sales	1,65,000
To Purchases		1,12,600	By Goods withdrawn (Jagan)	600
To Productive Wages		7,000	By Goods Lost by Fire	5,000
To Work Manager's Salary		3,000	By Closing Stock	20,000
To Gross Profit c/d		50,500		
		1,90,600		**1,90,600**
To Salaries & Wages	4,600		By Gross Profit c/d	50,500
(+) Outstanding	400	5,000	By Commission	2,400
To Office Expense		4,300	By Interest on Investment	3,600
To Legal Expense		1,500		
To Bad Debts	500			
(+) Additional B.D.	225	725		
To Commission		1,500		
To Loss by Fire		5,000		
To Depreciation on Land & Building		1,875		
To Net Profit trd Capital A/c				

Jagan (3/5)	21,960			
Magan (2/5)	14,640	36,600		
		56,500		**56,500**

Balance Sheet as on 31-3-2005

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Jagan's Capital			Goodwill		6,500
Balance b/d	30,000		Land & Building	25,000	
(+) Net Profit	21,960		(-) Depreciation	1,875	23,125
	51,960		Furniture		6,000
(-) Drawings	600	51,360	Loose Tools		3,000
Magan's Capital			Patents		4,000
Balance b/d	20,000		Investments		10,000
(+) Net Profit	14,640	34,640	Bills Receivable		4,000
Creditors		10,000	Debtors	20,000	
Bank Overdraft		5,000	(-) Bad debts	225	19,775
Outstanding			Closing Stock		20,000
Salaries & Wages		400	Cash in Hand		5,000
		1,01,400			**1,01,400**

Illustration 4 : A & B are partners and the trial balance and the necessary adjustments of there are given below :

Trial balance as on 31st March, 2010

Particulars	Rs.	Particulars	Rs.
Purchase	2,59,000	**Capital :**	
Sales Returns	4,250	A	1,27,000
Debtors	50,200	B	1,35,000
Opening Stock	21,000	Sales	3,05,000
Salaries	13,600	Purchase Returns	3,230
Wages	20,100	Creditors	21,070
Furniture Balance as on		Dividend on Investment	10,825
1-4-2009	16,750		
(+) Purchases 31.3.2010	1,700		
Machines	16,229		
Bad debts	315		
Advertisements	46,000		
(for 5 years w.e.f. 1/10/2009)			
Investments	1,20,500		
Current Account :			
A	3,000		

B	1,500		
Cash and Bank balance	27,981		
	6,02,125		**6,02,125**

Adjustments :

1. Closing Stock Rs.75,000/-.
2. Depreciation on machines at 5% and on furniture at 10% p.a.
3. Salaries to A Rs.2,000/- p.m.
4. Interest on Capital at 5%.

After considering the adjustments, prepare the trading and Profit & Loss Accounts for the year ended 31st March 2010 and Balance Sheets as on that date.

Solution :

In the books of M/s. An Co. & Co.

Trading, Profit and Loss Account for the year ended 31st March 2010

Dr. **Cr.**

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		21,000	By Sales	3,05,000	
To Purchases	2,59,000		(-) Returns	(4,250)	3,00,750
(-) Returns	(3,230)	2,55,770	By Closing Stock		75,000
To Wages		20,100			
To Gross Profit c/d		78,880			
		3,75,750			**3,75,750**
To Salaries		13,600	By Gross Profit b/d		78,880
To Depreciation on			By Dividend on		
Machinery	811		Investment		10,825
Furniture	1,675	2,486			
To Bad Debts		315			
To Advertisements	46,000				
(-) Prepaid $\left(\frac{46,000}{5}\times\frac{6}{12}\right)$	(41,400)	4,600			
To Net Profit c/d		68,704			
		89,705			**89,705**

Profit & Loss Appropriation Account for the year ended 31.03.2010

Dr. **Cr.**

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Int. on Capital			By Net Profit b/d		68,704
A	6,350				
B	6,750	13,100			
To A's Salaries		24,000			
(2,000 × 12)					
To Net Profit c/d to					
Current A/c					
A	15,802				
B	15,802	31,604			
		68,704			**68,704**

Partner's Current Account

Dr. **Cr.**

Particulars	A	B	Particulars	A	B
To Bal b/d	3,000	1,500	By Int. on Capital		
(Opening)			A/c	6,350	6,750
To Bal c/d	43,152	21,052	By Salaries	24,000	-
			By Net Profit	15,802	15,802
	46,152	**22,552**		**46,152**	**22,552**

Balance Sheet as on 31st March 2010

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Partners Capital			Machinery	16,229	
A	1,27,000		(-) Dep^n @ 5%	(811)	15,418
B	1,35,000	2,62,000	Furniture (op. bal)	16,750	
Partners Current A/c			(+) Purchased on	1,700	
			31.03.10		
A	43,152		(-) Dep^n @ 10% p.a.	(1,675)	16,775
B	21,052	64,204	(10,750 × 10%)		
Sundry Creditors		21,070	Sundry Debtors		50,200
			Investments		1,20,500
			Stock in Trade		75,000
			Cash & Bank bal.		27,981
			Prepaid Advt.		41,400

		3,47,274			**3,47,274**

7.12 EXERCISES

7.12.1 Theory Questions :

a) What is Partnership Deed?

b) What are provisions of Partnership Act relating Accounts of Partnership?

c) State different methods of maintaining Capital Account.

d) What are provisions of Indian Partnership Act 1932 in respect of interest on Capital, Drawings and Loan's from Partner?

e) What are different types of Partners?

7.12.2 Practical Questions

Q.1 R and K are partners in a firm sharing Profits and Losses in the ratio 3:2. Their trial balance on 31/03/2010 was as follows:

Trial Balance as on 31st March, 2010

Particulars	Debit (Rs.)	Particulars	Credit (Rs.)
Opening Stock	26,700	R's Capital	36,000
Purchases	60,000	K's Capital	24,000
Plant & Machinery	21,000	Sales	1,50,000
Furniture	1,400	Creditors	4,400
Carriage	1,500	Unpaid Wages	900
Wages and Salaries	45,000	Return Outwards	1,500
Traveling Expenses	9,750		
Taxes and Rent	1,950		
Bills Receivable	3,000		
Debtors	24,000		
Return Inwards	3,750		
Bank	13,500		
Commission	1,500		
Bad Debts	600		
Cash in hand	150		
R's Drawing	1,800		
K's Drawing	1,200		

	2,16,800		**2,16,800**

Prepare Trading and Profit & Loss Account for the year ending 31/03/2010 and the Balance Sheet as on that date after making the following adjustments.

1) Closing Stock was valued at Rs.27,900/-.
2) Depreciation Plant & Machinery by 10% p.a.

Q.2 Usha, Uma and Urmila were partners sharing profits & losses in the ratio 2:2:1 respectively. The trial balance of their firm on 31st March, 2010 was follows :

Trial balance

Particulars	Debit (Rs.)	Particulars	Credit (Rs.)
Opening Stock	8,000	**Capital Accounts :**	
Purchases	50,000	Usha	20,000
Wages	7,000	Uma	20,000
Carriage Inwards	2,000	Urmila	10,000
Electricity & Insurance	1,900	**Current Accounts :**	
Return Inwards	4,000	Usha	4,000
Salaries	9,700	Uma	2,550
Bad debts	4,100	Urmila	500
Bills Receivable	7,800	Sales	90,000
Debtors	10,200	Rent received	4,400
Building	30,000	Creditors	30,000
Traveling Expenses	4,900	Sundry income	350
Cash at Bank	5,900		
Prepaid Insurance	100		
Vehicle	10,000		
Audit Fees	700		
Machinery	25,500		
	1,18,800		**1,81,800**

Prepare Trading and Profit & Loss Account for the year ended 31st March, 2010 and the Balance Sheet as on that date after making the following adjustments :

1) Goods worth Rs.6,000/- were destroyed by fire and Insurance Company admitted the claim for Rs.5,300/-.
2) Outstanding Expenses were Wages of Rs.1,500/- and Electricity Rs.400/-.
3) Closing Stock was valued at Rs.42,500/-.

4) Provide Salary to Partner Usha Rs.1,000/- p.a. and Interest on Capital @ 12% p.a.

Q.3 From the following trial balance prepare the Trading and Profit & Loss Account for the year ending 31st March, 2010 and a balance sheet as on that date, after taking into considerations the following adjustments.

Trial Balance as on 31st March, 2010

Particulars	Debit (Rs.)	Particulars	Credit (Rs.)
Opening Stock	20,000	Bills Payable	10,000
Sundry Debtors	28,000	Returns Outwards	2,500
Purchases	40,000	Sundry Creditors	21,500
Wages	8,500	Sales	70,000
Salaries	2,700	10% Loan (taken on 1st Oct. 2009)	3,000
Office Expenses	2,445		
Insurance	1,300	Commission	1,400
Plant & Machinery	30,000	Discount Received	500
Rent	1,800	Rent Received	700
Traveling Expenses	1,400	**Capital of Partners :**	
Return Inwards	3,500	A	40,000
Land & Building	44,800	B	50,000
Bills Receivable	4,000		
Bank Balance	6,655		
Furniture	2,400		
Sundry Expenses	1,400		
Advertisement	700		
	1,99,600		**1,99,600**

Adjustments :

1) Stock as on 31.03.2010 was valued at Rs.25,000/-.
2) Outstanding Salaries Rs.6,000/- not provided.
3) Prepaid Insurance Rs.250/-.
4) Provide Interest on Capital @ 10% p.a.

Q.4 From the following Trial Balance of Jayshree trader, Jalgaon, prepare Trading and Profit and Loss Account for the year ending 31/3/2010 and Balance Sheet on that date :

Trial Balance

Particulars	Debit (Rs.)	Particulars	Credit (Rs.)
Opening Stock	10,000	Bank Overdraft	35,000
Purchases	60,000	Creditors	22,000
Wages	7,000	Reserve for doubtful	
Carriages	2,500	debts	700
Salaries and Wages	4,900	Sales	1,20,000
Printing	2,700	**Capital Account :**	
Advertisement	1,000	Hemant	32,000
Bad debts	2,900	Shantanu	16,000
Discount	2,500	**Current Account :**	
Debtors	16,000	Hemant	3,000
Bills Receivable	13,200	Shantanu	2,000
Building	30,000		
Machinery	42,000		
Cash in hand	5,200		
Motor Car	20,000		
Drawings :			
Hemant	4,800		
Shantanu	6,000		
	2,30,700		**2,30,700**

Adjustments :

1) Depreciate Building by 5% and Machinery by 10%.
2) Otstanding expenses were : Printing Rs.200/-, Wages Rs.1,200/-.
3) Goods of Rs.1,000/- purchased on 31st March, 2010 were included in Closing Stock but were not recorded in Purchases Book.
4) Cost price of Closing Stock was Rs.20,500/- while its market price was Rs.25,000/-.

Q.5 The trial balance of M/s. Shrikant Traders as on 31st March, 2010 is given below.

Trial Balance as on 31st March, 2010

Particulars	Debit (Rs.)	Particulars	Credit (Rs.)
Drawings	750	Sales	75,500
Land and Building	20,000	Purchase Returns	1,000
Plant & Machinery	6,000	Sundry Creditors	12,600
Cash at Bank	550	Discount earned	50
Purchases	47,500	Outstanding Salaries	100
Sales Returns	1,500		
Carriage Inward	350	**Capital Account :**	
Opening Stock	11,000	A	15,000
Wages	6,000	B	20,000
Sundry Debtors	17,600	**Current Account :**	
Salaries	2,500	A	1,000
Postage & Telegram	200	B	750
Rent & Insurance	400		
Bad debts	250		
Discount	100		
Trade Expenses	300		
Furniture	5,000		
Commission	500		
Prepaid Insurance	300		
Printing & Stationery	700		
Cash in hand	2,000		
Patents	2,500		
	1,26,000		**1,26,000**

Adjustments :

1) Stock as on 31st March, 2010 was valued at Rs.25,000/-.
2) Outstanding wages Rs.600/- and outstanding rent Rs.700/-
3) Provide 10% depreciation on Plant & Machinery and 5% depreciation of Furniture.
4) 5% interest allowed on capital.

Prepare a Trading Account and Profit and Loss Account for the year ended 31st March, 2010 and the Balance Sheet as on that date.

Q.6 From the following Trial Balance of M/s Chavan and Deshpande, you are required to prepare Trading and Profit and Loss Account for the year ended 31^{st} March, 2010 and the Balance Sheet as on that date after taking into account the necessary adjustment.

Trial Balance

Particulars	Debit (Rs.)	Credit (Rs.)
Chavan's Capital	-	1,80,000
Deshpande's Capital	-	1,50,000
Chavan's Drawings	14,450	-
Deshpande's Drawings	10,000	-
Stock on 01/04/2009	2,00,000	-
Bills Receivable	25,000	-
Purchases	2,75,000	-
Sales	-	4,00,000
Bills Payable	-	60,000
Returns Inward	5,000	-
Returns Outward	-	4,500
Plant and Machinery	1,00,000	-
Loose Tools	25,000	-
Patents	25,000	-
Sundry Debtors	1,25,000	-
Sundry Creditors	-	1,40,000
Cash at Bank	77,550	-
Wages	19,000	-
Salaries	17,500	-
Rates & Taxes	7,500	-
Insurance	3,000	-
Printing and Stationery	2,000	-
Power and Fuel	3,500	-
	9,34,500	**9,34,500**

Adjustments :

1) Stock as on 31^{st} March 2010 valued at Rs.2,42,000/-.
2) Depreciate Plant & Machinery by 10% p.a.

❖❖❖❖

8

COST ACCOUNTING

Unit Structure:

8.0 OBJECTIVES

After studying this chapter, you should be able to understand:

- Need for Cost Accounting
- Meaning of Cost, Costing and Cost Accounting
- Objectives of Cost Accounting
- Classification of Cost
- Elements of Cash
- Methods of Costing

8.1 INTRODUCTION

Cost Accounting is the system of accounting which is concerned with determination of costs of doing something which can be manufacturing or rendering service or even conducting any activity or function. The objective of Cost Accounting is to render detailed and useful information for guidance to Management.

Financial accounting is developed over the time to record, summarise and present the financial transaction or events which can be expressed in terms of money. This function was primarily concerned with record keeping, leading to preparation of Profit and Loss Account and Balance Sheet. The information obtained through financial statements is useful to the Management or Owner in several respects. However, the information provided by financial accounting is not sufficient for several purposes of decision making in many areas such as : determining output level, determining product selection – addition or dropping or changing product combination in the case of multi product company, determining or revising prices of products, whether Profit earned is optimum as compared with competitors and in comparison to earlier years.

The need of data for such details lead to the development of Cost Accountancy.

8.2 LIMITATIONS OF FINANCIAL ACCOUNTING

Financial accounting does not help in day to day management of the organisation. Cost Accounting has emerged mainly because of certain limitations of financial accounting, which are summarized as follows –

1) Financial accounting provides information about the business as a whole. But it does not reveal Profit or loss of each department or product or process.
2) Material and supplies can not be controlled effectively. There is no proper system of control of material which may in losses in the form of deterioration, scrap, misappropriation etc.
3) It does not provide cost information for fixation of prices of products and services.
4) It does not classify the expenses into direct and indirect, fixed and variable and controllable and non-controllable.
5) There is no system of recording loss of labour, i.e. idle time and labour cost is not recorded by jobs, processes etc.
6) Financial accounting is a historical record. It does not help in controlling the cost.
7) It does not facilitate cost reduction which is very important and necessary for cost control.
8) It fails to supply useful information to management for taking various decisions like replacement of labour by machine, introduction of new product, make or buy, selection of most profitable product mix etc.

Therefore, Cost Accounting has developed as a separate branch of accounting. Both cost and financial accounting are concerned with systematic recording and presentation of financial data. Financial accounting reveals Profit / Loss of business as a whole for a certain period. But Cost Accounting reveals Profit / Loss of different product lines. It helps to decide profitability of each process or each product.

8.3 MEANING OF COST, COSTING and COST ACCOUNTING

8.3.1 Cost :

Institute of Cost and Works Accountants of India, defines cost as "measurement, in monetary terms, of the amount of resources used for the purpose of production of goods or rendering services".

Thus the term cost means the amount of expenditure, actual or notional incurred or attributable to a given thing. It can be regarded as the price paid for attaining the objective. For e.g. Material cost is the price of materials acquired for manufacturing a product.

8.3.2 Costing :

The term costing has been defined as "the techniques and processes of ascertainment of costs. Whelden, has defined costing as, "the classifying recording and appropriate allocation of expenditure for the determination of costs the relation of these costs to sale value and the ascertainment of profitability." Therefore costing involves the following steps.

1) Ascertaining and Collecting of Costs
2) Analysis or Classification of Costs
3) Allocating total costs to a particular thing i.e. product, a contract or a process.

Thus costing simply means cost finding by any process or technique.

8.3.3 Cost Accounting :

Cost Accounting is a formal system of accounting by means of which cost of products or service, are ascertained and controlled.

"Whelden" defines Cost Accounting as "Classifying, recording and appropriate allocation of expenditure for determination of costs of products or services and for the presentation of suitably arranged data for the purpose of control and guidance of management."

Therefore, Cost Accounting is the application of costing principles, methods and techniques in the ascertainment of costs and analysis of savings or / and excesses as compared with previous experience or with standards. It provides, detailed cost information to various levels of management for efficient performance of their functions. The information supplied by Cost Accounting as a tool of management for making optimum use of scarce resources and ultimately add to the profitability of business.

Cost Accounting = Costing (+) Application of Cost control methods and ascertainment of profitability (+) Presentation of relevant information for managerial decision making.

8.4 COST CENTRE AND COST UNITS

8.4.1 Cost Centre :

It is a location, person or item of equipment for which cost may be ascertained and used for the purpose of cost control. It is a convenient unit of the organisation for which cost may be ascertained. The main purpose of ascertainment of cost is to control the cost and fill up the responsibility of the person who is incharge of the cost centre.

- **Types of cost centers :**

I. Personal Cost Centre :

It consists of a person or group of persons.
e.g. machine operator, salesmen, etc.

II. Impersonal Cost Centre :

It consists of a location or an item of equipment or group of these. E.g. Factory, Machine etc.

III. Operational Cost Centre :

This consists of machines or persons carrying on similar operations.

IV. Process Cost Centre :

This consists of a continuous sequence of operation or specific operations.

V. Production Cost Centre :

This is the centre where actual production takes place or these include, those departments that are directly engaged in manufacturing activity and contribute to the content and form of finished product.

e.g. Cutting, Assembly and Finishing Departments etc.

VI. Service Cost Centre :

This is the Centre which renders services to production centres. These contribute to the production process in an indirect manner.

e.g. Stores department, Repairs and Maintainance department, H.R. Department, Purchase Department etc.

8.4.2 Cost unit :

It is a unit of product, service or time in terms of which cost are ascertained or expressed. It is basically, a unit of quantity of product or service in relation to which costs may be ascertained or expressed.

Few examples of cost unit are given below.

Name of Industry	Cost unit
Textiles	Meter, yards
Transport	Passenger km
Power	Kilowatt – hour
Paints	Litre
Iron and Steel	Tonne
Canteen	Per meal
Chemical	Litre, kilogram
Readymade Garments	Number
Petrol	Litre

8.5 OBJECTIVES OF COST ACCOUNTING

Objectives of Cost Accounting are as follows :

1) **Ascertain Cost :** To ascertain the cost of product or a services reveled and enable measurement of profit by proper valuation of inventory.

2) **Analyse Costs :** To analysis costs or to classify the expenses under different heads of accounts viz. material, labour, expenses etc.

3) **Allocate and Apportion the Costs :** To allocate or charge the direct expenses or specific costs such as Raw Material, Labour to particular product, contract or process and to distribute common expenses to each product, contract or process on a suitable basis.

4) **Cost Reporting :** Cost Reporting or presentation includes :

   a) What to report i.e. what is the nature of information to be presented?

   b) Whom to Report i.e. to whom the report is to be addressed.

   c) When to Report i.e. when the report is to be presented i.e. Daily weekly monthly yearly etc.

   d) How to Report i.e. in what format the report is to be presented.

5) **Assist the Management :** Cost Accounting assist the management in the following ways

   a) Indicate to the management any inefficiencies and extent of various forms of waste of Raw Material, Time, Expenses etc.

   b) Help the management in fixing of selling price.

   c) Provide information to enable management to take decision of various types.

6) **Cost Control :** Cost Accounting assist the management in cost control. Cost control includes the following stages.

   a) Setting up of targets of cast and production for each period.

   b) Measuring the actual figures of performance relating to cost, production etc. for the period concerned.

   c) The figures of actual performance are to be compared with the targets to find out the variation.

d) Analysing the variance, whether favourable or adverse.

e) Immediate action has to be taken in case of adverse variation.

7) **Controlling Inventory :** Assist the management in controlling Inventory of Raw Material, goods in process, finished goods, spares and consumables etc.

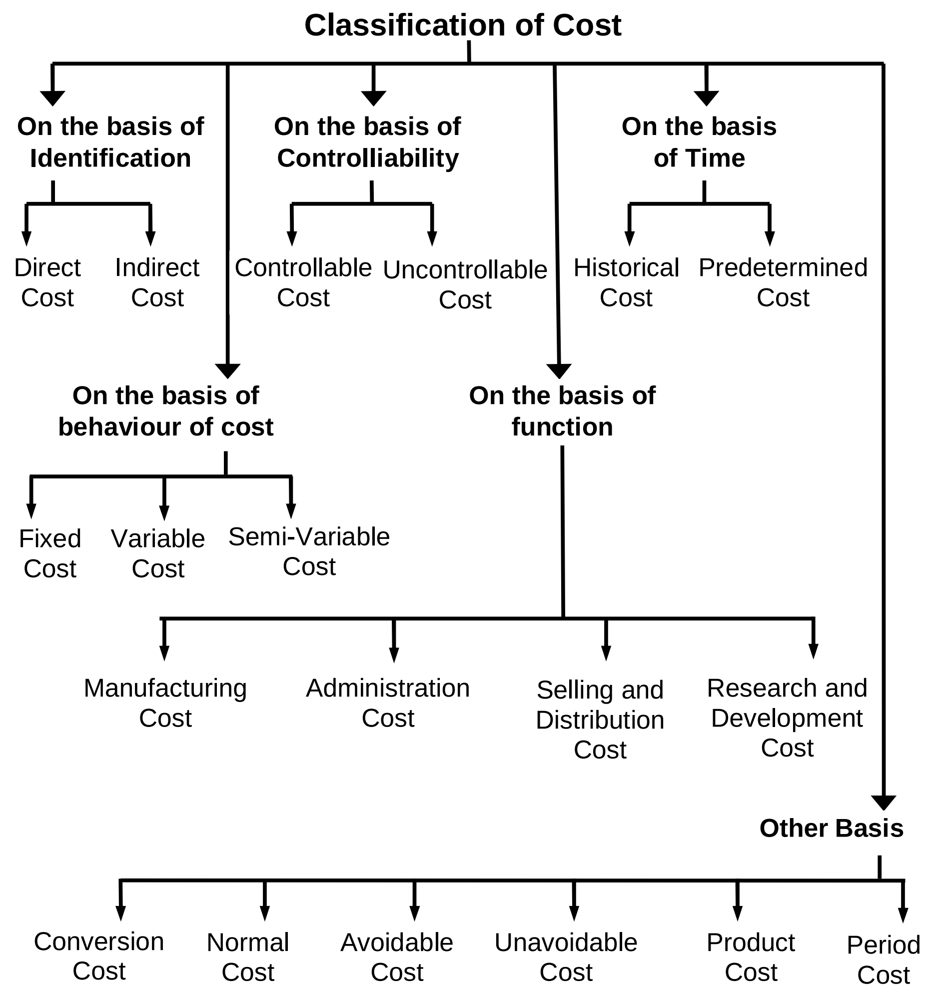
8) **Optimum Product Mix :** Advise the management in deciding optimum product mix merits and demerits of alterative courses of action viz. make of buy decisions, introduction or Automation mechanization, rationalization, system of production etc.

9) **Future Policies :** Advise management on future policies regarding Expansion, growth, capital investment, etc.

8.6 CLASSIFICATION OF COST

Classification is the process of grouping costs according to their common characteristics. It is a systematic placement of like items together according to their common features. There are various ways of classifying costs, according to their common features as given below.

Chart showing classification of cost :



I On the basis of Identification :

On the basis of identification of cost with cost units or jobs or processes, costs are classified into –

1) Direct Costs
2) Indirect Costs

1) Direct Costs : These are the costs which are incurred for and conveniently identified with a particular cost unit process or department. These are the expenditures which can be directly allocated to a particular job, product or an activity. Eg. Cost of Raw Material used, wages paid to labourers etc.

2) Indirect Costs : These are general costs and are incurred for the benefit of a number of cost units, processes or departments. These costs can not be conveniently identified with a particular cost unit or cost centre.
Example : Depreciation of Machinery, Insurance, Lighting, Power, Rent of Building, Managerial Salaries, etc.

II On the basis of behaviour of Cost

Behaviour means change in cost due to change in output. Costs behave differently when the level of production rises or falls. Certain costs change in direct proportion with production level while other costs remain unchanged. As such on the basis of behaviour of cost – costs are classified into

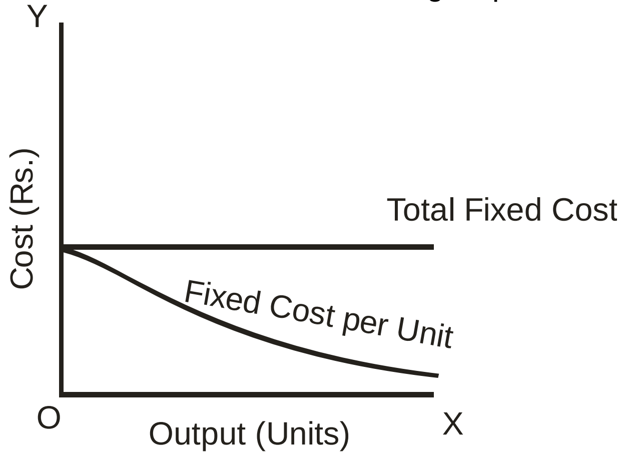
1) Fixed Costs.
2) Variable Costs.
3) Semi Variable Costs.

1) Fixed Costs : It is that portion of the total cost which remain constant irrespective of output upto the capacity limit. It is the cost which does not very with the change in the volume of activity in the short run. These costs are not affected by temporary fluctuation in the activity of an enterprise. These are also known as period costs as it is concerned with period. Rent of premises, tax and insurance, staff salaries, are the examples of fixed cost.

Characteristics of Fixed Cost are :

1) Large in value
2) Fixed amount within an output range
3) Fixed cost per unit decreases with increased output

4) Indirect Cost
5) Lesser degree of controllability
6) Influence Variable Cost and Working Capital

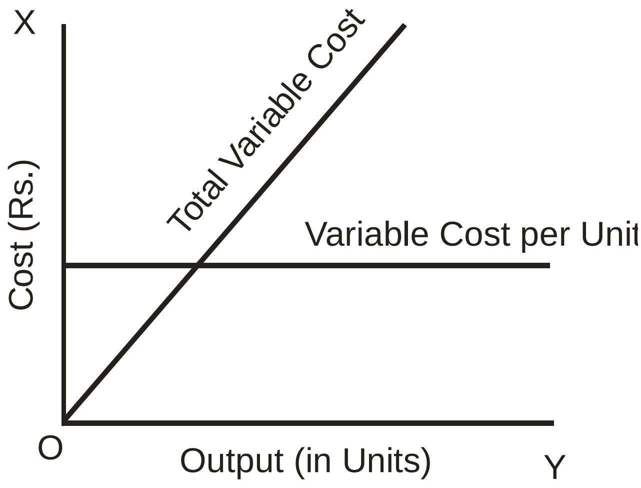


Behaviour of Fixed Cost

2) **Variable Cost:** It is that cost which directly very with the volume of activity. In other words, it is a cost which changes according to the changes in the volume of output. It tends to very in direct proportion to output. It means when the volume of output increases, total variable cost also increases when the volume of output decreases, total variable cost also decreases. But the variable cost per unit remains same. Direct material, Direct Labour, Direct Expenses are the examples of variable costs.

   Characteristics of Variable Cost are :

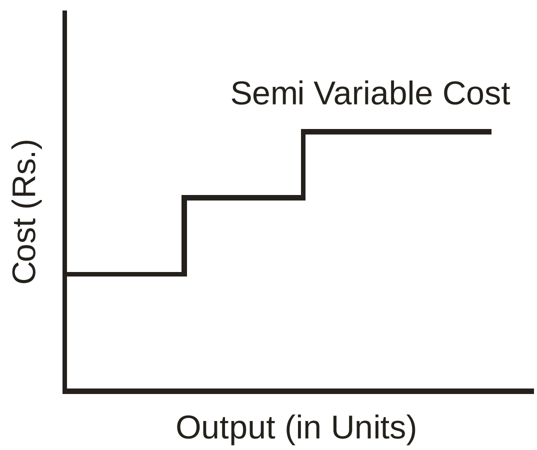
   1) Total cost changes in direct proportion to the change in total output.
   2) Cost per unit remains content.
   3) It is quite divisible.
   4) It is identifiable with the individual cost unit.
   5) Such costs are controlled by functional manager.



Behaviour of Variable Cost

3) **Semi-Variable Cost :** This is also referred as semi-fixed costs. These costs include both a fixed and a variable component. i.e. These are partly fixed and partly variable. They remain constant upto a certain level and registers change afterwards. These costs vary in some degree with volume but not in direct or same proportion. Such costs are fixed only in relation to specified constant condition.

   For example : Repairs and maintainance of machinery, telephone charges, maintainance of building, supervision, professional tax, compensation for accidents, light and power etc.



Behaviour of Semi-Variable Cost

III. On the basis of Controllability

On the basis of controllability, costs are classified into two types :

1) Controllable Cost

2) Uncontrollable Cost

1) **Controllable Cost :** These are the costs which can not be influenced or controlled by the concerned cost centre or responsibility centre. These costs may be directly regulated at a given level of management authority.

2) **Uncontrollable Cost :** These are the costs, which can not be influenced or controlled by the action of a specific member of an enterprise. For eg. it is very difficult to control costs like factory rent, managerial salaries etc.

The important points to be noted regarding this classification. First, controllable cost can not be distinguished from non-controllable costs, without specifying the level and scope of management authority. It means cost which is uncontrollable at one level of management may be controllable at another level of management. Eg. Rent and Factory Building may be beyond control for the production department but can be controlled by the administrative department by negotiations. Secondly all costs are controllable in the long run and at the some appropriate management level.

IV On the basis of Functions

An organisation performs many functions. On the basis of functions costs can be classified as follows :

1) **Manufacturing Costs :** It is the cost of all items involved in the manufacturing of a product or service. It includes all direct costs and all indirect costs related to the production. It includes cost of direct materials, direct labour, direct expenses, and overhead expenses related to production. Overhead expenses, means all indirect costs involved in the production process. This is termed as factory overhead or manufacturing overheads. Eg. Salaries of staff for production department, technical supervision, Expenses of stores department, Depreciation of Plant and Machinery, Repairs and maintainance of Factory Building and Machineries etc.

2) **Administration Cost :** These are costs incurred for general management of an organisation. It is the cost which is incurred for formulating the policy, directing the organisation of controlling the operations. These are in the nature of indirect costs and are also termed as administrative overhead. Eg. Salaries of Administrative Stall, General Office expenses like rent, lighting, telephone, stationery, postage etc.

3) **Selling and Distribution Costs :** Selling costs are the indirect costs relating to selling of products or services. They include all indirect cost in sales management for the organisation. Selling costs include all expenses relating to regular sales and sales promotion activities. Examples of expenses which are included in selling costs are :

1) Salaries, Commission and traveling expenses for sales personnel
2) Advertisement cost
3) Legal Expenses for debt realization
4) Market research cost
5) Show room expenses
6) Discount allowed
7) Sample and free gifts
8) Rent on Sales room
9) After sale services

Distribution costs are the costs incurred in handling a product from the time it is completed in the works until it reaches the ultimate consumer. Distribution expenses include all these expenses which are incurred in connection with making the goods available to customers. These expenses include the following.

1) Packing charges
2) Loading charges
3) Carriage on Sales
4) Rent of warehouse
5) Insurance and lighting of warehouse
6) Transportation costs
7) Salaries of godown keeper, driver, packing staff etc.

4) **Research and Development Cost :** Research and development costs are incurred to discover new ideas, processes, products by experiment. It includes the cost of the process which begins with the implementation of the decision to produce or improved product.

V On the basis of Time

On the basis of time of computation, costs are classified into historical costs and predetermined costs.

1) **Historical Costs :** These are the costs which are ascertained after these have been incurred. Historical costs are then nothing but actual costs. They represent the costs of actual operational performance. These costs are not available until after the completion of manufacturing operations.

2) **Pre determined Costs :** These are the future costs which are ascertained in advance of production on the basis of a specification of all the factors affecting cost and cost data. Predetermined costs are future costs determined in advance on the basis of standards or estimates. These costs are extensively used for the purpose of planning and control.

VI Other Basis

1) **Normal Cost :** Normal cost may be defined as a cost which is normally incurred on expected lines at a given level of output, in the condition in which that level of output in normally attained. This cost is a part of production.

2) **Abnormal Cost :** Abnormal cost is that cost which is not normally incurred at a given level of output, in the condition in which that level of output is normally attained. Such cost is over and above the normal cost and is not treated as a part of the cost of production.

3) **Avoidable Cost :** The cost which can be avoided under the present conditions is an avoidable cost. These are the costs which under given conditions of performance efficiency should not have been incurred. They are logically associated with some activity and situation and are ascertained by the difference of actual cost with the happening of the situation and the normal cost. Eg. when spoilage occurs in manufacturing in excess of normal limit, the resulting cost of spoilage is avoidable cost.

4) **Unavoidable Cost :** The cost which can not be avoidable under the present condition is an unavoidable cost. They are inescapable costs which are essentially to be incurred within the limits or norms provided for. It is the cost that must be incurred under a programme of business restriction.

CHECK YOUR PROGRESS

- Draw the chart showing Classification of Cost.
- Define the following terms:
    1. Costing
    2. Cost Accounting
    3. Impersonal cost center

4. Service Cost center
5. Direct Cost
6. Uncontrollable cost
7. Predetermined cost

- Give Examples:
    1. Fixed cost
    2. Variable cost
    3. Semi variable cost
    4. Manufacturing cost
    5. Administration cost
    6. Selling cost
    7. Distribution Cost

8.7 ELEMENTS OF COST

A cost is composed of three elements i.e. material, labour and expenses. Each of these elements may be direct or indirect. This is shown as follows :

Direct Costs	**Indirect Costs**
Direct Material	Indirect Material
Direct Labour	Indirect Labour
Direct Expenses	Indirect Expenses

8.7.1 Material Cost

It is the cost of material of any nature used for the purpose of production of a product or a service. Materials may be Direct Material or Indirect Material.

- **Direct material :** It is the cost of basic raw material used for manufacturing a product. Direct materials generally became a part of the finished product. No finished product can be manufactured without basic raw material. This cost is easily identifiable and chargeable to the product. For e.g. Leather in leather products, Steel in steel furniture, Cotton in textile etc. Direct material includes the following.

1) All materials specially purchased for production or the process.
2) All components purchased for production or the process.
3) Material transferred from one cost centre to another or one process to another process.

4) Primary packaging materials, wrappings, cardboard boxes etc necessary for production or protection of product.

However, in many cases, though a material forms a part of the finished product, yet it is not treated as direct material. Eg. nails used in furniture, thread used in stitching garments etc. This is because value of such materials is so small that it is quite difficult to measure it.

- **Indirect material :** It is the cost of material other than direct material which cannot be charged to the product directly. It can not be treated as part of the product. These are minor in importance. It is also known as expenses materials. It is the material which cannot be allocated to the product but can be apportioned to the cost units.

Examples : Lubricants, Cotton waste, Grease, Oil, Small tools, Minor items like thread in dress making, nails in furniture (nuts, bolts in furniture) etc.

Therefore, indirect materials can not be easily identified with specific job. They may not vary directly with the output. It is considered as a part of overheads.

8.7.2 Labour Cost

This is the cost of remuneration in the form of wages, Salaries, Commissions, Bonuses etc. paid to the workers and employees of an organisation.

- **Direct Labour Cost :** Direct Labour Cost is the amount of wages paid to those workers who are engaged on the manufacturing line. It consists of wages paid to workers engaged in converting of raw materials into finished products. The amount of wages can be conveniently identified with a particular line, product, job or process. These workers directly handle machines on the production line. Direct wages include payment made to the following group of workers.

1) Labour engaged on the actual production of the product
2) Labour engaged in aiding the operation viz. supervisor, foremen, shop Clerks and worker on internal transport.
3) Inspectors, Analysts, needed for such production.

Example : Carpenter in furniture making unit, tailor in readymade wear unit, Labour in construction work etc.

- **Indirect Labour Cost :** It is the amount of wages paid to those workers who are not engaged on the manufacturing line. It is of general character and can not be directly identified with a particular cost unit. This indirect labour is not directly engaged in the production operations but such labour assist or help in production operations. It can not be easily identified with specific job, contract of work order. It may not vary directly with the output. It is treated as part of overheads.

Example : Labour in Human Resource department, Labour in payroll department, Labour in stores, Labour in Securities Department, Labour in power house department etc.

8.7.3 Expenses

All costs other than material and labour are termed as expenses. It is defined as the cost of services provided to an undertaking and the notional cost of the use of owned assets.

- **Direct Expenses :** It is the amount of expenses which is directly chargeable to product manufactured or which may be allocated to product directly. It can be easily identified with the product. These are the expenses which are specifically incurred in connection with a particular job or cost unit. They are also called as chargeable expenses.

Example : Hire of special plant for a particular job, Travelling expenses in securing a particular contract, Carriage paid for materials purchased for specific job, Royalty paid in mining or production etc.

- **Indirect Expenses :** All indirect costs other than indirect materials and indirect labour costs, are termed as indirect expenses. It is the amount of expenses which can not be charged to the product directly. These can not be directly identified with particular job, process or work order and are common to cost units' or cost centres. Indirect expenses include factory expenses, administrative overheads, selling and distribution expenses etc.

8.7.4 Overhead

This is the aggregate of indirect material cost, indirect labour cost and Indirect expenses.

$$\text{Thus overhead} = (\text{Indirect Material}) + (\text{Indirect Labour}) + (\text{Indirect Expenses})$$

8.8 METHODS OF COSTING

Methods of Cost Accounting signify the systems used to assign cost elements to cost objects. These are the procedures by which product costs are accumulated. Different methods of cost determination are used because business vary in their nature and the type of products or services they produce. Following are the different methods of costing.

8.8.1 Job costing and Batch Costing:

Job costing is designed to accumulate cost data for a manufacturing firm which produces goods to specific order. It is also known as specific orders costing or production order costing. According to "ICMA", London, it is that category of basic costing method which is applicable where the work consists of separate contract job or batches each of which is authorized by specific order or contract. It is followed by manufacturing and non-manufacturing concerns. It is employed in industries in which –

a) A production is done on the basis of customer's own specifications.
b) Products are manufactured in distinguishable lots.
c) Products are not uniform.
d) It is practical to maintain a separate record of each lot from the time production is begun until it is completed.

Following is the list of concerns which generally employ job costing method.

a) Printing Work.
b) Design Engineering Concerns.
c) Repair Works.
d) Construction companies.
e) Furniture makers.
f) Hardware industry.
g) Automobile garages.
h) Interior decoration etc.

Batch Costing

It is a form of job costing in which a batches of identical products is taken as the cost unit. It is used when production consists of limited repetition work and a definite number of articles are manufactured in each batch to be held in stock for sale to customers generally. Thus batch is a cost unit consisting of a group of identical units.

Batch costing is applied in the manufacture of shoes, readymade garments, component parts of cars, radios, watches etc and manufacture of drugs, engineering equipments etc.

For eg. in foot wear industry it is not just economical to manufacture a pair of shoes to meet the requirement of one customer. But batches say 500 to 5000 shoes of each size, style colour etc are economically made and held in stock for sale on demand.

8.8.2 Contract Costing:

It is a method of costing in which each contract is taken as a separate costing unit for the purpose of cost ascertainment and control. The objective is find out the Profit or loss on each contract separately. Contract costing is employed in business undertakings engaged in building construction, road construction, bridge construction, dam construction and other civil engineering works, ship building etc.

Contracts are generally of large size. A contract generally takes more than one year to complete. Work on contract is carried out at the site of the contracts and not in factory premises. Payments by the customer (contractee) are made at various stages of completion of the contract based on architects certificate for the completed stage.

8.8.3 Process Costing:

It is a method of costing used to ascertain the cost of the product at each process operation or stage of manufacture where processes are carried on. According to ICMA London, “It is that form of operation costing where standardized goods are produced.”

Process costing is used to ascertain the cost of product at each stage of manufacture where material is passed through various operations to obtain a final product. This method of costing is used by those concern which manufacture articles of uniform standards. These concerns manufacture articles on a continuous flow basis.

Each process is treated as a cost centre and separate account is opened for each process. All costs related to a process are debited to its process account. The output passing through the process is also recorded. The output of one process becomes the input of next process and so on until the finished product is obtained. This method is suitable for Textile mills, Chemical works, Oil refining, Cement manufactures, Paper Manufacture, Steel production, Paint manufacture, Sugar works, Plastic manufactures etc.

8.8.4 Single (output) or unit costing:

It is a method of costing in which cost is ascertained in convenient units of product turned out by continuous manufacturing activity. The unit of costing is chosen according to the nature of product. This method of costing is used in those industries, in which the production consists of a single product or a few varieties of the same product with variations in size, shape, quality etc. and production is uniform and on continuous basis.

Examples of industries in which this method is commonly used are : Cement, Steel, Sugar, Paper brick works, dairies etc. Cost of units in these industries are a tonne of cement, or steel, or sugar, 1000 bricks, a gallon of milk etc.

This method is also known as single costing.

8.8.5 Operating Costing:

It is a method of costing which is used in those industries, which are engaged in providing services such as transport, electricity etc. The cost of providing a service is termed as operating cost. Operating costing is used in those industries, where services rendered to customers are of unique and standardized type.

The selection of a suitable cost unit (unit of service) is very important. The cost unit may be different for different type of industries. A few examples are given below.

Undertakings	**Cost Unit**
Transport	Per passenger km
Hospital	Per bed per day
Hotel	Per room per day
Electricity	Per kilowatt hour
Cinema	Per seat per show

8.8.5 Operation Costing:

Under this method each operation is treated as a cost centre. Costs are accumulated in each operation instead of each process. This method is used by industries engaged in repetitive mass production with continuous flow of work. These industries could be those engaged in the manufacture of leather products, toys, bicycles, ceiling fans, weighing machines etc.

8.9 KEY POINTS

- **Cost :** It is the amount of expenditure, actual or notional incurred on a given thing.
- **Costing :** It is process of ascertaining the cost.
- **Cost Centre :** It is a convenient unit for which cost may be ascertained.
- **Cost Unit :** It is a unit of product or service for which cost is ascertained.
- **Cost Control :** It involves comparing actual cost with the target and taking remedial action.

Objectives of –

- **Cost Accounting :** Ascertain Cost, Analyse Cost, allocate and apportion Cost, Cost Reporting, Assist the management, Cost control, Optimum product mix, Future policies.
- **Elements of Cost :** Direct Cost – Direct material, Direct labour, Direct expenses. Indirect Cost – Indirect material, Indirect labour, Indirect expenses.
- **Methods of Costing :** Job and Batch Costing, Contract Costing, Process Costing, Output Costing Operating Costing, Operation Costing.

8.10 ADDITIONAL READINGS

1) Cost Accounting – Principles and practice by M.N. Arora
2) Cost Accounting – An introduction by Nigam and Jain
3) Cost Accounting – Chopade and Choudhary

8.11 EXERCISE

1) What is meant by Cost Accounting? Explain in brief different ways of Cost Classification.
2) What is Cost Accounting? What are the elements of Cost Accounting?
3) What is Cost Accounting? Explain the methods of Costing.
4) What is Cost Accounting and what are the objectives of Cost Accounting?

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9

FINANCIAL MANAGEMENT

Unit Structure:

9.0 OBJECTIVES

After studying the unit the students will be able to:

- Know the meaning of Financial Management.
- Explain the Scope and role of Financial Management.
- Elaborate the Functional areas of Financial Management.
- Understand the various tools of FM, advantages and disadvantages of various tools.

9.1 MEANING

Finance may be defined as the art and science of managing money. The major areas of finance are Financial Services and Managerial Finance or Financial Management.

Financial Services is concerned with the design and delivery of advice and financial products to individuals, businesses and governments within the areas of banking are related institutions, personal financial planning, investments, real estate, insurance and so on.

Financial Management is concerned with the duties of the financial managers in the business firm. Financial managers actively manage the financial affairs of any type of business, namely, financial and non-financial, private and public, large and small, profit seeking and not for profit. They perform such varied tasks as budgeting, financial forecasting, cash management, credit administration, investment analysis, funds management and so on.

Financial Management as an integral part of overall management is not a totally independent area. It shows heavily related disciplines and fields of study, such as economic, accounting, marketing, production and quantitative methods.

9.2 SCOPE OF FINANCIAL MANAGEMENT

Financial management provides a conceptual and analytical framework for financial decision making. Financial management is an integral part of overall management. It covers both financial function of acquisition of funds and allocation of funds. Thus, apart from this involves acquiring the external funds and the main concern of financial management is the efficient and allocation of funds to various uses.

The financial management consider various financial problems of a firm. The main contents of this approach are –

What is the total volume of a firm or enterprise?

What should an enterprise acquire specific assets?

How should the funds required be financed?

It also consider How should be enterprise large and how fast should it grow?

In what form should it hold assets and what is the position of its liabilities.

The financial management covers the major problems of the firm. The main solutions to this problem corresponding under the various decisions taken by the financial managers. Mostly it covers various fields like investment, financing, dividend policy, capital budgeting, working capital management and so on.

9.3 ROLE OF FINANCIAL MANAGEMENT

Role of financial management is very important which are undertaken by finance manager.

1. **In performing financial analysis and planning :** The concern of financial analysis and planning is –
   a. Transforming financial data into a form that can be used to monitor financial condition.

b. Evaluating the need for increased / reduced productive capacity and

c. Determining the additional / reduced financing required.

This activity is fully depend on the financial management. It proves financial management plays on important role in performing financial analysis and planning.

2. **In making investment decisions :** Financial management plays an very important role in making investment decisions like current assets as well as fixed assets. Financial manager must determine and maintain certain optimum level of each assets. He should also decide which of the best fixed asset acquired and when the existing assets need to be modified or replaced or liquidated.

3. **In making financing decisions :** Financial management again plays an vital role in making financing decision. It means the finance manager consider which appropriate mix of short term and long term financing selected and the best individual short term or long term sources of financing at a given point of time. These decisions are dedicated as per necessities, but same require an in-depth analysis of the available financing alternatives, the financial manager considers their costs and their long term implications.

9.4 FUNCTIONAL AREAS OF FINANCIAL MANAGEMENT

Financial management can be broken down into three different functional areas are as follows –

1. The investment decision
2. The financing decision and
3. The dividend policy decision

1. **The Investment Decision :** The investment decision relates to the selection of assets in which the funds will be invested by firm. The assets can be acquired fall into 2 categories :

   i) Long term assets (fixed assets) which yields a return over a period of time.

   ii) Short term or current assets defined as those assets which in the normal course of business are convertible into cash without diminution in value usually within a year.

The investment decision policy is also known as capital budgeting management. If the funds are invested in a long term period for acquiring fixed assets is called as capital budgeting management and vice-versa. If the funds are invested in a current assets is popularly for short term period known as working capital management.

2. **Financing Decision :** The second major decision involved in financial management is the financing decision. This is concern with the financing mix or capital structure or leverage. The term capital structure refers to the proportion of debt and equity capital. It means the choice of the proportion of these sources of finance is the capital requirement. It gives the theoretical relationship between the employment of debt and the return to the shareholders.

3. **Dividend policy decision :** The major third decision area of financial management is decision relating to the dividend policy. The dividend decision should be analysed in relation to the financing decision of a firm. The two alternatives are available, i.e. i) The available profits can distributed among the shareholders in the form of dividend or ii) The available profits can be reinvested into business. The decision as to which course should be followed depends largely on a significant element in the dividend decision, the dividend pay our ratio, that is, what proportion of net profits should be paid out to the shareholders.

9.5 VARIOUS FINANCIAL MANAGEMENT TOOLS

Following are various financial management tools:

1. Cash flow statement
2. Fund flow statement
3. Ratio analysis

9.5.1 Cash Flow Statement :

Cash flow statement means a statement of showing net changes in the position of cash and cash equivalents.

As per as 3, this would include cash in hand and savings, current account balances with banks, demand deposits with banks and cash equivalents.

Cash equivalents are defined as short term and highly liquid investments that are readily convertible into cash which are subject to insignificant risk of changes in values.

Uses / advantages of Cash Flow Statement :

1. **Efficient Cash Management :** The most important function of management is to manage the cash resources in such a way that adequate cash is available for meeting the expenses. It helps to plan and co-ordinate the financial operation of the business.

2. **Internal Financial Management :** It provides a clear picture of cash flow operations. Therefore, it is very useful for internal financial management.

3. **Knowledge of changes in Cash Position :** It enables the management to know about the causes of changes in cash position. The finance manager can explain the relationship between profit and cash balance.

4. **Success or failure of Cash Planning :** Cash flow statement helps to management in making the comparison between actual and budgeted cash flow statement to know the success or failure in cash management. It also helps in taking necessary remedial measures in cash of any deviations.

5. **Projected Cash Flow :** It helps to know the projected cash inflow and cash outflow.

6. **Supplemental to Fund Flow Statement :** It is supplementary to Fund flow statement for analysis of cash.

7. **Tool of Analysis :** It analysis is certainly a better tool of analysis than the fund flow analysis for short term decisions.

Limitations of Cash Flow Statement :

1. **Misleading of Inter – Industry Comparison :** Cash flow statement does not measure the economic efficiency of one company in relation to another company. Therefore, due to inter-industry comparison of cash flow may mislead.

2. **Misleading Inter – Firm Comparison :** The terms and conditions of purchases and sales of different firms may not be the same. Hence, inter firm comparison becomes misleading.

3. **Influence of Management Policies :** Management policies influence the cash easily by making certain payments in advance or by postponing certain payments.

4. **Can not tally with Income Statement :** Cash Flow Statement can not be tally with income statement. Therefore, net cash flow does not mean income of the business.

5. **Not a substitute to other statement :** It can not be substitute to other statements. For eg. Fund Flow Statement and Balance Sheet.

9.5.2 Fund Flow Statement :

Fund flow statement shows the sources and uses of funds as well as net change in working capital. It is a financial statement which shows as to how a business entity has obtained its funds and how it has applied or employed its funds between the opening and closing Balance Sheet dates during the particular year or period.

Uses / advantages of Fund Flow Statement :

1. Fund flow statement helps the management in the assessment of long range forecasts of a cash requirements and availability of liquid resources. The manager can judge the quality of management decisions.

2. With the help of Fund Flow Statement, the investors are able to measure as to how the company has utilized the funds supplied by them and its financial strength. Also, the investors can judge the company's capacity to generate funds from operations.

3. It serves as effective tools to the Management for economic analysis as it supplies additional information which can not be provided by financial statement based on historical data.

4. Fund flow statement explains the relationship between changes in working capital and net profits.

5. Fund flow statement helps the management in making planning process of a company. It is also useful in assessing the resources available and the manner of utilization of the resources.

6. It explains the financial consequences of business activities. It also provides explicit and clean answer to questions regarding liquid and solvency position of the company.

7. Fund Flow Statement provides clues to the creditors and financial institutions as to the ability of a company to use funds effectively in the best interest of the investors, creditors and owners of the company.

Limitations of Fund Flow Statements

1. It should not be overlooked that Fund Statements ignore non-cash transactions, therefore it is considered as cruder device than the financial statement.

2. Fund Flow Statements merely rearrange a part of the information contained in financial statements. They do not serve as original evidence of financial status.

3. Though changes in cash resources are more significant, they are not highlighted by Fund Statements except being shown by them as a part of working capital.

4. As Fund Flow Statements are prepared from information provided by financial statements, they are essentially historical in nature.

Distinction between Cash Flow Statement & Fund Flow Statement

Cash Flow Statement	Fund Flow Statement
It shows net change in the position of cash and cash equivalents	It shows change in the position of 'working capital'.
It is based on narrower concept of funds i.e. cash and cash equivalents.	It is based on broader concept of funds i.e. working capital.
Now, it is mandatory for all the listed companies and is more widely used in India or abroad.	It is not mandatory and it is not being used by the companies.
Changes in working capital are adjusted for ascertaining cash generated from operations.	Statement of changes in working capital is prepared under fund flow statement.
In Cash flow statement, decrease in current liability or increase in current assets results in decrease in cash and vice – versa.	In working capital, decrease in current liability or increase in current asset brings increase in working capital and vice – versa.

9.5.3 Ratio Analysis:

Financial statement gives us clear idea about the financial position of the company. It will help the proprietor whether to continue the business or closed down or to make changes in working style of the business. Every businessman is interested in profit margin only. Financial statement gives the clear idea of the profit margin in amounting term. But with the help of ratio, we get the clear idea of comparison and with the help of ratio we are able to express the relationship between different figures.

Ratios express the relationship between two number as well as accounting figures. It shows the process of computing and presenting the relationship between items of the financial statement.

The ratio can be expressed in 3 terms:

1. Simple or pure ratio.
2. Percentage.
3. Rate.

9.6 EXERCISE

1. Explain fund flow and cash flow.
2. Distinguish between Fund flow and Cash flow.
3. Define financial management. Briefly explain the functional areas of FM.
4. Explain the tools of Financial Management.
5. Elaborate the role of Financial Management in decision making.

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10

RATIO ANALYSIS-I

Unit Structure:

10.0 OBJECTIVES

After studying the unit the students will be able to:

- Define Ratio.
- Understand the classification of ratio.
- Know the forms in which the ratios can be expressed.
- Explain the advantages and limitations of ratio analyses.

10.1 INTRODUCTION

Financial statement gives us clear idea about the financial position of the company. It will help the proprietor whether to continue the business or closed down or to make changes in working style of the business. Every businessman is interested in profit margin only. Financial statement gives the clear idea of the profit margin in amounting term. But with the help of ratio, we get the clear idea of comparison and with the help of ratio we are able to express the relationship between different figures.

10.2 MEANING

Ratios express the relationship between two number as well as accounting figures. It shows the process of computing and presenting the relationship between items of the financial statement.

10.3 FORMS:-

The ratio can be expressed in 3 terms:

1. Simple or pure ratio.
2. Percentage.
3. Rate.

1. Simple or pure ratio -

It gives a simple relationship between two figures. We take simple example of current ratio, it means consider the relationship between current assets and current liabilities, if the current assets are Rs.4,00,000/- and current liabilities are Rs.2,00,000/-, the ratio is derived by dividing Rs.4,00,000/- by Rs.2,00,000/-, then the answer is 2 which will be expressed on 2:1.

2. Percentage -

Some ratio's is expressed in terms of percentage. The relationship between profit and sales is expressed in percentage. For example- If sales are Rs.10, 00,000/- and gross profit is Rs.5,00,000/- then it is expressed as gross profit being 50% of sales.

3. Rate-

Ratios are also expressed in terms of rates. i.e. number of times or certain period. The relationship between stock is expressed in terms of rates. For Example- If stock turn over rate is said to be 6 times in a year, it mean that the stock is converted into sales 6 times in 12 months.

10.4 CLASSIFICATION

Ratios are classified as follow:

1. Based on financial statement
2. Based on function
3. Based on user

10.4.1 Based on financial statement :

The relationship between two figures which is expressed, it is taken from financial statement i.e. profit and loss a/c, balance sheet or both. This can be grouped as follows.

I. Balance sheet ratio -

The relationship between two figures is expressed by taking figures from balance sheet itself. There is no need to refer income statement. Actually, the relationship between the assets and liabilities is current ratio, liquid ratio, proprietary ratio capital gearing ratio, debt equity ratio, and stock-working capital ratio.

II. Income statement ratio -

The relationship between two groups is expressed from income statement itself. Mostly, it shows the relationship between profitability and sales of the firm. For Example - gross profit ratio, operating ratio, net profit ratio, net operating profit ratio and stock turnover ratio.

III. Combined ratios -

Under these ratio's the relationship between two figures is expressed by taking figures on from Balance Sheet and another from Income Statement. It shows the relationship between the profits and investment of the firm. For e.g. Return on Capital employed, Earning Per Share, Debtors Turnover Ratio, etc.

10.4.2 Based on Functions :

Accounting Ratio's can be classified on the basis of their function or according to their purpose, that is, Liquidity Ratio, Leverage Ratio, Activity Ratio, Profitability Ratio and Coverage Ratio or valuation Ratios.

I. Liquidity Ratio -

It analyse the short term and immediate financial position of the business organization and it also indicates the relationship between current assets and current liabilities. For e.g. Current Ratio, Liquid Ratio, Quick Ratio.

II. Leverage Ratio -

It shows the relationship between debts and own funds in financing the assets of the business. It includes debt equity ratio, capital gearing ratio and proprietary ratio. It also helps in knowing the solvency or the company and so it is known as capital structure ratio or solvency ratio.

III. Activity Ratio -

This ratio shows comparison of sales with different items of income statement and Balance Sheet. It shows the utilization of funds and efficiency of business important activity ratios of stock turnover ratio, debtors turnover ratio etc.

IV. Profitability Ratio -

It makes comparison of profits with sales and assets of the business profits include gross profit, operating net profit, profit before tax etc. It reflects overall efficiency of business. It includes gross profit ratio, net profit ratio, return on capital employed etc.

V. Coverage Ratio -

It is the relationship between profits of the company and amounts payable to outsider. Out of such profits in the form of dividends, interests, etc. it includes dividend payout ratio, debt ratio etc.

10.4.3 Based on users :

1. Ratio for shareholders –

Shareholders are interested in the safety of their funds and capital appreciation. It includes return on proprietors' funds and return on equity capital.

2. Ratio for Short Term Creditors:

Basically, creditors are interested in knowing the firms ability to meet short term obligation in time. This includes current ratio, liquid ratio.

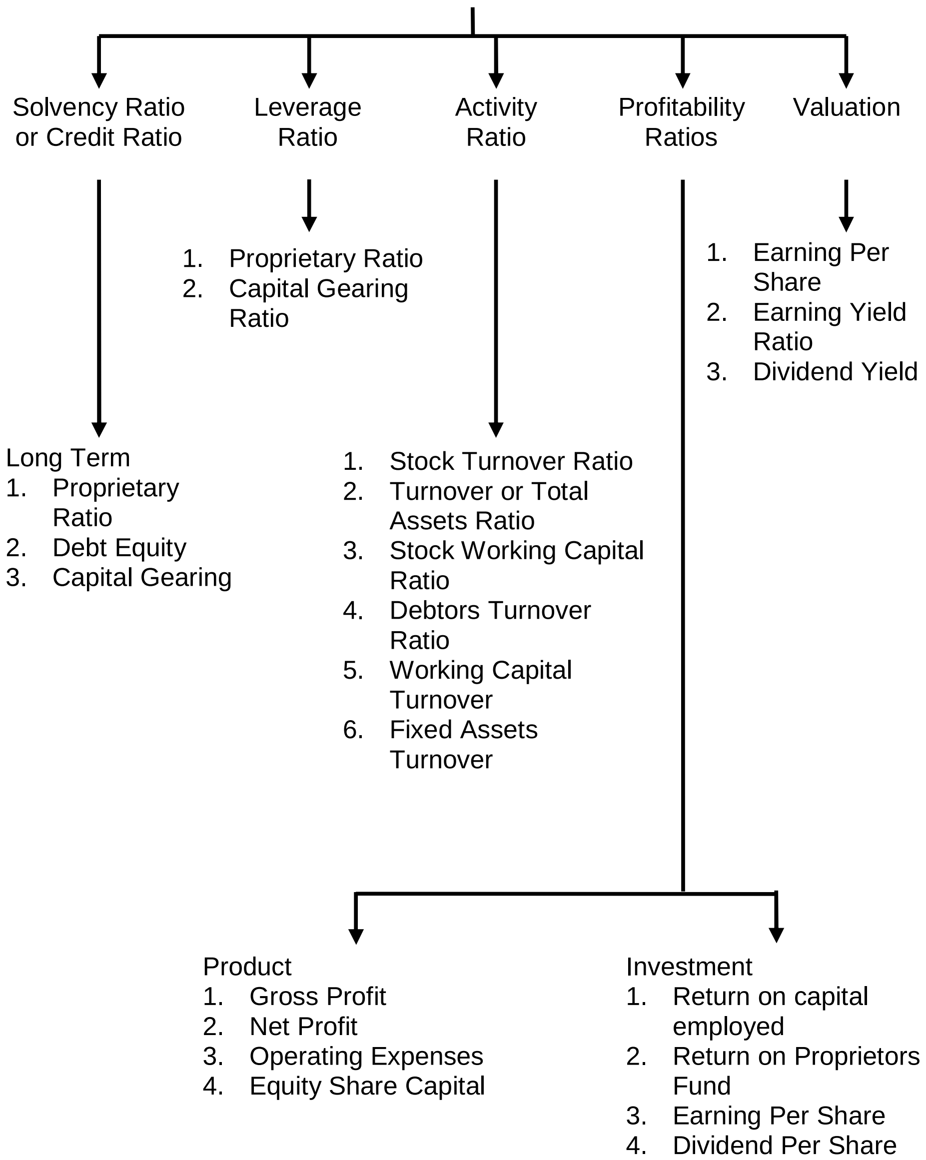
3. Ratio for Management :-

The management is interested in the returns on their investment. For e.g. Return on capital employed, turnover ratio, operating ratio etc.

4. Ratios for Long Term Creditors :-

They are interested in companies ability to pay interest and repay the debts when it is actually due. E.g. Debt Equity Ratio, Proprietary Ratio etc.

Classification of Ratios



CHECK YOUR PROGRESS

- Draw the chart showing Classification of Ratios.
- Define the following terms:
  1. Ratio
  2. Balance sheet ratio
  3. Liquidity ratio

4. Activity ratio
5. Coverage ratio

10.5 BALANCE SHEET RATIO

For making easy calculation or Ratio draw up Vertical Statement of Balance Sheet.

10.5.1 Vertical Format or Balance Sheet

Particulars	Amt	Amt	Amt
I. SOURCES OF FUNDS			
1. Equity Share Capital	XX		
2. Reserves & Surplus	XX		
Equity Shareholders (1 + 2) Funds		XX	
3. Preference Share Capital		XX	
Proprietors Fund (1 + 2 + 3)		XX	
4. Borrowed Funds		XX	XX
Total Sources of Funds			**XXX**
II. APPLICATION OF FUNDS			
1. Fixed Assets			
Goodwill	XX		
Plant & Machinery	XX		
Land & Building	XX	XX	
2. Investment		XX	
3.a) Current Assets			
i) Debtor	XX		
ii) Cash	XX		
iii) Bills Receivable	XX		
Quick Assets (I + ii + iii)		XX	
iv) Closing Stock	XX		
v) Prepayments	XX	XX	
Total Assets (a)		XX	
4.b) Current Liabilities			
i) Creditors	XX		
ii) Bills Payable	XX		
Quick Liabilities		XX	
iii) Bank Overdraft	XX		
iv) Other Quick Liabilities	XX	XX	
Total Current Liabilities (b)		XX	
5. Working Capital (a - b)		XX	XX

Total Application of Funds / Total Capital Employed (1 + 2 + 5)			**XXX**

10.5.2 Current Ratio -

This ratio compares the current assets with the current liabilities. It is expressed in the form of pure ratio. E.g. 2:1.

a. Current Ratio = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$

b. Current assets include assets which are circulated and liquidated in cash within one accounting period. E.g. Debtors (net), bills receivables, short term investment, inventories, loose tools etc.

c. Current Liabilities, any liability which is due to be paid within one accounting period is a current liability. E.g. Creditors, bills payable, outstanding expenses, proposed dividend, bank overdraft etc.

d. Significance - It indicates the strength of working capital and measures short term solvency of the business. It reflects the ability of business to pay its short term liabilities.

e. Standard - Normally, 2:1 is regarded as standard ratio which means current assets must be nearly two times of current liabilities.

f. Limitations - It ignores the components of working capital by considering liquid assets and deferred assets as same. It also ignores the quality of working capital by including dead stock in working capital.

g. Example:

Current Assets or a company on Rs. 4,00,000 and on the same data, current liabilities are Rs. 2,00,000. Then

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$
$$= \frac{4,00,000}{2,00,000}$$
$$= 2:1$$

10.5.3 Quick Ratio / Liquid Ratio / Acid Test Ratio -

Liquid ratio compares the quick assets with the quick liabilities. It is expressed in the form of a pure ratio and it is also known as quick ratio and Acid Ratio.

a. Quick Ratio = $\frac{\text{Quick Assets}}{\text{Quick Liabilities}}$

b. Quick Assets include all current assets minus stock and prepaid expenses.

c. Quick Liabilities includes all current liabilities minus advances received and bank overdraft.

d. Significance - It helps to know the immediate short term liabilities and abilities of business to pay them.

e. Standard - Normally, 1:1 is the standard quick ratio which means quick assets must be at least equal to quick liabilities.

f. Limitation- It may not indicate the long term solvency of the business.

g. Example:

From the following information given calculate 1) Quick Assets 2) Quick Liabilities and 3) Quick Ratio.

Particulars	Amt	Particulars	Amt
Cash	5,000	Outstanding Salaries	1,000
Debtors	10,000	Bank Overdraft	2,000
Creditors	5,000	Stock	3,000
Prepaid Expenses	2,000	Bills Payable	4,000
Bills Receivable	8,000		

Solution:-

Quick Assets:-

Cash	5,000
Debtors	10,000
Bills Receivable	8,000
Total	23,000

Quick Liabilities:-

Creditors	5,000
Outstanding Salary	1,000
Bills Payable	4,000
Total	10,000

$$\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{Quick Liabilities}}$$

$$= \frac{23,000}{10,000}$$

$= 2:3:1$

10.5.4 Stock-Working Capital Ratio -

This ratio shows the relationship between the closing stock and the working capital.

a. $\text{Stock – Working Capital Ratio} = \dfrac{\text{Stock}}{\text{Working Capital}} \times 100$

b. Stock means closing stock.

c. Working capital is equal to current assets minus current liabilities.

d. Significance - It shows the quality of working capital and the quantum of stock in it.

e. Standard - It is practically not possible to have a standard.

f. Example:

If inventory is Rs.80,000/- & Working Capital Rs.1,20,000/- the stock to Working Capital Ratio would be

$$= \frac{\text{Stock}}{\text{Working Capital}} \times 100$$

$$= \frac{80{,}000}{1{,}20{,}000} \times 100$$

Stock working capital ratio $= 67\%$

10.5.5 Proprietary Ratio / Net Worth Ratio / Assets Backing Ratio-

It compares proprietor's funds with total liabilities or total assets. It is expressed in terms of percentage.

a. $\text{Proprietory Ratio} = \dfrac{\text{Proprietors Funds}}{\text{Total Assets}} \times 100$

b. Proprietors funds, includes paid up preference share capital, paid up Equity Share Capital, Capital Reserve, Revenue Reserve, Security Reserve , Profit & Loss Account minus Accumulated losses and fictitious assets.

c. Total Assets includes Fixed Assets, investments and current assets.

d. Significance - It determines to what extent total assets are financed by proprietors. It also compares proprietors funds with total assets and total liabilities. It also indicated as Total Assets = Total Liabilities, Total Liabilities = Proprietors Funds + Loans + Current Liabilities.

e. Standard - It should be very high or very low. Normally, it should be guided as 65%-75% considered. But, it differs from business to business.

f. Example: **Proprietary Ratio -**

From the following information calculate proprietary Ratio or S Ltd.

Particulars	Amt
Equity share capital	1,50,000
Preference share capital	50,000
Reserves	30,000
Proprietors funds	2,30,000
Current Assets	1,00,000
Fixed Assets	2,50,000
Total Assets	3,50,000

$$\text{Proprietory Ratio} = \frac{\text{Proprietors Fund}}{\text{Total Assets}} \times 100$$

$$= \frac{23{,}000}{35{,}000} \times 100$$

$$= 66\%$$

10.5.6 Debt Equity Ratio -

This ratio compares the long term debts with shareholders' funds. It is usually expressed as a pure ratio.

a. $\text{Debt Equity Ratio} = \frac{\text{Debt}}{\text{Equity}}$

OR

$$\frac{\text{Loan Funds}}{\text{Owned Funds}}$$

b. Debt includes borrowed funds as secured / Unsecured loans including debentures, interest accrues and due on loans.

c. Proprietors funds includes paid up share capital, Reserves and surplus minus fictitious assets and accumulated losses.

d. Significance - This is a solvency ratio and it also indicated the proportion of debt and equity in financing the funds of the concerns. It also shows protection cover for long term creditors. The low debt equity ratio is considered as favourable to creditors. It indicates, low ratio means less dependence on long term debts.

e. Standard - If debts equity ratio is two third then it is considered as satisfactory ratio. It implies that out of three total funds debts would be 2 and Equity would be 1.

f. Example: **Debt Equity Ratio -**

From the following information calculate Debt - Equity Ratio or P Ltd.

Particulars	Amt
5 % Debentures	4,00,000
7 % Preference share Capital	2,00,000
Equity Capital	3,00,000

$$\text{Debt Equity Ratio} = \frac{\text{Borrowed funds}}{\text{Funds}}$$

$$= \frac{4,00,000}{5,00,000}$$

$$= 0.8$$

10.5.7 Capital Gearing Ratio / Financing Leverage Ratio / Capital Structure Ratio -

Gearing means the process of increasing the equity shareholders' return through the use of debt. Equity shareholders earn more when the rate or return on total capital is more than the rate of interest on debts.

a. $$\text{Capital Gearing Ratio} = \frac{\begin{array}{c}\text{Capital Bearing Fixed Rate}\\ \text{of Interest \& Dividend}\end{array}}{\begin{array}{c}\text{Capital Not Bearing Fixed Rate}\\ \text{of Interest \& Dividend.}\end{array}}$$

b. Capital bearing fixed rate of interest and dividend includes Preference share capital, debentures, loans etc.

c. Capital not bearing fixed rate of interest and dividend includes equity share capital, reserves and surplus, fictitious assets and accumulated losses.

d. Significance - It shows balance between debt and equity and it also shows whether a company is practicing trading on equity.

e. Example: **Capital Gearing Ratio-**

The following are the relevant extract from Balance sheet or ABC Ltd as on 31st Dec, 2003. Calculate the capital gearing ratio.

Liabilities	Amt
8,000 Equity share or Rs.10/- each Fully Paid	80,000
9% Preference Shares or Rs.100/- cash fully paid	1,50,000
Security (share) Premium	10,000
Capital Reserve	16,000
10% Debentures	50,000

$$\text{Capital Gearing Ratio} = \frac{\text{Capital entitled to fixed Interest / Dividend}}{\text{Capital not entitled to fixed Interest / Dividend}}$$

OR

$$= \frac{\text{Preference Capital} + \text{Debentures}}{\text{Equity Capital} + \text{Share Premium} + \text{Capital Reserve}}$$

$$= \frac{1{,}50{,}000 + 50{,}000}{80{,}000 + 10{,}000 + 16{,}000}$$

$$= \frac{2{,}00{,}000}{1{,}06{,}000}$$

$$= 1.89$$

10.6 REVENUE STATEMENT RATIO

10.6.1 Format of Revenue statement

Profit & Loss A/c.
Vertical Income / Revenue Statement

Particulars	Amt	Amt	Amt
Credit Sales		XX	
Cash Sales		XX	
Total Sales			XX
Opening Stock		XX	
Credit Purchases	XX		
Cash Purchases	XX		
Total Purchases		XX	
Direct Expenses		XX	
(-) Closing Stock		(XX)	
Cost of Good Sold			(XX)
Gross Profit			XX

Operating Exp			
Administrative Exp		XX	
Selling Expenses		XX	
Finance Exp (Excl. Interest)		XX	(XX)
Operating Profit			XX
(+) Non Operating Income			XX
			XX
(-) Non Operating Exp			(XX)
Profit Before Interest & Tax			XX
(-) Interest on loans			(XX)
Net Profit Before Tax			XX
(-) Income Tax			(XX)
Net Profit after Tax			XX
(-) Preference Dividend			(XX)
Profit available for Equity Shareholders			XX
(-) Equity Dividend			(XX)
Retained Earnings			**XX**

10.6.2 Gross Profit Ratio -

This ratio compares gross profit with net sales.

a. $\text{Gross Profit Ratio} = \dfrac{\text{Gross Profit}}{\text{Net Sales}} \times 100$

b. Gross Profit = Sales minus Cost of Goods Sold

   (Cost of Goods Sold = Opening Stock + Purchases + Direct Expense - Closing Stock)

c. Net Sales = Sales minus Sales Returns minus Allowances.

d. Significance - It indicates basic profitability of business concern, it also indicate the efficiency of the purchase department, production department and the sales department. It shows the percentage of mark up on the goods sold.

e. Example: **Gross Profit Ratio -**

Net Sales	Rs. 5,00,000
(-) Cost of Goods Sold	Rs. 4,20,000
Gross Profit	80,000

Calculate Gross Profit Ratio.

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{80{,}000}{5{,}00{,}000} \times 100$$

$$= 16\%$$

10.6.3 Operating Ratio -

It expresses the relationship between total operating costs and net sales.

a) Operating Ratio $= \dfrac{\text{Operating Cost}}{\text{Net Sales}} \times 100$

$$= \frac{\text{cost of goods sold} + \text{Operating Expenses}}{\text{Net Sales}} \times 100$$

b) It expresses the relationship between each item of expenditure with sales. It brings out the relationship between elements of operating cost and net sales.

c) Significance - This enables the management in controlling cost and improving profit ability as well as the auditor and income tax department to judge the correctness and reliability of various expenses.

d) Limitations - If expenses of fixed amount the ratio of expenses to sales may be increased or decreased in value. The ratio of variable expenses may remain same even though sales are increased.

e) Example: **Operating Ratio -**

Calculate operating ratio from the following information.

Sales	Rs. 20,00,000
Gross Profit	Rs. 7,00,000
Operating Expenses	Rs. 5,00,000

Cost of goods sold = Sales less Gross Profit
1,30,000 = 20,00,000 - 7,00,000

$$\text{Operating Ratio} = \frac{\text{Cost of Goods Sold} + \text{Operating expenses}}{\text{Net Sales}} \times 100$$

$$= \frac{13{,}00{,}000 + 5{,}00{,}000}{20{,}00{,}000} \times 100$$

$$= 90\%$$

Calculate various expenses ratios and operating ratio from the following information.

i)	Cost of goods sold	Rs. 40,000
ii)	Office & Administrative expenses	Rs. 20,000
iii)	Selling & distribution Expenses	Rs. 15,000
iv)	Sales	Rs. 1,00,000

i) Cost of goods sold Ratio = $\frac{\text{cost of goods sold}}{\text{Sales}} \times 100$

$$= \frac{40,000}{10,000} \times 100$$

$$= 40\%$$

ii) Office & administrative Expenses Ratio

$$= \frac{\text{Office \& Administrative Expenses}}{\text{Sales}} \times 100$$

$$= \frac{20,000}{1,00,000} \times 100$$

$$= 20\%$$

iii) Selling & distribution Expenses Ratio

$$= \frac{\text{Selling \& distribution Expenses}}{\text{Sales}} \times 100$$

$$= \frac{15,000}{1,00,000} \times 100$$

$$= 15\%$$

iv) Operating Ratio $= \frac{\text{Cost of goods sold} + \text{Operating Exp}}{\text{Net Sales}} \times 100$

$$= \frac{40,000 + 20,000 + 15,000}{1,00,000} \times 100$$

$$= 75\%$$

10.6.4 Net Profit Ratio -

Net profit ratio indicates the relationship between net profit and the sales. It is usually expressed in the form of a percentage.

a) It is calculated in three ways.

i. $\text{Net Operating Profit Ratio} = \frac{\text{Net Operating Profit}}{\text{Net Sales}} \times 100$

ii. $\text{Net Profit Ratio} = \frac{\text{Net Profit before tax}}{\text{Net Sales}} \times 100$

iii. $\text{Net Profit Ratio} = \frac{\text{Net Profit after tax}}{\text{Net Sales}} \times 100$

b) Net Profit before tax = Operating Net profit + Non operating income - Non operating expenses.

Net profit after tax = Net profit before tax - income tax

c) Net Sales = Gross sales minus Returns minus allowances

d) Significance - It indicates overall profitability of business organization, it also indicates as to what portion of net profit is available to the proprietors.

e) Limitations - It cannot be used as a text Net profit Ratio without considering other revenue statement ratio. It may be also affected by non operating income of expenses, income from extra ordinary transaction. In such cases, Net profit ratio may be showing higher or lower volume even though sales and other cost may be showing the same tendency as before and hence net profit Ratio is isolation cannot provide clear idea about the company's profitability.

f) Example: **Net Profit Ratio -**

Calculate Net Profit Ratio from the following :

Operating Net Profit	Rs.1,50,000
Non Operating Income	Rs.25,000
Non Operating Expenses	Rs.20,000
Net Sales	Rs.10,00,000

$$\text{Net Profit Ratio} = \frac{\text{Net Profit before Tax}}{\text{Sales}} \times 100$$

NPBT = Operating Net Profit + Non Operating Income - Non Operating Expenses

= 1,50,000 + 25,000 - 20,000

= 1,55,000

$$\text{NP Ratio} = \frac{1{,}55{,}000}{10{,}00{,}000} \times 100$$

$$= 15.5\%$$

10.6.5 Stock Turnover Ratio / Stock velocity Ratio / inventory Turnover Ratio -

Stock turnover ratio shows the relationship between the cost of goods sold and the average stock.

a) Stock turnover Ratio $= \dfrac{\text{cost of goods sold}}{\text{Average stock}}$

OR

$$= \frac{\text{Net Sales}}{\text{Average stock at selling price}}$$

b) Cost of goods sold = Opening stock + Purchases + Direct expenses - closing stock

c) $\text{Average stock} = \dfrac{\text{Opening stock} + \text{closing Stock}}{2}$

d) Significance - Stock turnover ratio helps in determining the frequency of inventory replacement. It also helps in determining the liquidity of business organization.

e) Limitations - It should be studied along with current ratio stock working capital ratio. Stock being differed from current assets, current ratio may be satisfactory due to large stock, but it may suffer bud quick ratio.

f) Example: **Stock Turnover Ratio -**

If cost of sales is Rs.25,00,000/- and opening stock Rs.3,00,000/- and closing stock Rs.2,00,000/-. Calculate Stock Turnover Ratio.

$$\text{Average Stock} = \frac{\text{Opening Stock} + \text{Closing Stock}}{2}$$

$$= \frac{3{,}00{,}000 + 2{,}00{,}000}{2}$$

$$= 2{,}50{,}000$$

$$\text{Stock Turnover Ratio} = \frac{\text{Cost of Sales}}{\text{Average Stock}}$$

$$= \frac{25{,}00{,}000}{2{,}50{,}000}$$

$$= 10 \text{ times}$$

10.6.6 Operating Profit Ratio -

Operating profit ratio indicates the relationship between Operating profit and Sales.

a) $\text{Operating Profit Ratio} = \dfrac{\text{Operating Profit}}{\text{Net Sales}} \times 100$

b) Operating profit = Gross profit minus operating expenses,

- Operating expenses =
  1. Office and administrative expenses
  2. Selling a distribution expenses
  3. Finance expenses excluding interest on loans and Debentures.

c) Net Sales = Sales less Returns less Allowances.

d) Significance - It is a profitability ratio, which shows the relationship between profits and sales, it also indicates profits from operations.

e) Example: **Operating Profit Ratio -**

Calculate operating net profit ratio from the following data.

Gross Profit	Rs.4,00,000
Office Expenses	Rs.1,50,000
Selling Expenses	Rs.1,00,000
Sales	Rs.10,00,000

Operating Net Profit = Gross Profit less Selling Expenses less Office Expenses

1,50,000 = 4,00,000 - 1,00,000 - 1,50,000

$$\text{Operating Net Profit Ratio} = \frac{\text{Operating Net Profit}}{\text{Net Sales}} \times 100$$

$$= \frac{1,50,000}{10,00,000} \times 100$$

$$= 15\%$$

10.7 COMPOSITE RATIO

10.7.1 Return on capital employed -

This ratio measures the relationship between net profit (before interest & tax) and the capital employed to earn it. It is expressed as a percentage.

a) $$\text{Return on capital employed} = \frac{\text{Net profit before interest, Tax, dividend}}{\text{Capital employed}} \times 100$$

b) Net Profit before interest, tax and dividend

c) Capital Employed = Proprietors fund + Long Term Loans

OR

Fixed Assets + Current Assets - current liabilities.

d) Significance - It gives clear index or utilization of assets earning capacity. This ratio measures the overall profitability from the total funds employed. It means, measures the relationship between net profit before interest, tax and capital employed to earn net profit.

e) Limitations - This ratio is based on earning and capital employed of the business. These components are subject to various manipulations by management or based on various different accounting policies.

f) Example: **Return On Capital Employed -**

Calculate return on capital employed from the following data.

Net Profit	Rs. 2,00,000
Capital Employed	Rs. 20,00,000

$$\text{Return on Capital Employed} = \frac{\text{Net Profit}}{\text{Capital Employed}} \times 100$$

$$= \frac{2,00,000}{20,00,000} \times 100$$

$$= 10\%$$

1.7.2 Return on proprietors fund / Return on proprietors Equity -

It measures the relationship between profits available to proprietor funds.

a) $$\text{Return on proprietors fund} = \frac{\text{Net profit after Tax}}{\text{proprietors fund}} \times 100$$

b) Net profit after Tax

c) Proprietors funds includes paid up Preference share capital, paid up equity share capital, capital Reserve, Revenue Reserve, Security Reserve, Profit and Loss A/C surplus minus Accumulated losses and fictitious Assets.

d) Significance - Higher ratio signifies better utilization of funds. It also measures the overall performance of a business in regards utilization of total resources available.

e) Example: **Return on Proprietors fund-**

The following is the relevant extract from the Profit & Loss A/c & Balance Sheet of SR Ltd. as on 31. 03. 2004

Profit & Loss A/c, for the year ended 31. 03. 04

Dr. **Cr.**

Particulars	Amt	Particulars	Amt
To Administrative Exp.	80,000	By Gross Profit b/d	2,00,000
To Selling Expenses	30,000		
To Provision for Tax	20,000		
To Net Profit c/d	70,000		
	2,00,000		**2,00,000**

Balance Sheet as on 31. 03. 2004

Particulars	Amt	Amt
Share Capital		
600, 7% Preference Shares of Rs.100/- each fully paid	60,000	
1,500, Equity Shares of Rs.100/- each fully paid	1,50,000	2,10,000
Reserves		
General Reserve	40,000	
Capital Redemption Reserve	30,000	
Dividend Equalisation Fund	20,000	90,000
		3,00,000

$$\text{Return on Proprietors Fund} = \frac{\text{Net Profit}}{\text{Proprietors Fund}} \times 100$$

$$= \frac{70,000}{3,00,000} \times 100$$

$$= 23.3\%$$

10.7.3 Return on Equity Share Capital –

It indicates the rate of earning on equity share capital.

a) $\text{Return on Equity Share Capital} = \dfrac{\text{Net Profit after Tax} - \text{Preference Dividend}}{\text{Equity Share Capital}} \times 100$

b) Net Profit after Tax minus Preference dividend.

c) Equity Share Capital includes paid up equity share capital.

d) Significance - It includes an investor in shares of company whether continue to hold or dispose off such shares. It also enables investors to compare earnings of the company with that another company. Higher ratio signifies better utilization of shareholders fund and higher return on equity share capital.

e) Example: **Return on Equity Share Capital -**

From the following information calculate Return on Equity Capital Ratio.

Net Profit after Tax	3,25,000
7% Preference share capital	1,50,000
Paid up Equity share capital	10,00,000

$$\text{Return on Equity Capital} = \frac{\text{Net Profit less Preference dividend}}{\text{Paidup Equity Capital}} \times 100$$

$$= \frac{3,25,000 - (7\% \text{ of } 1,50,000)}{10,00,000} \times 100$$

$$= \frac{3,25,000 - 10,500}{10,00,000} \times 100$$

$$= \frac{3,14,500}{10,00,000} \times 100$$

$$= 31.45\%$$

10.7.4 Earning Per Share -

It shows earning per equity share, whether or not company declares dividend.

a) $\text{Earning per share} = \dfrac{\text{Net Profit after Tax} - \text{Preference Dividend}}{\text{Number of Equity Shares}}$

b) Net profit after Tax minus Preference dividend.

c) Number of equity shares outstanding.

d) Significance - Higher ratio signifies better utilization of funds available and the company may pay dividend at a higher rate in future. Higher ratio indicates higher overall profitability and effective utilization of equity capital.

e) Example: **Earning Per Share-**

Net Profit after Tax	Rs.2,25,000
8% Preference Share Capital	Rs.2,00,000
Paid up Equity Share Capital (Rs. 100/- each)	Rs.10,00,000

$$\text{Earning Per Share} = \frac{\text{Net Profit after Tax} - \text{Preference dividend}}{\text{No. of Equity Share}}$$

$$\text{No. of Equity Shares} = \frac{\text{Share Capital}}{\text{Face Value Per Share}}$$

$$= \frac{10{,}00{,}000}{100}$$

$$= 10{,}000 \text{ Shares}$$

$$= \frac{2{,}25{,}000 - (8\% \text{ of } 2{,}00{,}000)}{10{,}000}$$

$$= \frac{2{,}25{,}000 - 16{,}000}{10{,}000}$$

$$= \frac{2{,}09{,}000}{10{,}000}$$

$$= \text{Rs. } 20.90$$

10.7.5 Dividend Payout Ratio -

It shows the relationship between the dividend paid to equity shareholders out of the profits available to equity shareholders.

a) $\text{Dividend Payout Ratio} = \frac{\text{Dividend Per Equity Share}}{\text{Earning per Share}}$

b) Dividend per share equity share means dividend paid on one equity share.

c) Earning per share is calculated as per above formula.

d) Significance - It measures dividend paying capacity of the company. Higher ratio signifies the company has utilized larger portion of its earning for payment of dividend. Low ratio indicates that smaller portion of earning has been utilized for payment of dividend. It also indicated that larger portion of earnings had been retained.

e) Example: **Dividend Payout Ratio -**

Net Profit after Tax	Rs. 3,25,000
7% Preference Share Capital	Rs. 2,00,000
Paid up Equity share	
Capital of Rs. 10 per share	Rs. 10,00,000
Equity Dividend @ Rs. 1 per share	

$$\text{Dividend Payout Ratio} = \frac{\text{Dividend to Equity Shareholders}}{\text{Profit available to Equity shareholders}} \times 100$$

$$= \frac{10,00,000}{3,25,000 - 14,000} \times 100$$

$$= \frac{10,00,000}{3,25,000\ (7\%\ \text{of}\ 2,00,000)} \times 100$$

$$= \frac{10,00,000}{3,11,000} \times 100$$

$$= 32.15\%$$

10.7.6 Dividend Yield Ratio -

It shows the relationship between dividend per share earned by shareholder on market price of each share.

a) $\text{Dividend Yield Ratio} = \dfrac{\text{Dividend Per Share}}{\text{Market Price per share}}$

b) Dividend per share is derived by dividing Total Dividend payout to Number of Shares.

c) Market price per share is the quotation price in the stock market.

d) Significance - This ratio indicates the ultimate current return which investors will get as a percentage on its current market value of shares. It also indicates dividend policy of the company.

e) Example: **Dividend Yield Ratio -**

Dividend per Share	Rs.10
Market Price per Share	Rs.100

$$\text{Dividend Yield Ratio} = \frac{\text{Dividend Per Share}}{\text{Market Price Per Share}}$$

$$= \frac{10}{100} \times 100$$

$$= 10\%$$

10.7.7 Price Earnings Ratio -

It brings out the relationship between market price per share with earning per share.

a) $\text{Price Earning Ratio} = \dfrac{\text{Market Price Per share}}{\text{Earning per Share}}$

b) Market price of one share is value of one share in the market.

c) Earning per share.

d) Significance - It indicates the relationship between market price of share and current earning per share. It also helps in determining the future value of the share.

e) Example: **Price Earnings Ratio -**

Net Profit after Tax	Rs.3,25,000
7% Preference Share Capital	Rs.2,00,000
Paid up Equity Share	
Capital of Rs. 100 per share	Rs.10,00,000
Market Price per share	Rs.210/-

$$\text{Earning Per Share} = \frac{\text{Net Profit ater Tax} - \text{Preference dividend}}{\text{No. of Equity Shares}}$$

$$\text{No. of Equity Shares} = \frac{\text{Equity Share Capital}}{\text{Face Value Per Share}}$$

$$\text{Price Earning Ratio} = \frac{\text{Market Price Per Share}}{\text{Earning Per Share}}$$

$$\text{No. of Equity Shares} = \frac{10,00,000}{100} = 10,000 \text{ Shares}$$

$$\text{EPS} = \frac{3,25,000 - 14,000}{10,000} = 31.10$$

$$\text{PER} = \frac{210}{31.10} = 6.75$$

10.7.8 Fixed Assets Turnover Ratio –

It indicates the frequency of fixed assets utilization.

a) $\text{Fixed Assets Turnover Ratio} = \dfrac{\text{Net Assets}}{\text{Fixed Assets}}$

b) Net Sales = Gross Sales minus Sales Return minus Allowances.

c) Fixed Assets includes assets acquired for long term use in the business and not for sale in ordinary course of business. For e.g. Goodwill, Land & Building, Plant & Machinery, Vehicles etc.

d) Significance - It indicates efficiency in or extend of utilization of fixed assets. Higher ratio indicates high degree of efficiency in utilization and low degree signifies vice-versa.

e) Example: **Fixed Assets Turnover Ratio -**

If sales are Rs.10,00,000/- and Fixed Assets are Rs.3,00,000/- calculate Fixed Assets.

$$\text{Turnover Ratio} = \frac{\text{Net Sales}}{\text{Fixed Assets}} = \frac{1,00,000}{3,00,000} = 3.33$$

10.7.9 Total Assets Turnover Ratio -

It shows the relationship between net sales and total assets.

a) $\text{Total Assets Turnover Ratio} = \dfrac{\text{Net Sales}}{\text{Total Assets}}$

b) Net Sales = Gross sales minus Returns minus Allowances.

c) Total Fixed Assets = Fixed Assets + Investment + Current Assets but excluding fictitious assets.

d) Significance - It indicates how efficiency assets are employed overall.

e) Example: **Total Assets Turnover Ratio -**

Total Assets = Fixed Assets + Current Assets
5,00,000 = 3,00,000 + 2,00,000

Turnover Rs.10,00,000/-

$$\text{Total Assets Turnover Ratio} = \frac{\text{Net Sales}}{\text{Total Assets}}$$

$$= \frac{10,00,000}{5,00,000}$$

$$= 20$$

10.7.10 Debt Service Ratio / Interest Coverage Ratio -

This ratio shows the relationship between earning before interest and interest on long term loans. The main purpose of this ratio is to find out the number of times the fixed interest charges are covered by the income before interest and tax.

a) $$\text{Debt Service Ratio} = \frac{\text{Net Profit before Interest \& Tax}}{\text{Fixed Interest Charges}}$$

b) Profit before interest & tax means the amount of net profit before interest and tax. Interest means the interest payable on loans.

c) Fixed interest charges mean interest on long term loans.

d) Significance - Its main purposed is to measure the interest paying capacity of the company.

e) Example: **Debt Service Ratio -**

Find out the Debt Service Ratio from the following details

a) Profit before interest and tax Rs.1,00,000/-

b) Interest payable Rs.25,000/-

$$\text{Debt Service Ratio} = \frac{\text{Profit before Interest \& Tax}}{\text{Interest}}$$

$$= \frac{1,00,000}{25,000}$$

$$= 4$$

10.7.11 Debt Service Coverage Ratio -

It shows the relationship between net profits and interest plus installments payable on loans. It is expressed as a pure number.

a) $$\text{Debt Service Coverage Ratio} = \frac{\text{Cash Profits available for debt servicing}}{\text{Interest} + \text{Installment due on loans}}$$

b) Cash profits available for debt servicing are calculated as follows:

   i) Net Profit after interest and Tax

   ii) (+) Non cash debits to Profit & Loss A/c

   (E.g. Depreciation, goodwill w/off, loss on sales of Fixed Assets etc)

   iii) Cash Profits for debt servicing.

c) Interest means interest on long term loans during the year.

   Installment means installments due on long term loans during the year.

d) Significance - This ratio indicates the company's ability to pay interest and principal amount on time as it indicates whether company is able to pay interest and repayment of loan out of earnings of the company. It is more useful for lender as it takes care of total repayment liability.

e) Example: **Debt Service Coverage Ratio**

Find out the Debt Service Coverage Ratio from the following details.

1) Profit after interest and tax Rs.2,50,000/-
2) Interest Payable Rs.25,000/-
3) Depreciation Rs.15,000/-
4) Loan installment payable during the year Rs.1,45,000/-.

$$\text{Debt Equity Ratio} = \frac{\text{Net Profit before Interest \& Tax}}{\text{Fixed Interest Charges}}$$

$$= \frac{2,50,000 + 15,000 + 25,000}{25,000 + 1,45,000}$$

$$= 1.70$$

10.7.12 Debtors Turnover Ratio / Debtors Velocity / Accounts Receivable Turnover -

This shows the relationship between net credit sales and average trade debtors. It is expressed as a rate.

a) $\text{Debtors Turnover Ratio} = \dfrac{\text{Net Credit Sales}}{\text{Debtors} + \text{Bills Receivables}}$

OR

$$\frac{\text{Credit Sales}}{\text{Average Account Receivable}}$$

b) Net Credit Sales = Gross Credit Sales minus Sales Returns

c) Debtors and bills receivable may be taken at the average of opening and closing amounts. If the details are not available only the closing balance may be considered.

d) Example: **Debtors Turnover Ratio -**

From the following information calculate the Debtors Turnover Ratio -

Net Credit Sales	7,30,000
Net Debtors	75,000
Net Bills Receivable	25,000

$$\text{Debtors Turnover Ratio} = \frac{\text{Credit Sales}}{\text{Debtors} + \text{Bills Receivable}}$$

$$= \frac{7,30,000}{1,00,000}$$

$$= 7.3 \text{ times}$$

10.7.13 Creditors Turnover Ratio –

This shows the relationship between the net credit purchases and the average trade creditors. This ratio is normally expressed as a "rate".

a) $\text{Creditor Turnover Ratio} = \dfrac{\text{Credit Purchases}}{\text{Average Accounts Payable}}$

OR

$$\frac{\text{Credit Purchases}}{\text{Creditors} + \text{Bills Payable}}$$

b) Net Credit Purchases = Gross Credit Purchases - Purchase Return - Allowances on Credit Purchases

c) Creditors and bills payable may be taken at the average of the opening and closing amount. If the details are not available, only the closing balance may be considered.

d) Example: **Credit turnover ratio.**

From the following information calculate the credit turnover ratio.

Net Credit Purchases	Rs. 1,00,000
Creditors	Rs. 20,000
Bills Payable	Rs. 5,000

$$\text{Creditor Turnover} = \frac{\text{Credit Purchases}}{\text{Creditors} + \text{BillsPayable}}$$

$$= \frac{1,00,000}{20,000 + 5,000}$$

$$= \frac{1,00,000}{25,000}$$

$$= 4 \text{ times}$$

10.7.14 Debt Collection Period –

This ratio gives average debt collection period and indicates the extend to each the debts have being collected in time.

a) $\text{Debt Collection Period} = \dfrac{\text{Number of days or months in a year}}{\text{Debtors Turnover Ratio}}$

b) Significance - It indicates credit and collection policy and it also indicates effectiveness of collection from debtors.

c) Example: **Debt Collection Period -**

Debt collection period is calculated from above illustration of the point **10.7.12**

$$\text{Debt Collection Period} = \frac{365}{\text{Debtors Turnover Ratio}}$$

$$= \frac{365}{7.33}$$

$$= 50 \text{ days.}$$

10.7.15 Creditors Payout Ratio -

This shows the relationship between Number of days or months in a year with the promptness in payment of credit purchases.

a) $\text{Creditor Payout Ratio} = \dfrac{\text{No. of day sin a year}}{\text{Creditor Turnover Ratio}}$

b) Significance - It should be compared with actual credit available from suppliers and whether the company is taking full benefit of the credit period allowed by creditors.

c) Example: **Credit Collection Period -**

It is calculated from above illustration No. 10.7.13

$$\text{Credit Collection Period} = \frac{365}{\text{Creditors Turnover Ratio}}$$

$$= \frac{365}{4}$$

$$= \frac{12}{4} \quad \text{91 days or 3 months.}$$

10.8 ADVANTAGES AND LIMITATIONS OF RATIO ANALYSIS

10.8.1 Advantages of Ratios Analysis:

Ratio analysis is an important and age-old technique of financial analysis. The following are some of the advantages / Benefits of ratio analysis:

1. **Simplifies financial statements:** It simplifies the comprehension of financial statements. Ratios tell the whole story of changes in the financial condition of the business

2. **Facilitates inter-firm comparison:** It provides data for inter-firm comparison. Ratios highlight the factors associated with with successful and unsuccessful firm. They also reveal strong firms and weak firms, overvalued and undervalued firms.

3. **Helps in planning:** It helps in planning and forecasting. Ratios can assist management, in its basic functions of forecasting. Planning, co-ordination, control and communications.

4. **Makes inter-firm comparison possible:** Ratios analysis also makes possible comparison of the performance of different divisions of the firm. The ratios are helpful in deciding about their efficiency or otherwise in the past and likely performance in the future.

5. **Help in investment decisions:** It helps in investment decisions in the case of investors and lending decisions in the case of bankers etc.

10.8.2 Limitations of Ratios Analysis:

The ratios analysis is one of the most powerful tools of financial management. Though ratios are simple to calculate and easy to understand, they suffer from serious limitations.

1. **Limitations of financial statements:** Ratios are based only on the information which has been recorded in the financial statements. Financial statements themselves are subject to several limitations. Thus ratios derived, there from, are also subject to those limitations. For example, non-financial changes though important for the business are not relevant by the financial statements. Financial statements are affected to a very great extent by accounting conventions and concepts. Personal judgment plays a great part in determining the figures for financial statements.

2. **Comparative study required:** Ratios are useful in judging the efficiency of the business only when they are compared with past results of the business. However, such a comparison only provide glimpse of the past performance and forecasts for future may not prove correct since several other factors like market conditions, management policies, etc. may affect the future operations.

3. Ratios alone are not adequate: Ratios are only indicators, they cannot be taken as final regarding good or bad financial position of the business. Other things have also to be seen.

4. **Problems of price level changes:** A change in price level can affect the validity of ratios calculated for different time periods. In such a case the ratio analysis may not clearly indicate the trend in solvency and profitability of the company. The financial statements, therefore, be adjusted keeping in view the price level changes if a meaningful comparison is to be made through accounting ratios.

5. Lack of adequate standard: No fixed standard can be laid down for ideal ratios. There are no well accepted standards or rule of thumb for all ratios which can be accepted as norm. It renders interpretation of the ratios difficult.

6. **Limited use of single ratios:** A single ratio, usually, does not convey much of a sense. To make a better interpretation, a number of ratios have to be calculated which is likely to confuse the analyst than help him in making any good decision.

7. **Personal bias:** Ratios are only means of financial analysis and not an end in itself. Ratios have to interpreted and different people may interpret the same ratio in different way.

8. **Incomparable:** Not only industries differ in their nature, but also the firms of the similar business widely differ in their size and accounting procedures etc. It makes comparison of ratios difficult and misleading.

10.9 EXERCISE

1. Explain the advantages and limitations of ratio analyses.
2. Briefly explain the classification of Ratios.
3. Give significance of Following Ratios:
   - Proprietors ratio
   - Debt Equity ratio
   - Gross profit ratio
   - Stock turnover ratio
   - Earnings per share
   - Creditors payout ratio
4. Give formula of the ratio:
   - Current Assets
   - Quick liabilities
   - Proprietors fund
   - Capital gearing ratio
   - Net profit before tax
   - Capital employed
   - Total Assets

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11

RATIO ANALYSES-II

Unit Structure:

11.0 OBJECTIVES

After studying the unit the students will be able to solve the practical problems on Ratio analyses.

11.1 SOLVED PROBLEMS

Q.1 The following are summarized Profit and Loss Account for the year ending 31st March, 2005 and the Balance Sheet as on that date of A Ltd.

Profit & Loss Account

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To Opening Stock To Purchases To Gross Profit	10,000 55,000 50,000	By Sales By Closing Stock	1,00,000 15,000
	1,15,000		1,15,000
To Administrative Expenses To Interest To Selling Expenses To Net Profit	15,000 3,000 12,000 20,000	By Gross Profit	50,000
	50,000		50,000

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Share Capital (Rs.10/- each)	1,00,000	Land & Building	50,000
		Plant & Machinery	30,000
Profit & Loss Account	20,000	Stock	15,000
Creditors	25,000	Debtors	15,000
Bills Payable	15,000	Bills Receivable	12,500
		Cash & Bank	17,500
		Furniture	20,000
	1,60,000		1,60,000

Average Debtors Rs.12,500/-

Credit Purchases Rs.40,000/-

Credit Sales Rs.80,000/-

Calculate –

(i) Stock Turnover Ratio (ii) Debtors turnover ratio,

(iii) Creditors turnover ratio, (iv) Working Capital turnover ratio,

(v) Sales to Capital employed, (vi) Return on shareholders funds,

(vii) Gross Profit Ratio, (viii) Net Profit ratio,

(ix) EPS, (x) Operating ratio.

Solution :

i) Stock turnover ratio $= \dfrac{\text{Cost of goods sold}}{\text{AverageStock}}$

$$= \frac{50,000 \text{ [Sales – G.P.]}}{10,000 + 15,000 / 2}$$

$$= \frac{50,000}{12,500}$$

= 4 times

ii) Debtors turnover ratio $= \dfrac{\text{Credit Sales}}{\text{Average Debtors}}$

$$= \frac{80,000}{12,500}$$

$= 6.4$ times

iii) Creditors turnover ratio $= \dfrac{\text{Credit Purchases}}{\text{Average Accounts Payable}}$

$= \dfrac{40,000}{40,000\ [\text{Crs} + \text{B.P.}]}$

$= 1$ time

iv) Sales to Capital employed $= \dfrac{\text{Sales}}{\text{(working Capital)}}$
$[\text{Current Assets} - \text{Current Liabilities}]$

$= \dfrac{1,00,000}{20,000}$

$= 5$ times

v) Sales to Capital Employed $= \dfrac{\text{Sales}}{\text{Capital employed}} \times 100$

$= \dfrac{1,00,000}{\underset{(\text{Equity})}{1,00,000} + \underset{(\text{P\&L A/c})}{20,000}}$

$= \dfrac{1,00,000}{1,20,000}$

$= 83 : 1$

vi) Returns on Shareholders funds $= \dfrac{\text{Net Profit}}{\text{Shareholders funds}} \times 100$

$= \dfrac{20,000}{1,20,000} \times 100$

$= 16.67\ \%$

vii) Gross Profit Ratio $= \dfrac{\text{Gross Profit}}{\text{Sales}} \times 100$

$= \dfrac{50,000}{1,00,000} \times 100$

$= 50\ \%$

viii) Net Profit Ratio $= \dfrac{\text{Net Profit}}{\text{Sales}} \times 100$

$= \dfrac{20,000}{1,00,000} \times 100$

$= 20\ \%$

ix) EPS $= \dfrac{\text{Net Profit}}{\text{No. of Equity Shares}}$

$= \dfrac{20{,}000}{10{,}000}$

$= \text{Rs.}2/-$

x) Operating ratio $= \dfrac{\text{Cost of Good Sold} + \text{Operation Expenses}}{\text{Sales}}$

$= \dfrac{50{,}000 + 27{,}000 \times 100}{1{,}00{,}000}$

$= 77\ \%$

Q.2 From the following information, you are required to prepare a Balance Sheet.

Particulars	Rs.
Working Capital	75,000
Reserves and Surplus	1,00,000
Bank Overdraft	60,000
Current Ratio	1.75
Liquid Ratio	1.75
Fixed assets to proprietors' Funds	.75
Long-term liabilities	Nil

Solution :

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Share capital	2,00,000	Fixed Assets	2,25,000
Reserves & Surplus	1,00,000	Stock	60,000
Bank Overdraft	60,000	Debtors and Cash	1,15,000
Creditors	40,000		
	4,00,000		4,00,000

Workings :

1. Current Assets

Current Ratio = 1.75

Working Capital should be = .75

$$\text{Working Capital} \times \frac{175}{75} = \text{Rs.}75{,}000 \times \frac{175}{75} = \text{Rs.}1{,}75{,}000$$

2. **Liquid Assets (Debtors and Cash)**

   Liquid Ratio – 1.15

   If current assets are 175 liquid assets should be 115

$$\text{Current Assets} \times \frac{175}{175} = \text{Rs.}1{,}75{,}000 \times \frac{115}{175} = \text{Rs.}1{,}15{,}000$$

3. **Stock**

   Current Assets – Liquid Assets

   = Rs.1,75,000 – Rs.1,15,000

   = Rs.60,000

4. **Fixed Assets**

   Shareholders' Equity should be equal to total net assets.

   Proprietory ratio – 7.5

   If fixed assets are 75 to proprietors' funds, net current assets should be 25 of the total net assets.

$$\text{Net Current Assets} \times \frac{75}{25} = \text{Rs.}75{,}000 \times \frac{75}{25} = \text{Rs.}2{,}25{,}000$$

5. **Shareholders' Funds**

   If fixed assets are 75 shareholders' funds should be 100

$$\text{Fixed Assets} \times \frac{100}{75} = \text{Rs.}2{,}25{,}000 \times \frac{100}{75} = \text{Rs.}3{,}00{,}000$$

   Share Capital = Shareholder's Funds – Reserves and Surplus

   Rs.3,00,000 – 1,00,000 = Rs.2,00,000

6. **Creditors**

   Current assets – Working Capital – Bank Overdraft

   Rs.1,75,000 – 75,000 – 60,000 = Rs.40,000

Q.3 From the following Balance Sheet of Tara Ltd. calculate Long Term Debt Equity, Proprietory, Capital Gearing, Stock Working Capital Ratios.

Liabilities	Rs.	Assets	Rs.
Equity Share Capital	2,00,000	Land and Building	1,40,000
8% Preference Share Capital	60,000	Plant & Machinery	80,000
Reserves	30,000	Furniture & Fixtures	20,000
Profit & Loss A/c	20,000	Debtors	80,000
9% Debentures	40,000	Stock	70,000
Creditors	60,000	Cash in hand	30,000
Outstanding Exp	5,000	Prepaid Expenses	10,000
Provision for Taxation	20,000	Preliminary Expenses	20,000
Proposed Dividend	15,000		
	4,50,000		4,50,000

Solution :

Vertical Balance Sheet of Tara Ltd.

Particulars	Amt	Amt	Amt
I. SOURCES OF FUNDS			
1. Proprietors' Fund :			
a) Equity Share Capital (EC)		2,00,000	
b) Reserves & Surplus			
Reserves	30,000		
Profit & Loss A/c	20,000		
	50,000		
c) Less : Preliminary Exp. (PC)	(20,000)		
(RS)		30,000	
(EF)		2,30,000	
d) 8% Preference Share Capital		60,000	
Proprietors' Funds (PF)			2,90,000
2. Loan Funds :			
9% Debentures			40,000
Capital Employed (CE)			**3,30,000**

II. APPLICATION OF FUNDS			
1. Fixed Assets			
Land & Building		1,40,000	
Plant & Machinery		80,000	
Furniture & Fixtures		20,000	
(FA)			2,40,000
2. Working Capital			
a) Current Assets			
Debtor	80,000		
Cash-in-hand	30,000		
Stock (CST)	70,000		
Prepaid Expenses	10,000		
(CA)		1,90,000	
b) Current Liabilities			
Creditors	60,000		
Outstanding Expenses	5,000		
Provision for Taxation	20,000		
Proposed Dividend	15,000		
(CL)		(1,00,000)	
Working Capital (WC)			90,000
Capital Employed (CE)			**3,30,000**

1) Long Term Debt Equity $= \dfrac{\text{Long Term Debt}}{\text{Shareholder's Fund}} = \dfrac{BF}{PF}$

$= \dfrac{40,000}{2,90,000}$

$= 0.14 : 1$

2) Proprietory Ratio $= \dfrac{\text{Proprietor's Funds}}{\text{Total Assets}} \times 100$

$= \dfrac{PF}{TA} \times 100$

$= \dfrac{2,90,000}{4,30,000} \times 100$

$= 67.44\%$

TA = FA + CA = 2,40,000 + 1,90,000 = 4,30,000

3) Capital Gearing Ratio $= \dfrac{\text{Capital Entitled to Fixed Rate of Dividend / Interest}}{\text{Other Capital}}$

$= \dfrac{PC + BF}{EF}$

$= \dfrac{\text{Preference Capital} + \text{Debentures} + \text{Long Term Loans}}{\text{Equity Capital} + \text{Net Reserves} - \text{Preliminary Expenses}}$

$= \dfrac{60,000 + 40,000}{2,30,000}$

$= \dfrac{1,00,000}{2,30,000} = 0.43 : 1$

4) Stock Working Capital Ratio $= \dfrac{\text{Stock}}{\text{Working Capital}} \times 100$

$= \dfrac{CST}{WC} \times 100$

$= \dfrac{70,000}{90,000} \times 100$

$= 77.78\%$

Q.4 X Ltd. and Y Ltd. are in the same line of business. Following are their Balance Sheets as on 31st December 2003.

Balance Sheet as on 31st December, 2003

Liabilities	X Ltd. (Rs.)	Y Ltd. (Rs.)	Assets	X Ltd. (Rs.)	Y Ltd. (Rs.)
Equity Share Capital	7,00,000	2,00,000	Land	1,00,000	80,000
Reserve & Surplus	1,00,000	1,00,000	Building	2,50,000	2,00,000
12% Debentures	2,00,000	5,00,000	Plant & Machinery	5,00,000	3,00,000
Creditors	1,20,000	70,000	Debtors	2,10,000	1,10,000
Bills Payable	40,000	20,000	Stock	1,00,000	2,00,000
Proposed Dividend	20,000	20,000	Cash & Bank	55,0000	40,000
Provision for Tax	35,000	20,000			
	12,15,000	9,30,000		12,15,000	9,30,000

You are required to rearrange the Balance Sheets (in Vertical form) and calculate the following ratios for both the companies (any three)

a) Proprietory Ratio   b) Capital – Gearing Ratio

c) Current Ratio   d) Stock Working Capital Ratio

(Mar 2003, adapted)

Solution :

Balance Sheet as on 31st December, 2003

Particulars		Amt	Amt
I. SOURCES OF FUNDS			
1. Shareholders Fund			
a) Share Capital		7,00,000	2,00,000
b) Reserves & Surplus		1,00,000	1,00,000
Proprietors' Funds (A+B)	(PF/EF)	8,00,000	3,00,000
2. Borrowed Funds :			
12% Debentures	(BF)	2,00,000	5,00,000
Total Funds Available	**(1 + 2)**	**10,00,000**	**8,00,000**
II. APPLICATION OF FUNDS			
1. Fixed Assets			
Land		1,00,000	80,000
Building		2,50,000	2,00,000
Plant & Machinery		5,00,000	3,00,000
	(FA)	8,50,000	5,80,000
2. Working Capital			
Current Assets			
Debtor		2,10,000	1,10,000
Cash & Bank		55,000	40,000
Stock	(CST)	1,00,000	2,00,000
	(CA)	3,65,000	3,50,000
Current Liabilities			
Creditors		1,20,000	70,000
Bills Payable		40,000	20,000
Proposed Dividend		20,000	20,000
Provision for Tax		35,000	20,000
	(CL)	2,15,000	1,30,000
Working Capital (CA – CL)	(WC)	1,50,000	2,20,000
Total Funds Employed	**(1 + 2 + 3)**	**10,00,000**	**8,00,000**

Calculation of Ratios:

No.	Ratios	X Ltd.	Y Ltd.
1	**Proprietory Ratio** $= \frac{\text{Proprietors' Funds}}{\text{Total Assets}} \times 100$ $= \frac{PF}{TA} \times 100$ [TA = FA – CA]	$= \frac{8,00,000}{12,15,000} \times 100$ = 65.84 %	$= \frac{3,00,000}{9,30,000} \times 100$ = 32.26 %
2	**Capital Gearing Ratio** $= \frac{\text{Capital Entitled to Fixed Yield}}{\text{Capital not so Entitled to any Fixed Yield}}$ $= \frac{PC + BF}{EF}$	$= \frac{2,00,000}{8,00,000}$ = 0.25 : 1	$= \frac{5,00,000}{3,00,000}$ = 1.67 : 1
3	**Current Ratio** $= \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{CA}{CL}$	$= \frac{3,65,000}{2,15,000}$ = 1.70 : 1	$= \frac{3,50,000}{1,30,000}$ = 2.69 : 1
4	**Stock Working Capital Ratio** $= \frac{\text{Stock}}{\text{Working Capital}} \times 100$ $= \frac{CST}{WC} \times 100$	$= \frac{1,00,000}{1,50,000} \times 100$ = 66.67 %	$= \frac{2,00,000}{2,20,000} \times 100$ = 90.90 %

Q.5 Following figures have been extracted from the book of Voodoo Ltd.

Particulars	Rs.	Particulars	Rs.
Land and Building	6,00,000	Misc. Current Assets	5,000
Plant and Machinery	5,00,000	P&L Acccount	2,00,000
Equity Capital	5,00,000	General Reserves	1,00,000
Preference Capital	2,00,000	Sundry Creditors	80,000
Stock	2,40,000	Bills Payable	60,000
Debtors	2,00,000	Misc. Current Liabilities	60,000
Cash and Bank	55,000	Debentures	4,00,000

You are required to –

a) Rearrange above figures in the vertical form and

b) Calculate – (i) Debt-Equity Ratio (ii) Proprietory Ratio (iii) Capital Gearing Ratio.

(April 98, adapted)

Solution :

Balance Sheet of Voodoo Ltd. as on ……

Particulars		Amt		Amt
I. SOURCES OF FUNDS				
1. Proprietors' Fund				
a) Equity Share Capital	(EC)		5,00,000	
b) P&L Account			2,00,000	
c) General Reserve			1,00,000	
Equityholders' Funds (A+B)	(EF)		8,00,000	
d) Preference Capital	(PC)		2,00,000	
Proprietors Funds	(PF)			10,00,000
2. Borrowed Funds :				
Debentures	(BF)			4,00,000
Capital Employed (1 + 2)	**(CE)**			**14,00,000**
II. APPLICATION OF FUNDS				
1. Fixed Assets				
Land & Building			6,00,000	
Plant & Machinery			5,00,000	
	(FA)			11,00,000
2. Working Capital				
Debtors		2,00,000		
Cash / Bank		55,000		
Misc. Current Assets		5,000		
Stock	(CST)	2,40,000		
Current Assets	(CA)		5,00,000	
Sundry Creditors		80,000		
Bills Payable		60,000		
Misc. Current Liabilities		60,000		
Current liabilities	(CL)		2,00,000	
Working Capital	(WC)			3,00,000
Capital Employed (1 + 2)	**(CE)**			**14,00,000**

1) Debt – Equity Ratio $= \dfrac{\text{Borrowed Fund}}{\text{Proprietors' Fund}} = \dfrac{BF}{PF}$

$= \dfrac{4,00,000}{10,00,000} = 0.4$

OR

$= \dfrac{\text{Borrowed Fund}}{\text{Borrowed Fund} + \text{Proprietor's Fund}}$

$= \dfrac{BF}{BF + PF} = \dfrac{4,00,000}{14,00,000} = 0.29$

2) Proprietory Ratio $= \dfrac{\text{Proprietors' Fund}}{\text{Total Assets}} \times 100$

$= \dfrac{PF}{TA} \times 100$

$= \dfrac{10,00,000}{*16,00,000} \times 100 = 62.50\ \%$

3) Capital Gearing Ratio $= \dfrac{\text{Capital Entitled to Fixed Rate of Dividend / Interest}}{\text{Other Capital}}$

$= \dfrac{PC + BF}{EF} = \dfrac{6,00,000}{8,00,000} = 0.75 : 1$

* Note : Total Assets = Fixed Assets + Current Assets

= 11,00,000 + 5,00,000

= 16,00,000

Q.6 Following is the Balance Sheet of Roland Ltd.

Balance Sheet as on 31st March, 2004

Liabilities	Rs.	Assets	Rs.
Equity Share Capital	1,00,000	Cash in hand	2,000
6% Preference Share		Cash at Bank	10,000
Capital	1,00,000	Bills Receivable	30,000
7% Debentures	40,000	Debtors	70,000
8% Public Deposits	20,000	Stock	40,000
Bank Overdraft	40,000	Advances	20,000

Creditors	60,000	Furniture	30,000
Unpaid Dividend	10,000	Machinery	1,00,000
Outstanding Exp.	7,000	Land & Building	2,20,000
Reserves	1,50,000	Goodwill	30,000
Provision for Tax	20,000	Preliminary Expenses	10,000
Profit & Loss Account	20,000	Calls in Arrears in Equity Shares	5,000
	5,67,000		5,67,000

Convert the above Balance Sheet in vertical form and calculate – (i) Current Ratio (ii) Quick Ratio (iii) Proprietary Ratio (iv) Capital Gearing Ratio (v) Stock Working Capital Ratio.

(Oct. 01, adapted)

Solution :

Vertical Balance Sheet as on 31st March, 2003

Particulars		Amt	Amt	Amt
I. SOURCES OF FUNDS				
1. Owners' Fund				
a) Equity Share Capital				
Equity Share Capital		1,00,000		
Less : Calls-in-arrears		(5,000)		
	(EC)		95,000	
b) Reserves and Surplus				
Reserve		1,50,000		
Profit & Loss Account		20,000		
		1,70,000		
c) Less : Preliminary Exp.		(10,000)		
Reserves & Surplus	(RS)		1,60,000	
Equityholders' Funds	(EF)		2,55,000	
d) 6% Preference Capital	(PC)		1,00,000	
Proprietors Funds	(PF)			3,55,000
2. Borrowed Funds :				
a) Secured Loans				
7% Debentures			40,000	
b) Unsecured Loans				
8% Public Deposit			20,000	
	(BF)			60,000
Capital Employed (1 + 2)	**(CE)**			**4,15,000**

II. APPLICATION OF FUNDS				
1. Fixed Assets				
Goodwill		30,000		
Land & Building		2,20,000		
Machinery		1,00,000		
Furniture		30,000		
	(FA)			3,80,000
2. Working Capital				
a) Current Assets				
Cash-in-hand		2,000		
Cash at Bank		10,000		
Bills Receivable		30,000		
Debtors		70,000		
Advances		20,000		
	(QA)	1,32,000		
	(CST)	40,000		
	(CA)		1,72,000	
b) Current liabilities				
Creditors		60,000		
Unpaid Dividend		10,000		
Outstanding Expenses		7,000		
Provision for Tax		20,000		
	(QL)	97,000		
Bank Overdraft		40,000		
	(CL)		1,37,000	
Working Capital	(WC)			35,000
Capital Employed (1 + 2)	**(CE)**			**4,15,000**

Calculation of Ratios :

1) Current Ratio $= \dfrac{\text{Current Assets}}{\text{Current Liabilities}} = \dfrac{CA}{CL}$

$$= \frac{1{,}72{,}000}{1{,}37{,}000} = 1.26 : 1$$

2) Quick Ratio $= \dfrac{\text{Quick Assets}}{\text{Quick Liabilities}} = \dfrac{QA}{QL}$

$$= \frac{1{,}32{,}000}{97{,}000} = 1.36 : 1$$

3) Proprietory Ratio $= \frac{\text{Proprietor's Funds}}{\text{Total Assets}} \times 100$

$= \frac{PF}{TA} \times 100$

$= \frac{\text{Proprietors' Fund}}{\text{Fixed Assets} + \text{Current Assets}} \times 100$

$= \frac{3,55,000}{5,52,000} = 64.31\%$

4) Capital Gearing Ratio $= \frac{\text{Capital Entitled to Fixed Rate of Interest or Dividend}}{\text{Capital not so entitled to Fixed Rate of Dividend}}$

$= \frac{PC + BF}{EF}$

$= \frac{1,60,000}{2,55,000} = 0.63 : 1$

5) Stock Working Capital Ratio $= \frac{\text{Stock}}{\text{Working Capital}} \times 100$

$= \frac{40,000}{35,000} \times 100 = 114.29\%$

Q.7 From the following given below prepare Balance Sheet in a vertical form, suitable for analysis and calculate the following ratios:

a) Capital Gearing Ratio
b) Proprietory Ratio
c) Current Ratio
d) Liquid Ratio
e) Stock to Working Capital

(Oct. 06, adapted)

Particulars	Rs.	Particulars	Rs.
Cash at Bank	12,500	Land & Building	2,00,000
Expenses paid in Advance	15,500	Stock	68,250
Creditors	1,01,500	Debtors	1,30,750
Bills Receivable	5,250	Plant & Machinery	1,36,000
12% Debentures	62,500	Loan from Director	1,00,000
Equity Share Capital	2,50,000	(Repayable after three years)	
Profit & Loss A/c (Cr.)	54,250		
	5,67,000		5,67,000

Solution:

Vertical Balance Sheet as on …

Particulars	Amt	Amt	Amt
I. SOURCES OF FUNDS			
1. Shareholder's Fund			
a) Share Capital			
Equity Share Capital		2,50,000	
b) Reserves and Surplus			
Profit & Loss Account – Cr. bal		54,250	
Own fund / Net Worth (A + B)			3,04,250
2. Loan Funds :			
a) Secured Loans			
12% Debentures		62,500	
b) Unsecured Loans			
Loan from Directors (Repayable for		1,00,000	
3 years)			1,62,500
Total Funds Available (1 + 2)			**4,66,750**
II. APPLICATION OF FUNDS			
1. Fixed Assets			
A. Tangible Assets	2,00,000		
Land & Building	1,36,000		
Plant & Machinery	3,36,000		
B. Intangible Assets	NIL	3,36,000	
2. Long Term Investments		NIL	
Total Fixed Assets			3,36,000
3. Working Capital			
A. Current Assets			
a. Quick Assets			
Cash at Bank	12,500		
Bills Receivable	5,250		
Debtors	1,30,750		
Total Quick Assets		1,48,500	
b. Non-Quick Assets			
Expenses paid in Advance	15,500		
Stock	68,250	83,750	
Total Current Assets		2,32,250	
B. Less : Current Liabilities			
a. Quick Liabilities			
Creditors	1,01,500		
b. Non-Quick Liabilities	NIL		
Total Current Liabilities		1,01,500	
Working (A – B)			1,30,750
Total Funds Employed (2 + 3)			**4,66,750**

Ratios :

a) Capital Gearing Ratio $= \dfrac{\text{Capital Entitled to Fixed Rate of Interest or Dividend}}{\text{Capital not so entitled to Fixed Rate of Dividend}}$

$$= \frac{\text{Preference Share Capital} + \text{Borrowed Funds}}{\text{Equity Share Capital} + \text{Reserves} - \text{Misc. Expenses}}$$

$$= \frac{1{,}62{,}500}{2{,}50{,}000 + 54{,}250}$$

$$= \frac{1{,}62{,}500}{3{,}04{,}250} = 0.534 : 1$$

b) Proprietory Ratio $= \dfrac{\text{Shareholders Funds}}{\text{Total Assets}}$

$$= \frac{3{,}04{,}250}{5{,}68{,}250} = 0.535 : 1$$

Total Assets = Fixed Assets + Investment + Current Assets

= 3,36,000 + Nil + 2,32,250 = Rs.5,68,250

c) Current Ratio $= \dfrac{\text{Current Assets}}{\text{Current Liabilities}}$

$$= \frac{2{,}32{,}250}{1{,}01{,}500} = 2.288 : 1$$

d) Liquid Ratio $= \dfrac{\text{Quick Assets}}{\text{Quick Liabilities}}$

$$= \frac{1{,}48{,}500}{1{,}01{,}500} = 1.463 : 1$$

e) Stock to Working Capital $= \dfrac{\text{Stock}}{\text{Working Capital}}$

$$= \frac{68{,}250}{1{,}30{,}750} = 0.522 : 1$$

Q.8 (A) Following is the Profit and Loss Account of Saurav Limited for the year ended 31st March, 2003. You are required to prepare Vertical Income Statement for the purpose of analysis.

Particulars	Rs.	Particulars		Rs.
To Opening Stock	700	By Sales		
To Purchases	900	Cash	520	
To Wages	150	Credit	1,500	
To Factory Expenses	350		2,020	
To Office Salaries	25	Less : Returns &		
To Office Rent	39	Allowances	20	2,000
To Postage & Telegram	5	By Closing Stock		600
To Directors Fee	6	By Dividend on		
To Salesmen Salaries	12	Investment		10
To Advertising	18	By Profit on Sale of		
To Delivery Expenses	20	Furniture		20
To Debenture Interest	20			
To Depreciation				
On Office Furniture	10			
On Plant	30			
On Delivery Van	20			
To Loss on Sales of Van	5			
To Income Tax	175			
To Net Profit	145			
	2,630			**2,630**

(B) From the above Vertical Income Statement Calculate: (i) Gross Profit Ratio, (ii) Operating Costs Ratio excluding Finance expenses (iii) Stock Turnover Ratio.

(Oct. 2003, adapted)

Solution :

Vertical Income Statement for the year ended 31st March, 2003

Particulars		Rs.	Rs.
Credit Sales	CRS	1,500	
Cash Sales		520	
Less : Returns		(20)	
1. Total Sales	S		2,000
Opening Stock	OST	700	
Purchases	CRP	900	
Factory Expenses		350	

Wages		150	
Depreciation : Machinery		30	
Less : Closing Stock	(CST)	(600)	
2. Cost of Goods Sold	COGS		1,530
3. Gross Profit	GP		470
4. Administration Expenses			
Office Rent		39	
Salaries		25	
Postage		5	
Depreciation		10	
Directors Fees		6	
	AE		85
5. Selling Expenses			
Salaries		12	
Advertising		18	
Depreciation		20	
Delivery Expenses		20	
	SE		70
6. Operating Expenses	OE		155
7. Operating Profit [GP – OE]	OP		315
Dividend		10	
Profit on Sale of Furniture		20	
Loss on Sale of Van		(5)	
8. Net Non-Operating Profit / Loss	NO		25
9. Profit before Interest & Tax	PBIT		340
Interest on Debentures	INT		20
10. Net Profit Before Tax	NPBT		320
Income Tax			175
11. Net Profit After Tax	NPAT		145
Preference Dividends			0
12. Profit Av. For Equityholders	PAES		145
Equity Dividends	ED		0
13. Retained Earnings	RET		145

Calculation of Ratios :

i) Gross Profit Ratio $= \dfrac{\text{Gross Profit}}{\text{Net Sales}} \times 100\,\text{Gr}$

$= \dfrac{470}{2{,}000} \times 100 = 23.5\%$

ii) Operating Cost Ratio $= \dfrac{\text{Operating Cost}}{\text{Net Sales}} \times 100$

$= \dfrac{1{,}685}{2{,}000} \times 100 = 84.25\%$

Operating Cost = Cost of Sales + Operating Expenses

= 1,530 + 175 = 1,705

iii) Stock Turnover Ratio $= \dfrac{\text{Cost of Goods Sold}}{\text{Average Stock}}$

$= \dfrac{1{,}530}{650} = 2.35$ Times

Average Stock $= \dfrac{\text{Opening Stock} + \text{Closing Stock}}{2}$

$= \dfrac{700 + 600}{2} = 650$

Q.9 The following figures relate to the trading activities of Z Ltd., for the year ended 31st March 2003.

Particulars	Rs.
Sales	10,57,000
Closing Stock	4,60,000
Purchases	8,35,000
Loss on Sales of Assets	45,000
Advertising	32,750
Rent	18,750
Profit on Sale of Shares	25,000
Provision for taxation	1,00,000
Salaries	35,750
Salesmen's Salaries	14,250
Depreciation	36,000
Sales Returns	57,000
Depreciation on Delivery Van	8,000
Printing and Stationery	17,500
Audit Fees	12,000
Opening Stock	2,25,000
Dividend received on Shares	15,000

You are required to rearrange above income statement in vertical form and compute the following ratios.

a) Gross Profit Ratio,

b) Operating Ratio

c) Net Operating Profit Ratio

d) Selling and Distribution Expenses to Sales Ratio

e) Net Profit Ratio **(Oct. 96 adapted)**

Solution :

Vertical Income Statement for the year ended 31-03-2003

Particulars		Rs.	Rs.	Rs.
1. Gross Sales			10,57,000	
2. Returns			57,000	
3. Net Sales (1 – 2)	S			10,00,000
4. Less : Cost of Goods Sold				
a) Opening Stock			2,25,000	
b) add : Purchases			8,35,000	
c) Less : Closing Stock			(4,60,000)	
	COGS			6,00,000
5. Gross Profit (3 – 4)	GP			4,00,000
6. Less :				
a) Operating Expenses				
Administrative Expenses :				
Rent		18,750		
Salaries		35,750		
Depreciation		36,000		
Printing & Stationery		17,500		
Audit Fees		12,000		
	AE		1,20,000	
b) Selling and Distribution Expenses				
Advertisement		32,750		
Salesman Salaries		14,250		
Depreciation of Delivery Vans		8,000		
	SE		55,000	
Operating Expenses	OE			1,75,000
7. Operating Net Profit (5 – 6)	OP			2,25,000
8. Add : Non-operating Income				
Profit on Sale of Shares			25,000	
Dividend on Shares			15,000	40,000
9. Less : Non-Operating Expenses				2,65,000
Loss on Sale of Assets				45,000
10. Net Profit before Tax (7 + 8 – 9)	NPBT			2,20,000
11. Less : Provision for Taxation	IT			1,00,000
12. Net Profit after Tax (10 – 11)	NPAT			1,20,000

a) Gross Profit Ratio $= \frac{\text{G.P.}}{\text{Net Sales}} \times 100$

$= \frac{4,00,000}{10,00,000} \times 100 = 40\%$

b) Operating Ratio $= \frac{\text{COGS} + \text{OE}}{\text{Net Sales}} \times 100$

$= \frac{7,75,000}{10,00,000} \times 100 = 77.50\%$

c) Net Operating Profit Ratio

$$= \frac{\text{Operating N. P.}}{\text{Net Sales}} \times 100 = \frac{2,25,000}{10,00,000} \times 100 = 22.50\%$$

d) Selling & Distr. Exp. to Sales Ratio

$$= \frac{\text{Selling \& Dist. Expenses}}{\text{Net Sales}} \times 100$$

e) Net Profit Ratio = $\frac{\text{Net Profit Before Tax}}{\text{Sales}} \times 100 = \frac{2,20,000}{10,00,000} \times 100$

$= 22\%$

Compute Various Ratios

Q.10 (Two Companies)

The summarised final accounts of two companies are as follows:

Balance Sheet

Liabilities	X Ltd. Rs.	Y Ltd. Rs.	Assets	X Ltd. Rs.	Y Ltd Rs.
Share Capital	88,000	88,000	Fixed Assets	1,21,000	96,800
Reserves	42,900	35,200	Current Assets	1,25,400	1,03,400
8% Debentures	22,000	22,000	Less: Current Liabilities	93,500	55,000
	1,52,900	**1,45,200**		**1,52,900**	**1,45,200**

Revenue Statement for the year

Particulars	X Ltd. Rs.	Y Ltd. Rs.
Sales	3,30,000	2,64,000
Less: Cost of Sales	2,37,600	1,98,000
Gross Profit	**92,400**	**66,000**
Less: Operating Expenses	63,800	44,000
Net Profit before Tax	28,600	22,000
Less: Tax	12,100	9,240
Profit after Tax	**16,500**	**12,760**
Less: Dividend	8,800	6,600
Retained Earning	**7,700**	**6,160**

You are required to calculate the following ratios:

(1) Proprietory ratio (2) Capital gearing ratio (3) Gross profit ratio (4) Operating ratio (5) Return on capital employed ratio (6) Return on proprietor's equity ratio (7) Expenses ratio (8) Net profit ratio.

(Apr. 95, adapted)

Solution:

Vertical Balance Sheet

Particulars		X Ltd.		Y Ltd.	
		Rs.	Rs.	Rs.	Rs.
i) **Sources of Funds**					
a. Equity Capital	EC	88,000		88,000	
b. Reserves	RS	42,900		35,200	
1. Equity Funds	EF/PF		1,30,900		1,23,200
2. Borrowed Funds					
8% Debentures	BF		22,000		22,000
Capital Employed	CE		**1,52,900**		**1,45,200**
ii) **Application of Funds**			1,21,000		96,800
1. Net Fixed Assets	FA				
2. Working Capital					
a. Current Assets	CA	1,25,400		1,03,400	
b. Less: Current Liabilities	CL	93,500		55,000	
	WC		31,900		48,400
Capital Employed	CE		**1,52,900**		**1,45,200**

No	Ratio	X Ltd.	Y Ltd.
(1)	**Proprietory Ratio** $=\frac{\text{Proprietors Funds}}{\text{Total Assets}}\times 100$ $=\frac{PF}{TA}\times 100$ **Note:** TA = FA + CA or CE + CL	$=\frac{88,000+42,900}{1,21,000+1,25,400}\times 100$ $=\frac{1,30,900}{2,46,400}\times 100=53\%$	$=\frac{88,000+35,200}{96,800+1,03,400}\times 100$ $=\frac{1,23,200}{2,00,200}\times 100$ $=62\%$
(2)	**Capital Gearing Ratio** $=\frac{\text{Capital Entitled to Fixed Interest/ Dividend}}{\text{Capital not so Entitled}}$ $=\frac{PC+BF}{EF}$	$=\frac{22,000}{88,000+42,900}$ $=\frac{22,000}{1,30,900}$ = 0.17:1	$=\frac{22,000}{88,000+35,200}$ $=\frac{22,000}{1,23,200}=0.18:1$
(3)	**Gross Profit Ratio** $=\frac{\text{Gross Profit}}{\text{Sales}}\times 100$ $=\frac{GP}{S}\times 100$	$=\frac{92,400}{3,30,000}\times 100=28\%$	$=\frac{66,000}{2,64,000}\times 100=25\%$
(4)	**Operating Ratio** $=\frac{COGS+OE}{\text{Sales}}\times 100$	$=\frac{2,37,600+63,800}{3,30,000}\times 100$ $=\frac{3,01,400}{3,30,000}\times 100$ $=91.33\%$	$=\frac{1,98,000+44,000}{2,64,000}\times 100$ $=\frac{2,42,000}{2,64,000}\times 100$ $=91.67\%$
(5)	**Return on Capital Employed Ratio** $=\frac{PBIT}{\text{Capital Employed}}\times 100$	$=\frac{28,600}{1,52,900}\times 100$ $=18.71\%$	$=\frac{22,000}{1,45,200}\times 100$ $=15.15\%$
(6)	**Return on Proprietors Equity Ratio** $=\frac{N.P.A.T}{\text{Proprietors Equity (Fund)}}\times 100$	$=\frac{16,500}{1,30,900}\times 100$ $=12.61\%$	$=\frac{12,760}{1,23,200}\times 100$ $=10.36\%$

(7)	**Expenses Ratio** (a) $\frac{COGS}{Sales} \times 100$	$= \frac{2,37,600}{3,30,000} \times 100 = 72\%$	$= \frac{1,98,000}{2,64,000} \times 100 = 75\%$
	(b) $\frac{O.E.}{Sales} \times 100$	$= \frac{63,800}{3,30,000} \times 100$ $= 19.33\%$	$= \frac{44,000}{2,64,000} \times 100$ $= 16.67\%$
(8)	**Net Profit Ratio** $= \frac{\text{N.P.B.T.}}{\text{Sales}} \times 100$	$= \frac{28,600}{3,30,000} \times 100$ $= 8.67\%$	$= \frac{22,000}{2,64,000} \times 100$ $= 8.33\%$

Q.11 From the following Balance Sheet of X Ltd. compute –
(a) Liquid Ratio (b) Proprietory Ratio (c) Stock Turnover Ratio (d) Capital Gearing Ratio (e) Debtors Velocity and offer you comments in brief.

Balance Sheet as on 31st March, 2003

Particulars	Rs.	Particulars	Rs.
Preference Share Capital	2,00,000	Fixed Assets	12,00,000
Equity Share Capital	5,00,000	Stock	5,40,000
Reserves	10,00,000	Sundry Debtors	8,00,000
Secured Loans	4,00,000	Advance Income-tax	1,20,000
Current Liabilities	5,40,000	Cash at Bank	7,90,000
Provisions	8,10,000		
Total	**34,50,000**	**Total**	**34,50,000**

Total Sales during the year was Rs. 77,76,000 (including Cash Sales Rs. 5,76,000) which yielded a Gross Profit of 25% on Sales. The Stock on 31st March, 2002 was Rs. 4,32,000. Assume for your working 360 days for the year.

Solution:

(a) **Liquid Ratio** = $\frac{\text{Quick Assets}}{\text{Quick Liabilities}} = \frac{\text{QA}}{\text{QL}} \qquad = \frac{15,90,000}{13,50,000}$

$= 1.18 : 1$

(b) **Proprietory Ratio** = $\frac{\text{Proprietor's Funds}}{\text{Total Assets}} \times 100 = \frac{\text{PF}}{\text{TA}} \times 100$

$$= \frac{17,00,000}{34,50,000} \times 100$$

$$= 49\%$$

(c) **Stock-Turnover Ratio** = $\frac{\text{COGS}}{\text{Avg. Stock}}$

$$= \frac{\text{Sales - GrossProfit}}{\frac{\text{Opening Stock + Closing Stock}}{2}} \quad = \frac{58,32,000}{4,86,000}$$

$$= 12 \text{ times}$$

Stock Velocity = $\frac{\text{No. of days in year}}{\text{Stock Turnover Ratio}} \quad = \frac{360}{12}$

$$= 30 \text{ days}$$

(d) **Capital Gearing Ratio** = $\frac{\text{Pref. Capital + Borrowed Funds}}{\text{Equity Share Capital + Reserves}}$

$$= \frac{6,00,000}{15,00,000}$$

$$= 0.40 : 1$$

(e) **Debtors Velocity** = $\frac{\text{Debtors + BR}}{\text{Credit Sales}} \times 360 \quad = \frac{8,00,000}{72,00,000} \times 360$

$$= 40 \text{ days}$$

Working Note:

X Ltd.
Vertical Balance Sheet

Particulars		Rs.	Rs.	Rs.
I) Sources of Funds				
a. Capital				
Equity Share Capital	EC		5,00,000	
Reserves & Surplus	RC		10,00,000	
Equity Funds	EF		15,00,000	
Preference Share Capital	PC		2,00,000	
Proprietor's Funds	PF			17,00,000
b. Borrowed Fund:				
Secured Loans	BF			4,00,000
Capital Employed	CE			21,00,000
II) Application of Funds				
a. Fixed Assets	FA			12,00,000
b. Working Capital				
Debtors	DR		8,00,000	
Cash at Bank	... ...		7,90,000	
Quick Assets	QA		15,90,000	
Add: Stock	CST		5,40,000	
Advance Tax	... ...		1,20,000	
Current Assets	CA		22,50,000	
Less: Quick/Current Liabilities				
Current Liabilities	... ...	5,40,000		
Provisions	... ...	8,10,000		
	CL		13,50,000	
Working Capital (CA-CL)	WC			9,00,000
Capital Employed	CE			**21,00,000**

Q. 12 Following are the Trading and Profit and Loss Account of Sarmer Ltd. for the year ending 31st December, 2002 and Balance Sheet on that date:

P and L Account

Particulars	Rs.	Particulars	Rs.
To Opening Stock	1,45,000	By Sales	7,50,000
To Purchases	6,10,000	By Closing Stock	1,55,000
To Gross Profit C/d	1,50,000		
	9,05,000		**9,05,000**
To Sundry Expenses	80,000	By Gross Profit B/d	1,50,000
To Net Profit	70,000		
	1,50,000		**1,50,000**

Balance Sheet

Liabilities		Rs.	Assets	Rs.
Share Capital		7,00,000	Net Block	5,50,000
Reserve & Surplus	50,000		Stock	1,55,000
Add: Profit for the year	70,000	1,20,000	Debtors	1,80,000
Bank Overdraft		35,000	Cash	1,20,000
Creditors		1,50,000		
		10,05,000		**10,05,000**

You are required to calculate the following ratios. Current Ratio, Quick Ratio, Gross Profit to Sales, Stock Turnover, Debtors Turnover Ratio, NP to paid up Capital.

(April 98, adapted)

Solution:

(1) **Gross Profit Ratio** = $\frac{\text{Gross Profit}}{\text{Net Sales}} \times 100 = \frac{\text{GP}}{\text{S}} \times 100$

$$= \frac{1,50,000}{7,50,000} \times 100$$

$$= 20\%$$

(2) **Stock Turnover Ratio** = $\frac{\text{COGS}}{\text{Average Stock}} = \frac{\text{COGS}}{\frac{\text{OST} + \text{CST}}{2}}$

$$= \frac{6,00,000}{1,50,000}$$

$$= 4 \text{ times}$$

Average Stock = $\frac{\text{Opening Stock} + \text{Closing Stock}}{2} = 1,50,000$

(3) **Current Ratio** = $\frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\text{CA}}{\text{CL}} = \frac{4,55,000}{1,85,000}$

$$= 2.46 : 1$$

(4) **Quick Ratio** = $\frac{\text{Quick Assets}}{\text{Quick Liabilities}} = \frac{\text{QA}}{\text{QL}} = \frac{3,00,000}{1,50,000}$

$$= 2 : 1$$

(5) **Debtors Turnover Ratio** = $\frac{\text{Credit Sales}}{\text{Debtors + Bill Receivable}} = \frac{\text{CRS}}{\text{DR + BR}}$

$$= \frac{7,50,000}{1,80,000}$$

$$= 4.17 \text{ times}$$

(period 88 days)

(6) **N.P. to Paid-up Capital** = $\frac{\text{N.P.A.T.}}{\text{Paid-up Share Capital}} \times 100$

$$= \frac{\text{NPAT}}{\text{EC}} \times 100 \qquad = \frac{70,000}{7,00,000} \times 100$$

$$= 10\%$$

Note:

Vertical Income Statement

Particulars		**Rs.**	**Rs.**
Sales	S		7,50,000
Less: Cost of Goods Sold:			
Opening Stock	OST	1,45,000	
Add: Purchases	... ...	6,10,000	
	... ...	7,55,000	
Less: Closing Stock	CST	1,55,000	
Cost of Goods Sold	COGS		6,00,000
Gross Profit	GP		1,50,000
Less: Operating Expenses	OE		80,000
Net Profit	NP		70,000

Vertical Balance Sheet

Particulars		**Rs.**	**Rs.**	**Rs.**
I) Sources of Funds				
Equity Capital	EC		7,00,000	
Reserves & Surplus	RS		1,20,000	
Shareholders Funds	EF/PF			8,20,000
Borrowed Funds	BF			Nil
Capital Employed	CE			8,20,000

II) Application of Funds	FA			5,50,000
Fixed Assets (Net Block)				
Working Capital:	DR		1,80,000	
Debtors	... ...		1,20,000	
Cash	QA		3,00,000	
Quick Assets	CST		1,55,000	
Add: Stock	CA		4,55,000	
Current Assets				
Quick Liabilities:	CD/QL			
Creditors	... ...			
Add: Bank O.D.	CL	1,50,000	1,85,000	
Current Liabilities	WC	35,000		2,70,000
Working Capital (CA-CL)				
	CE			8,20,000
Capital Employed				

Q.13 From the following Profit and Loss Accounts and Balance Sheets after calculating following ratios: (1) Current ratio (2) Proprietory ratio (3) Debt-Equity ratio (4) Stock working capital ratio (5) Liquid ratio (6) Cost of sales to sales ratio (7) Administrative exp. to sales ratio (8) Selling expenses to sales ratio.

Balance Sheet

Liabilities	2003 Rs.	2002 Rs.	Assets	2003 Rs.	2002 Rs.
Capital of Rs. 10 each	70,000	70,000	Fixed Assets	90,000	92,000
Reserves	80,000	68,000	Current Assets	1,10,000	1,12,000
Secured Loans	22,000	24,000	Loans and Advances	52,000	40,000
Current Liabilities	26,000	30,000			
Provisions	54,000	52,000			
	2,52,000	**2,44,000**		**2,52,000**	**2,44,000**

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

Particulars	2003 Rs.	2002 Rs.	Particulars	2003 Rs.	2002 Rs.
To Opening Stock	44,000	40,000	By Sales	2,10,000	2,00,000
To Purchases	84,000	72,000	By Closing Stock	46,000	44,000
To Wages	40,000	36,000			
To Factory Exp.	32,000	28,000			
To Administrative Expenses	8,000	6,000			

To Selling Exp.	6,000	10,000			
To Managerial Remuneration	2,000	2,000			
To Tfd. to Reserve	2,000	2,000			
To Income Tax	22,000	24,000			
To Proposed Dividend	6,000	8,000			
To Balance C/fd.	10,000	16,000			
	2,56,000	**2,44,000**		**2,56,000**	**2,44,000**

(Oct. 95, adapted)

Solution:

No	Ratio	31-03-2003	31-03-2002
(1)	**Current Ratio** $= \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\text{CA}}{\text{CL}}$	$= \frac{1,10,000+52,000}{26,000+54,000}$ $= \frac{1,62,000}{80,000} = 2.03:1$	$= \frac{1,12,000+40,000}{30,000+52,000}$ $= \frac{1,52,000}{82,000} = 1.85:1$
(2)	**Proprietory Ratio** $= \frac{\text{Proprietor's Funds}}{\text{Total Assets*}} \times 100$ $= \frac{\text{PF}}{\text{TA}} \times 100$ *Fixed + Current	$= \frac{1,50,000}{2,52,000} \times 100$ $= 59.52\%$ or $= 0.6:1$	$= \frac{1,38,000}{2,44,000} \times 100$ $= 56.56\%$ or $= 0.57:1$
(3)	**Debt-Equity Ratio** (i) $\frac{\text{Borrowed Fund}}{\text{Proprietor's Fund}} = \frac{\text{BF}}{\text{PF}}$ **OR** (ii) $\frac{\text{Borrowed Fund}}{\text{Borrowed Fund} + \text{Proprietor's Fund}}$ $= \frac{\text{BF}}{\text{BF}+\text{PF}}$	$= \frac{22,000}{1,50,000} = 0.15:1$ $= \frac{22,000}{1,72,000} = 0.13:1$	$= \frac{24,000}{1,38,000} = 0.17:1$ $= \frac{24,000}{1,62,000} = 0.15:1$

(4)	**Stock to W.C. Ratio** $=\frac{\text{Closing Stock}}{\text{W.C.}}\times 100$ $=\frac{\text{CST}}{\text{WC}}\times 100$	$=\frac{46,000}{82,000}\times 100$ $=56.10\%$	$=\frac{44,000}{70,000}\times 100$ $=62.86\%$
(5)	**Liquid Ratio** $=\frac{\text{Quick Assets}}{\text{Quick Liabilities}}=\frac{\text{QA}}{\text{QL}}$	$=\frac{1,16,000}{80,000}=1.45:1$	$=\frac{1,08,000}{82,000}=1.32:1$
(6)	**Cost of Sales to Sales Ratio** $\frac{\text{COGS}}{\text{Sales}}\times 100=\frac{\text{COGS}}{\text{S}}\times 100$	$=\frac{1,54,000}{2,10,000}\times 100$ $=73.33\%$	$=\frac{1,32,000}{2,00,000}\times 100$ $=66\%$
(7)	**Administrative Expenses Ratio** $=\frac{\text{Administrative Expenses}}{\text{Sales}}\times 100$ $=\frac{\text{AE}}{\text{S}}\times 100$	$=\frac{10,000}{2,10,000}\times 100$ $=4.76\%$	$=\frac{8,000}{2,00,000}\times 100$ $=4\%$
(8)	**Selling Expenses Ratio** $=\frac{\text{Selling Expenses}}{\text{Sales}}\times 100$ $=\frac{\text{SE}}{\text{S}}\times 100$	$=\frac{6,000}{2,10,000}\times 100$ $=2.86\%$	$=\frac{10,000}{2,00,000}\times 100$ $=5\%$

Note: Before calculating the ratios, it is necessary to convert Horizontal Financial Statements in Vertical Form.

Commentary Limited
Vertical Balance Sheets

Particulars		2003		2002	
		Rs.	Rs.	Rs.	Rs.
I) Sources of Funds					
Owners Funds:					
Capital	EC	70,000		70,000	
Reserves	RS	80,000		68,000	
Equity / Proprietory Funds	EF/PF		1,50,000		1,38,000
Loan Funds:					
Secured Loans	BF		22,000		24,000
Capital Employed	CE		1,72,000		1,62,000
II) Application of Funds					
Fixed Assets	FA		90,000		92,000
Working Capital					
Quick Assets (CA + LA – Stock)	QA	1,16,000		1,08,000	
Stock	CST	46,000		44,000	
Current Assets	CA	1,62,000		1,52,000	
Less:					
Quick Liabilities / Current Liabilities	QL/CL	80,000		82,000	
	WC		82,000		70,000
Capital Employed	CE		1,72,000		1,62,000

Vertical Income Statement

Particulars		2003		2002	
		Rs.	Rs.	Rs.	Rs.
Sales	S		2,10,000		2,00,000
Less: Cost of Goods Sold					
Opening Stock	... ...	44,000		40,000	
Add: Purchases	... ...	84,000		72,000	
Wages	... ...	40,000		36,000	
Factory Expenses	... ...	32,000		28,000	
		2,00,000		1,76,000	
Less: Closing Stock	... ...	46,000		44,000	
	COGS		1,54,000		1,32,000
Gross Profit	GP		56,000		68,000
Less: Operating Expenses	... ...				
Administration Expenses (incl. Managerial Remuneration)	AE	10,000		8,000	
Selling & Dist. Expenses	SE	6,000		10,000	
Operating Expenses	OE		16,000		18,000

Operating Profit	OP		40,000		50,000
Less: Income-tax	IT		22,000		24,000
Profit after Tax	PAT		18,000		26,000
Less: Proposed Dividends	ED		6,000		8,000
			12,000		18,000
Less: Tfd. to Reserves	... ...		2,000		2,000
Profits retained	RE		10,000		16,000

Q.14 Profit & Loss A/c. and Balance Sheet of SIDHARTH LTD. for the year ended 31st March, 2007:

Trading Profit & Loss Account for the year ended 31st March 2007

Dr. **Cr.**

Particulars	**Rs.**	**Particulars**	**Rs.**
To Opening Stock	70,000	By Sales	9,00,000
To Purchases	5,40,000	By Closing Stock	80,000
To Wages	2,14,000		
To Gross Profit c/d	1,56,000		
	9,80,000		**9,80,000**
To Salaries	26,000	By Gross Profit b/d	1,56,000
To Rent	5,000	By Interest on Investment	5,000
To Miscellaneous Exp.	15,000		
To Selling Exp.	10,000		
To Depreciation	30,000		
To Interest	5,000		
To Provision for Tax	20,000		
To Net Profit c/d	50,000		
	1,61,000		**1,61,000**

Balance Sheet as on 31st March, 2007

Liabilities	**Rs.**	**Assets**	**Rs.**
Equity Share Capital (Rs. 10)	1,50,000	Fixed Assets 1,60,000 (-) Depreciation 30,000	1,30,000
8% Preference Share Capital (Rs. 100)	1,00,000	Investment	1,00,000
Reserve & Surplus	62,000	Stock	80,000
10% Debenture	50,000	Debtors	60,000
Bank Loan (Payable after 5 years)	40,000	Bills Receivable	50,000

Creditors	60,000	Cash	85,000
Provision for Tax (C.Y.)	20,000	Preliminary Expenses	5,000
Bank Overdraft	20,000		
Proposed Pref. Dividend	8,000		
	5,10,000		**5,10,000**

Note: Market value of Equity share is Rs. 12 and Dividend paid per Equity share is Rs. 2. Calculate the following ratio:

(a) Acid Test Ratio
(b) Capital Gearing Ratio
(c) Operating Ratio
(d) Dividend Payout Ratio
(e) Debt Service Ratio
(f) Creditors Turnover Ratio
(g) Earning per Share
(h) Stock Turnover Ratio
(i) Price Earning Ratio

(Mar. 08, adapted)

Solution:

Balance Sheet Ratios:

1. Quick/Liquid Ratio = $\frac{\text{QA}}{\text{QL}} = \frac{60,000+50,000+85,000}{60,000+20,000+8,000}$

$$= \frac{1,95,000}{88,000} = 2.22$$

2. **Capital Gearing Ratio** = $\frac{\text{PC + BF}}{\text{EF}} = \frac{1,00,000+50,000+40,000}{1,50,000+62,000-5,000}$

$$= \frac{1,90,000}{2,07,000} = 0.92$$

Profit & Loss Ratios:

3. **Operating Ratio** = $\frac{\text{COGS + OE}}{\text{S}} \times 100$

$$= \frac{(70,000+5,40,000+2,14,000-80,000) + (26,000+5,000+15,000+10,000+30,000)}{9,00,000}$$

$$= \frac{8,30,000}{9,00,000} \times 100 = 92\%$$

Stock Turnover Ratio = $\frac{COGS}{(OST+CST)/2} = \frac{7,44,000}{75,000} = 9.92$

Composite Ratios:

4. **Debt Service** $= \frac{\text{PBIT}}{\text{INT}} = \frac{\text{Sales - COGS - OE + Interest}}{\text{Interest on Debentures}}$

$$= \frac{9,00,000 - 8,30,000 + 5,000}{5,000} = \frac{75,000}{5,000} = 15.00$$

5. **Creditors Turnover** = $\frac{CRP}{(CD + BP)} = \frac{5,40,000}{60,000} = 9.00$

6. **Creditors Velocity** = $\frac{365}{CTR} = \frac{365}{9.00} = 40.56$

7. **Dividend Pay-out Ratio** = $\frac{ED}{PAES} \times 100 = \frac{30,000}{42,000} = 0.71$

8. **EPS** $= \frac{\text{Profitfor Equityholders}}{\text{No. of Equity Shares}} = \frac{42,000}{15,000} = \text{Rs.}2.80$

9. **Price Earning Ratio** = $\frac{\text{Marke Price}}{\text{EPS}} = \frac{12}{2.80} = 4.29$

Working Note:

Vertical Balance Sheet

Particulars		Rs.	Rs.	Rs.
I) Sources of Funds				
Equity Share Capital	EC		1,50,000	
Reserves & Surplus	... ...	62,000		
Less: Preliminary Expenses	... ...	(5,000)		
Net Reserves & Surplus	RS		57,000	
Equity Shareholder's Funds	EF		2,07,000	
Pref. Share Capital	PC		1,00,000	
Proprietor's Funds	PF			3,07,000
Borrowed Funds				
10% Debentures	... ...		50,000	
Bank Loan (payable after 5 years)	... ...		40,000	
	BF			90,000
Capital Employed (PF+BF)	CE			3,97,000
II) Use of Funds				
Fixed Assets	... ...	1,30,000		
Trade Investments	... ...	1,00,000		
Total Fixed Assets	FA			2,30,000

Quick Assets				
Debtors	DR	60,000		
Bills Receivable	BR	50,000		
Cash /Bank	... ...	85,000		
	QA	1,95,000		
Closing Stock	CST	80,000		
Current Assets	CA		2,75,000	
Quick Liabilities				
Creditors	CD	60,000		
Prov. For Tax	... ...	20,000		
Proposed Dividends	... ...	8,000		
	QL	88,000		
Bank Overdraft	OD	20,000		
Current Liabilities	CL		1,08,000	
Working Capital	WC			1,67,000
Capital Employed (FA+WC)	CE			3,97,000

Vertical Income Statement

Particulars		Rs.	Rs.	Rs.
Credit Sales	CRS	9,00,000		
Total Sales	S		9,00,000	
Opening Stock	OST	70,000		
Credit Purchases	CRP	5,40,000		
Wages	... ...	2,14,000		
Less: Closing Stock	(CST)	(80,000)		
Cost of Goods Sold	COGS		7,44,000	
Gross Profit	GP			1,56,000
Admin. Expenses				
Salaries	... ...	26,000		
Rent	... ...	5,000		
Misc. Expenses	... ...	15,000		
	AE		46,000	
Selling Expenses	SE		10,000	
Depreciation	... ...		30,000	
Operating Expenses	OE			86,000
Operating Profit	OP			70,000
Interest on Investments	... ...			5,000
Profit Before Int. & Tax	PBIT			75,000
Interest on Debentures	INT			5,000
Net Profit Before Tax	NPBT			70,000
Income Tax	... ...			20,000
Net Profit After Tax	NPAT			50,000
Preference Dividends	... ...			8,000
Profit Avl. For Eq. holders	PAES			42,000
Equity Dividends (Rs. 2 x 15,000)	ED			30,000
Retained Earnings	RET			12,000

Q.15 Following is the Profit and Loss A/c and Balance Sheet of Adhiraj Ltd:

Profit and Loss A/c for the Year ended 31st December, 2006

Particulars	Rs.	Particulars	Rs.
To Opening Stock	20,000	By Sales	4,50,000
To Purchases	2,00,000	By Closing Stock	80,000
To Wages	50,000		
To Factory Exp.	70,000		
To G.P. c/d	1,90,000		
	5,30,000		**5,30,000**
To Administrative Exp.	60,000	By Gross Profit b/d	1,90,000
To Selling Exp.	40,000	By Interest Received	5,000
To Interest on Loan	5,000		
To Debenture Interest	8,000		
To Net Profit	82,000		
	1,95,000		**1,95,000**
To Tax Provision		By Net Profit	82,000
To Proposed Dividend			
To Balance Profit			
	82,000		**82,000**

Balance Sheet as on 31st December, 2006

Liabilities	Rs.	Assets	Rs.
Equity Share Capital (Rs. 10)	2,00,000	Land & Building	1,75,000
9% Preference Share Capital	1,50,000	Machinery	1,50,000
8% Debenture	1,00,000	Furniture	1,00,000
Reserve	50,000	Goodwill	50,000
Profit & Loss A/c	30,000	Patents	50,000
Short Term Loan (Repaid within one year)	1,00,000	Vehicles	1,40,000
Bank Overdraft	75,000	Investment	50,000

Sundry Creditors	1,40,000	Stock	80,000
Bills Payable	30,000	Debtors	90,000
Provision for Tax	20,000	Bills Receivable	30,000
Proposed Dividend	20,000		
	9,15,000		**9,15,000**

Market price of equity share is Rs. 7.
Calculate the following ratios:

(a) Acid Test Ratio
(b) Capital Gearing Ratio
(c) Stock Turnover Ratio
(d) Debtors Turnover Ratio
(e) Creditors Turnover Ratio
(f) Return on Capital Employed Ratio
(g) Stock Working Capital Ratio
(h) Operating Ratio
(i) Earning Per Share
(j) Price Earning Ratio

(Mar. 07, adapted)

Solution:

Ratios:

(a) **Quick/Liquid/Acid Test Ratio** = $\dfrac{\text{Quick Assets}}{\text{Quick Liabilities}}$

$$= \frac{1,20,000}{3,10,000} = 0.387:1$$

(b) **Capital Gearing Ratio**

$$= \frac{\text{Preference Share Capital + Borrowed Funds}}{\text{Equity Share Capital + Reserves - Misc. Expenses}}$$

$$= \frac{2,50,000}{2,80,000} = 0.893$$

(c) **Stock Turnover Ratio** = $\dfrac{\text{Cost of Goods Sold}}{\text{Average Stock}}$

$$= \frac{2,60,000}{50,000} = 5.20 \text{ times}$$

Average Stock = $\dfrac{\text{Opening Stock + Closing Stock}}{2}$

$$= \frac{20,000 + 80,000}{2} = 50,000$$

(d) **Debtors Turnover Ratio** = $\frac{\text{Credit Sales}}{\text{Debtors}} = \frac{\text{CRS}}{(\text{DR} + \text{BR})}$

$$= \frac{4,50,000}{1,20,000} = 3.75$$

(e) **Creditors Turnover Ratio** = $\frac{\text{Credit Purchases}}{\text{Creditors}} = \frac{\text{CRP}}{(\text{CD} + \text{BP})}$

$$= \frac{2,00,000}{1,70,000} = 1.176$$

(f) **Return on Capital Employed** = $\frac{\text{PBIT} \times 100}{\text{CE}}$

$$= \frac{90,000}{5,30,000} \times 100 = 16.98\%$$

(g) **Stock to Working Capital** = $\frac{\text{Stock}}{\text{Working Capital}}$

$$= \frac{80,000}{(1,85,000)} = (0.43)$$

(h) **Operating Ratio** = $\frac{[\text{COGS} + \text{OE}] \times 100}{\text{S}} = \frac{3,65,000}{4,50,000} \times 100 = 81.11\%$

(i) **Earning Per Share** = $\frac{\text{PAES}}{\text{No. of Equity Shares}} = \frac{48,500}{20,000} = 2.425$

(j) **Price Earnings Ratio** = $\frac{\text{Market Price}}{\text{EPS}} = \frac{7}{2.425} = 2.90$

Working Note:

Balance Sheet as on 31st December, 2006

Particulars		Rs.	Rs.
I) SOURCES OF FUNDS			
1. **Owner's Funds**			
(a) Equity Share Capital	EC	2,00,000	
(b) Reserves and Surplus	RS		
Reserve	... ...	50,000	
Profit & Loss A/c	... ...	30,000	
Equity Shareholder's Funds	EF	2,80,000	

(c) Preference Share Capital	PC	1,50,000	
Proprietor's Funds	PF		4,30,000
2. **Borrowed Funds**			
8% Debentures	BF		1,00,000
CAPITAL EMPLOYED	CE		5,30,000
II) APPLICATION OF FUNDS			
1. **Fixed Assets**			
Land & Building	... ...	1,75,000	
Machinery	... ...	1,50,000	
Furniture	... ...	1,00,000	
Vehicles	... ...	1,40,000	
Goodwill	... ...	50,000	
Patents	... ...	50,000	
2. **Trade Investments**	FA	50,000	
Total Fixed Assets			7,15,000
3. **Working Capital**			
A. **Current Assets**			
a. **Quick Assets**			
Debtors	DR	90,000	
Bills Receivable	BR	30,000	
Total Quick Assets	QA	1,20,000	
b. **Non-Quick Assets**			
Closing Stock	CST	80,000	
Total Current Assets	CA	2,00,000	
B. **Less: Current Liabilities**			
a. **Quick Liabilities**			
Creditors	CD	1,40,000	
Bills Payable	BP	30,000	
Prov. for Tax		20,000	
Proposed Dividends		20,000	
Short Term Loan		1,00,000	
	QL	3,10,000	
b. **Non-Quick Liabilities**			
Bank Overdraft	OD	75,000	
Total Current Liabilities	CL	3,85,000	
Working Capital (CA-CL)	WC		(1,85,000)
CAPITAL EMPLOYED (FA+WC)	CE		5,30,000

Vertical Income Statement for the Year Ended 31st December, 2006

Particulars		**Rs.**	**Rs.**
Net Sales	S		4,50,000
Less:			
(a) Opening Stock	OST	20,000	
(b) Credit Purchases	CRP	2,00,000	
(c) Wages	... ...	50,000	
(d) Factory Expenses	... ...	70,000	
		3,40,000	
Less: (e) Closing Stock	CST	(80,000)	
Cost of Goods Sold	COGS		2,60,000
			1,90,000
Gross Profit	GP		
Less: Operating Expenses			
(a) Administration Expenses	... ...	60,000	
(b) Selling Expenses	... ...	40,000	
(c) Finance Expenses			
Interest on Short term Loan	... ...	5,000	
Total Operating Expenses	OE		1,05,000
Operating Profit	... ...		85,000
Non-Operating Interest Income	... ...		5,000
Profit Before Interest & Tax	PBIT		90,000
Interest on Debentures	... ...		(8,000)
Net Profit Before Tax	NBIT		82,000
Less: Income Tax	IT		20,000
Net Profit After Tax	NPAT		62,000
Less: Preference Dividends	... ...		13,500
(9% x 1,50,000)			
Profit Available for Equity holders	PAES		48,500
Less: Equity Dividends	... ...		6,500
(20,000 – 13,500)			
Retained Earnings	... ...		42,000

11.2 EXERCISE

Q.1 Re-arrange the following Balance Sheet, and Profit and Loss Account of Eden woods Ltd. in a form suitable for analysis and calculate the following ratios:
(a) Current Ration (b) Stock Turnover Ratio
(c) Liquidity Ratio (d) Debt Equity Ratio
(e) Gross Profit Ratio (f) Net Profit Ratio

Balance Sheet as at 31st March, 2003

Liabilities	Rs.	Assets	Rs.
Bills Payable	25,000	Fixed Assets	1,25,000
Sundry Creditors	50,000	Sundry Debtors	50,000
Debentures	1,00,000	Bank Balance	25,000
Reserves	50,000	Inventory	1,25,000
Equity Share Capital	50,000		
Preference Share Capital	50,000		
Total	**3,25,000**	Total	**3,25,000**

Profit and Loss Account for the year ended 31st March, 2003

Particulars	Rs.	Particulars	Rs.
To Opening Inventories	75,000	By Sales	5,00,000
To Purchases	1,50,000	By Closing Inventories	1,25,000
To Manufacturing Expenses	50,000	By Profit on sale of Shares	25,000
To Direct Wages	1,00,000		
To Administrative Expenses	25,000		
To Selling Expenses	25,000		
To Loss on Sale of Assets	27,500		
To Interest on Debentures	5,000		
To Net Profit	1,92,500		
Total	**6,50,000**	Total	**6,50,000**

(April 96, adapted)

**[Ans.: B/S (v) Total Rs. 2,50,000; (a) 2.67:1 (b) 2.5 (c) 1 : 1
(d) 0.67 : 1 or 0.4 : 1 (e) 50% (f) 38.5%]**

Q.2 The following is the Trading and Profit and Loss A/c and Balance Sheet of Sham Ltd.

Trading and Profit and Loss Account as on 31st March, 2003

Particulars	Rs.	Particulars	Rs.
To Opening Stock	10,000	By Sales	1,50,000
To Purchases	55,000	By Closing Stock	15,000
To Wages	20,000		
To Power & Fuel	10,000		
To Gross Profit c/d	70,000		
	1,65,000		**1,65,000**
To Administration Expenses		By Gross Profit b/d	70,000
To Interest		By Rent Received	1,500
To Depreciation on Machinery			
To Selling Expenses			
To Loss by Fire			
To Provision for Tax			
To Net Profit			
	71,500		**71,500**
To Interim Dividend	10,000	By Opening Balance	15,000
To Closing Balance	25,000	By Net Profit	20,000
	35,000		**35,000**

Balance Sheet as on 31st March, 2003

Liabilities	Rs.	Assets	Rs.
Equity Share Capital	1,00,000	Land & Building	50,000
Profit & Loss A/c	25,000	Plant & Machinery	30,000
Creditors	15,000	Furniture	20,000
Secured Loans	10,000	Stock	15,000
Bank Overdraft	25,000	Debtors	15,000
Provision for Tax	5,000	Investments	12,500
Outstanding Expenses	5,000	Cash	17,500
		Goodwill	20,000
		Miscellaneous Expenditure	5,000
	1,85,000		**1,85,000**

Calculate the following ratios after converting above financial statements in vertical form :-

(1) Inventory Turnover Ratio (2) Gross Profit Ratio

(3) Operating Ratio (4) Current Ratio

(5) Proprietory Ratio (6) Liquid Ratio

(April 2002, adapted)

[Ans.: B/S (v) Total Rs. 1,30,000; (1) 6.8 (2) 43.33% (3) 74.67% (4) 0.95 : 1 (5) 66.67% (6) 1.30 : 1]

Q.3 (From Details): Given below are extracts of Financial Statement of M/s. D.K. Ltd.

Particulars	**31-3-2004 Rs.**
Stock	2,60,000
Debtors	1,00,000
Cash	1,40,000
Bills Receivable	1,00,000
Creditors	1,00,000
Bank Balance (Cr.)	30,000
Outstanding Expenses	10,000
Bills Payable	50,000
Total Purchases	8,00,000
Cash Purchases	2,00,000
Cash Sales	3,00,000
Credit Sales	12,00,000
Credit allowed to Customers	1½ months
Credit allowed to Suppliers	3 months

From the above find out the following Ratios and give your comment for the year ended 31-3-2004:

(1) Current Ratio (2) Liquid Ratio (3) Debtors Turn Over Ratio and Age of Debtor. (4) Creditors Turn Over Ratio and Age of Creditors.

(October 2001, adapted)

[Ans.: (1) 3.16 : 1 (2) 2.13 : 1 (3) 6 (4) 4 times, 3 months]

Q.4 Following are the financial statements of two similar companies :

Balance Sheet as at 31^{st} December, 2006

Liabilities	X Ltd. Rs.	Y Ltd. Rs.	Assets	X Ltd. Rs.	Y Ltd. Rs.
Share Capital					
Equity Share of Rs. 10/- each	4,000	4,000	Land and Building	1,400	1,200
Revenue Reserve	1,950	1,600	Plant	4,100	3,200
8% Debenture	1,000	1,000	Stock	2,850	2,100
Trade Creditors	2,800	1,400	Debtors	2,600	1,900
Other Creditors	250	200	Investment (Long Term)	-	300
Provision for Tax	900	700	Bank	100	300
Proposed Dividend	300	200	Deposit	150	100
	11,200	**9,100**		**11,200**	**9,100**

Income Statement for 2006

	X Ltd. Rs.	Y Ltd. Rs.		X Ltd. Rs.	Y Ltd. Rs.
Cost of Sales	10,800	9,000	Sales	15,000	12,000
Operating Exps	2,900	2,000			
Taxation	550	410			
Net Profit after Tax	750	590			
	15,000	**12,000**		**15,000**	**12,000**

On the basis of above information. You are required to compute separately the following ratio:

(1) Capital Gearing Ratio (2) Current Ratio

(3) Debtors Turnover Ratio (4) Return on Proprietory Fund

Vertical final accounts need not be prepared.

(Oct. 07, adapted)

[Ans: X Ltd (1) 0.168 (2) 1.34 : 1 (3) 5.77 (4) 12.61%
Y Ltd (1) 0.179 (2) 1.76 : 1 (3) 6.32 (4) 10.54 %]

Q.5 Following are the Balance Sheets of X Ltd. and Y Ltd as on 31st March, 2004 together with supplementary information for the year ended on that date:

Balance Sheet as on 31st March, 2004

Liabilities	X Ltd. Rs.	Y Ltd. Rs.	Assets	X Ltd. Rs.	Y Ltd. Rs.
Paid-up Share Capital	2,00,000	3,50,000	Goodwill	30,000	50,000
Reserves	50,500	60,000	Building	1,20,000	2,40,000
Profit & Loss A/c	12,250	1,02,200	Plant and Machinery	29,000	42,000
Bank Overdraft	11,250	14,800	Stock	66,000	93,000
Sundry Creditors	36,000	58,000	Debtors	85,000	1,75,000
Provision for Taxation	20,000	15,000			
	3,30,000	**6,00,000**		**3,30,000**	**6,00,000**

Additional Information:

Particulars	X Ltd. Rs.	Y Ltd. Rs.
Sales for the year	8,40,000	10,50,000
Stock on 31st March, 2003	60,000	1,07,000
Gross Profit	2,10,000	2,50,000

You are required to compute the following ratios of both companies

(a) Current Ratio

(b) Liquid Ratio

(c) Proprietary Ratio

(d) Stock Turnover Ratio and

(e) Debtors Turnover Ratio in no. of times

All sales are on credit basis.

(Oct. 2005, adapted)

[Ans: X Ltd. (a) 2.245: 1 (b) 1.52 : 1 (c) 0.80 : 1 (d) 10 (e) 9.88
Y Ltd. (a) 3.05 : 1 (b) 2.40 : 1 (c) 0.85 : 1 (d) 8 (e) 6]

Q.6 (From Details): The following are the extracts from the financial statements of M/s. Salman Ltd., as on 31st March 2002 and 2003 respectively.

Particulars	**31-3-2002 Rs.**	**31-3-2003 Rs.**
Stock	10,000	25,000
Debtors	20,000	20,000
Bills Receivable	10,000	5,000
Advances (Recoverable in Cash or kind)	2,000	--
Cash on Hand	18,000	15,000
Creditors	25,000	30,000
Bills Payable	15,000	20,000
Bank Overdraft	--	2,000
9% Debentures	5,00,000	5,00,000
Sales for the year	3,50,000	3,00,000
Gross Profit	70,000	50,000

You are required to compute for both these years: (i) Current Ratio; (ii) Liquid Ratio; (iii) Stock Turnover Rate; (iv) Number of days outstanding of debtors; (v) Stock-Working Capital Ratio.

[Ans: C.R: 1.5 & 1.25; L.R: 1.25 & 0.8; S.T.R: 28 & 14.29 times; D.T.R: 31 & 30 days; S.W.C: 0.5 & 1.92]

Q.7 (From Details): Calculate from the following details furnished by Suraj Ltd. (a) Current Ratio (b) Liquid Ratio (c) Creditors Turnover Ratio and Average Credit Period (d) Debtors Turnover Ratio and Average Credit Period (e) Stock Turnover Ratio.

Particulars	**Rs.**
Stock	8,00,000
Debtors	1,70,000
Cash	30,000
Creditors	3,00,000
Bank Overdraft	40,000
Outstanding Expenses	60,000
Total Purchases	9,30,000
Cash Purchases	30,000

Gross Profit Rates

(April 2000, adapted)

[**Ans: (a) CR 2.5: 1 (b) LR 0.56 : 1 (c) CTR 3 times (d) DTR 7.29 times (assume Opening Stock = Closing Stock) (e) STR 1.16 times]**

Q.8 Calculate from the following details furnished by Pardeshi Ltd.:
(a) Current Ratio
(b) Liquid Ratio
(c) Credit Turnover Ratio and Average Credit Period
(d) Debtors Turnover Ratio and Average Credit Period
(e) Stock Turnover Ratio

	Rs.
Stock	1,00,000
Debtors	1,40,000
Cash	60,000
Creditors	1,60,000
Bank Overdraft	30,000
Outstanding Expenses	10,000
Total Purchases	6,60,000
Cash Purchases	20,000
Gross Profit Ratio	$33\frac{1}{3}\%$

(Oct. 2000, adapted)
[Ans: (a) 1.5: 1 (b) 1.18 : 1 (c) 4 times (d) 7.07 times (e) 6.6 times]

Q.9 From the following information, relating to a limited company, prepare a statement of Proprietor's Funds.

(i) Current Ratio	2
(ii) Liquid Ratio	1.5
(iii) Fixed Assets /Proprietor's Funds	3/4
(iv) Working Capital	Rs. 75,000
(v) Reserves and Surplus	Rs. 50,000
(vi) Bank Overdraft	Rs. 10,000

There were no long-term loans or fictitious assets.

All workings must form part of your answer.

[Ans: (i) Shareholder's Funds – Rs. 3,00,000
(ii) Fixed Assets – Rs. 2,25,000 (iii) Working Capital – Rs. 75,000)

Q.10 From the following information of X Engineering Co. complete the Proforma Balance Sheet if sales are Rs. 16,00,000.

Sales to Net Worth	2.3 times
Current Liabilities to Net Worth	42%
Total Liabilities to Net Worth	75%
Current Ratio	2.9
Sales to Closing Inventory	4.5
Average Collection Period	64 days

Proforma Balance Sheet

Liabilities	Rs.	Assets	Rs.
Net Worth	?	Fixed Assets	?
Long term Liabilities	?	Cash	?
Current Liabilities	?	Stock in Trade	?
	?	Debtors	?

Calculations are to be made to the nearest rupee.

[Ans: Net worth Rs. 6,95,652; Long term liabilities Rs. 2,29,565; Current Liabilities Rs. 2,92,174; Fixed Assets Rs. 3,70,086; Debtors Rs. 2,80,548; Stock Rs. 3,55,555; Cash Rs. 2,11,202]

Q.11 From the following information, prepare a summarised Balance Sheet as at 31st March, 2004.

	Rs.
Working Capital	1,20,000
Reserves & Surplus	80,000
Bank Overdraft	20,000
Fixed Assets Proprietory Ratio	0.75
Current Ratio	2.50
Liquid Ratio	1.50

Your working notes should form part of the answer.

[Ans: B/S Total Rs. 5,60,000; Fixed Assets Rs. 3,60,000; Stock Rs. 80,000; Capital Rs. 4,00,000]

Q.12 Based on the following information of the financial ratios, prepare Balance Sheet of Star Enterprises Ltd. as on December 31st, 2002. Explain your working and assumptions.

Current Ratio	2.5
Liquidity Ratio	1.5
Net Working Capital	Rs. 6,00,000
Stock Turnover Ratio	5
Ratio of Gross Profit to Sales	20%
Turnover Ratio to Net Fixed Assets (COGS /FA)	2
Average Debt Collection Period	2.4 months
Fixed Assets to Net Worth	0.80
Long-term Debt to Capital and Reserve	7/25

Ans:

Balance Sheet as on December 31st 2002

Liabilities	Rs.	Assets	Rs.
Share Capital and Reserves	**12,50,000**	**Fixed Assets (Cost)**	
Long-term Debts	**3,50,000**	**Less Depreciation**	**10,00,000**
Current Liabilities	**4,00,000**	**Current Assets:**	
		Stock in Trade	**4,00,000**
		Sundry Debtors	**5,00,000**
		Cash	**1,00,000**
	20,00,000		**20,00,000**

Q.13 From the following information prepare a Balance Sheet with as many details as possible.

(1) Current Ratio 2.5 : 1
(2) Liquid Ratio 1.5:1
(3) Fixed Assets / Proprietor's Fund 0.75
(4) Working Capital Rs. 60,000
(5) Reserves and Surplus Rs. 40,000
(6) Bank Overdraft Rs. 10,000
(7) There is no long-term loan or fictitious asset.

Ans:

Balance Sheet

Liabilities		Rs.	Assets		Rs.
Share Capital		**2,00,000**	**Fixed Assets**		**1,80,000**
Reserves and Surplus		**40,000**	**Current Assets**		
Current Liabilities			**Liquid Assets**	**45,000**	
Bank Overdraft	**10,000**		**Stock**	**55,000**	**1,00,000**
Quick Liabilities	**30,000**	**40,000**			
		2,80,000			**2,80,000**

Q.14 From the following information, prepare a summarised Balance Sheet as at 31st March, 2002.

Stock Turnover	6
Fixed Assets Turnover Ratio (Sales ÷ Fixed Assets)	4
Capital Turnover Ratio (Sales ÷ Capital)	2
Gross Profit Ratio	20%
Debt Collection Period	2 months
Gross Profit	Rs. 60,000
Closing Stock was Rs. 5,000 in excess of opening stock	
Creditors	49,000

All workings should form part of your answer.

Ans:

Balance Sheet as on 31-3-2002

Liabilities	Rs.	Assets	Rs.
Capital	**1,50,000**	**Fixed Assets**	**75,000**
Creditors	**49,000**	**Debtors**	**50,000**
		Closing Stock	**42,500**
		Cash & Bank (Bal. Fig.)	**31,500**
	1,99,000		**1,99,000**

Q.15 Shri Devdas asks you to prepare his Balance Sheet from the particulars furnished hereunder:

Gross Profit margin	20%
Stock velocity: 6	
Capital	Rs. 1,50,000
Fixed Assets	Rs. 75,000
Debt collection period	2 months
Creditors payment period	73 days
Gross Profit was	Rs. 60,000

Excess of closing stock over opening stock was Rs. 5,000

Difference in Balance Sheet represents bank balance.

[Ans: Bank – Rs. 31,500]

❖❖❖❖

12

WORKING CAPITAL MANAGEMENT

Unit Structure:

12.0 OBJECTIVES

After studying this chapter you should be able to understand

- Concept of Working Capital
- Nature of Working Capital
- Need for Working Capital
- Working Capital Cycle
- Classification of Working Capital
- Determinants of Working Capital

12.1 INTRODUCTION

Every organization requires Fixed Capital for purchase of fixed assets viz. Land and Building, Plant and Machinery, Furniture, Vehicles etc. In addition to fixed capital an organisation also requires additional capital for financing day to day activities. Such capital which is required for financing day to day activities in the business is called Working Capital.

Working Capital is that part of the funds of a business which is used for day to day operation. It is the money required to keep the business running smoothly. (It is required for smooth conduct of business activities.) In the absence of Working Capital, fixed assets can not be employed gainfully. It is the working capital which decides success or failure of an organisation. It is the life blood of an organisation.

Forecasting Working Capital and Control of Working Capital is a continuous process and therefore, part of parcel of the overall management of the business.

12.2 MEANING AND DEFINITION OF WORKING CAPITAL

The term Working Capital has been defined by different authors in different ways.

According to "Hoagland", "Working Capital is descriptive of that capital which is not fixed. But, the more common use of Working Capital is to consider it as the difference between the book value of the current assets and the current liabilities.

Gerestenberg defines Working Capital as, "Circulating capital means, Current Assets of a Co. that are changed in the ordinary course of business from one form to another as for example from cash to inventories, inventories to receivables and receivables to cash."

The accounting principles Board of the American Institute of Certified Public Accountants define Working Capital as, "Working Capital is represented by the excess of current assets over current liabilities and identifies the relatively liquid portion of the total enterprise, capital which constitutes a margin or buffer for maturing obligation within the ordinary operating cycle of the business."

From the above definitions, Working Capital means the excess of Current Assets over Current Liabilities. Working Capital is the amount of net Current Assets. It is the investments made by a business organisation in short term Current Assets like Cash, Debtors, Bills receivable etc.

Current Assets are those assets which will be converted into Cash or will be realised within a year. These assets will be liquidated in the near future.

Current liabilities are those liabilities which will have to be paid within a year and include such income received in advance for which are to be given within 12 months.

Working Capital = Current Assets – Current Liabilities

12.3 WORKING CAPITAL CYCLE

Working Capital cycle is also known as operating cycle concept. This concept is based on continuity of flow of funds through business operations. This flow of value is caused by different operational activities during a given period of time. The operational activities of an organisation may include :

a) Purchase of raw materials.

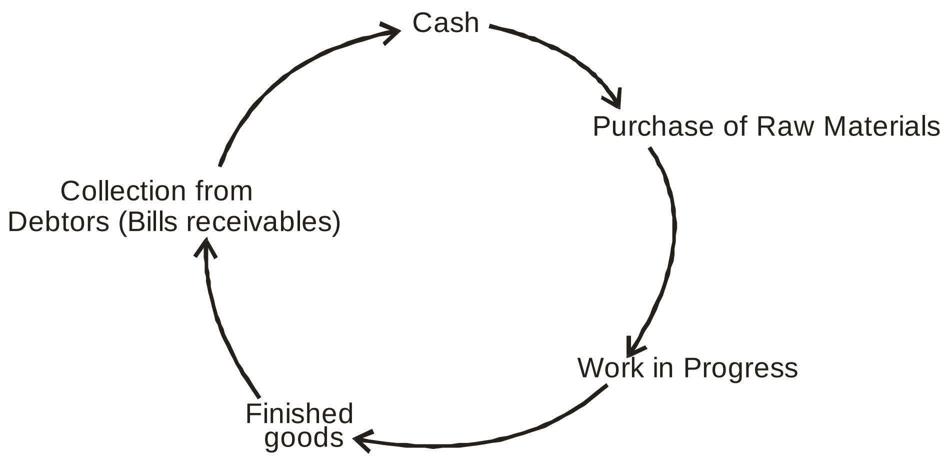
b) Conversion of raw materials into finished products.

c) Sale of finished products.

d) Realisation of accounts receivables.

The operating cycle of a manufacturing concern begins on the day it purchases raw material to produce the goods and ends on the day it receives the sale price from debtors. The period between these two days is the duration of the entire operating cycle.

Operating cycle of a manufacturing organisation

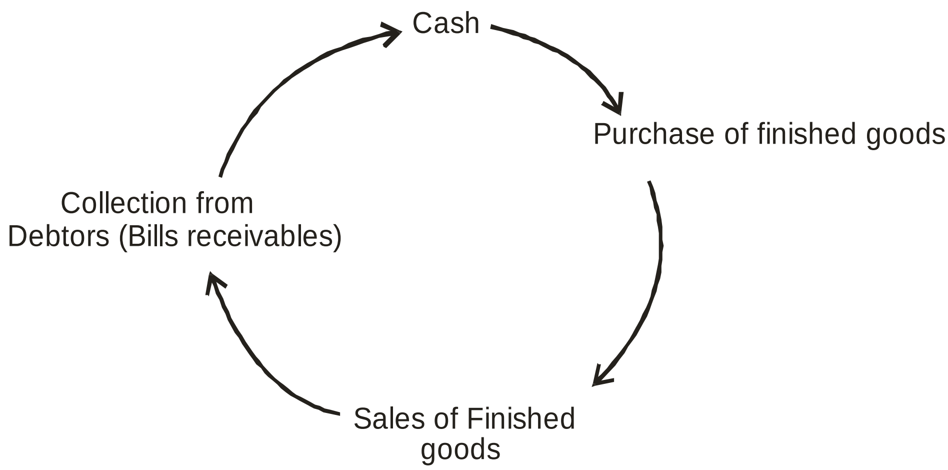


Operating cycle of a Trading Organisation :

In case of trading organisation, operational activities include:

1) Purchase of finished goods.
2) Sale of finished goods on cash or credit.
3) Collection from debtors (Bills Receivables).

Operating Cycle



When the goods are sold on credit basis, the sale of goods cannot be converted into cash instantly because of time lag between sales and realization of cash. Due to time lag between sales and realization of receivables, there is a need for sufficient Working Capital to deal with the problem which arises due to lack of immediate realization of cash against goods sold. The operating cycle is the length of time required for conversion of cash into raw material, raw material into work in progress, work in progress into finished goods, finished goods into bills receivables, bills receivables into cash and the same cycle repeats. Therefore operating cycle is a continuous process.

12.4 CLASSIFICATION OF WORKING CAPITAL

Working Capital can be classified into :

1) Gross and Net Working Capital.
2) Permanent and Temporary Working Capital.
3) Balance Sheet and Cash Working Capital.
4) Positive and Negative Working Capital.

1) Gross and Net Working Capital

Gross Working Capital is equal to total current assets only. It is identified with current assets alone. It is the value of non – fixed assets of an organisation and includes all current assets only. Items of current assets are stock of raw material, work in progress, finished goods spares and consumables, stores, sundry debtors, bills receivables, cash and bank balances, prepaid expenses, accrued income, advance payments, short term investments etc.

Gross Working Capital indicates the quantum of Working Capital available to meet current liabilities. This is very useful for planning of business activities in normal course.

Therefore, $\boxed{\text{Gross Working Capital} = \text{Total Current Assets}}$

Net Working Capital is the excess of current assets over current liabilities i.e. current assets less current liabilities.

$$\text{Net Working Capital} = \text{Total Current Assets} \; (-) \; \text{Total Current Liabilities}$$

In other words, total value of current assets is reduced by total current liabilities such as sundry creditors, bills payable, bank overdraft, income received in advance, outstanding liabilities, etc.

This is most common type of Working Capital. It indicates the amount available to meet short term dues of the concern. This concept is useful for calculating the amount of current assets available to meet the current liabilities. It indicates the liquidity of the concern in the immediate future.

2) Permanent and Temporary Working Capital

- **Permanent Working Capital**

A business organisation must always have a minimum amount of Working Capital to meet the current liabilities as and when they arise. In other words a concern must have minimum amount of fund to ensure liquidity and solvency. It is the minimum aggregate of cash, inventory and debtors maintained to carry on business operations smoothly at any time during an accounting period such minimum amount of Working Capital required to enable the concern to operate at the any level of activity is called permanent Working Capital. The quantum of permanent Working Capital will very according to the level of business activities from time to time.

Permanent Working Capital is of two types :

a) Initial Working Capital

b) Regular Working Capital

a) Initial Working Capital

This is the amount of Working Capital required at the inception of an organisation. In the initial stages, when the revenues are not regular, it may be difficult for a company to obtain credit from banks and at the same time it may be required to grant credit to its customers. In such cases, adequate Working Capital is required to activate the circulation of capital and keep it moving till the collection from debtors and other cash receipts exceed the payment. Therefore, it is the Working Capital in the initial stage to start the business and to commence the operating cycle.

b) Regular Working Capital :

This is the amount of Working Capital required for the continuous operations of an enterprise. It refers to the excess of current assets over current liabilities. Every organisation has to maintain a minimum stock of materials, finished goods and cash to ensure its smooth working and to meet its immediate obligations. This is the minimum amount of capital required to enable the concern to operate at the lowest level of activity. Such minimum amount of Working Capital is called Permanent Working Capital or Core Working Capital.

Then Permanent Working Capital is the quantum of funds required permanently for the production of goods and services on a continuing basis to satisfy the demands of customers Permanent Working Capital has following features.

a) It is constantly changing. They change from one current asset to another as in case of raw materials. Raw materials as they are in process, become semi finished goods, then finished goods and when they are sold become debtors, debtors when realized become cash and so on.

b) The size of permanent Working Capital will increase as long as the business is growing and expanding.

c) Permanent Working Capital is different from fixed assets which are sunk in the business operations and retain their firm for a long period.

- **Temporary or Variable Working Capital**

If the business organisation wants to increase its level of activity and produce and sell more goods, naturally it will need additional amount of Working Capital. If the increase in level of activity is temporary or seasonal, the additional Working Capital required is called Temporary Working Capital.

The amount of Temporary Working Capital varies with the level of activity (level of production). When the production is at higher level, larger Temporary Working Capital is needed, when the production level is lower, smaller amount of Temporary Working Capital is required. Therefore, Temporary Working Capital is also called as Variable or Fluctuating Working Capital.

Sometimes temporary Working Capital may be Seasonal Working Capital. It is the amount of Working Capital required at stated intervals to meet the changing seasonal requirements. When the season approaches, business needs more funds to meet the seasonal pressure of demand. For e.g. Sugar factories require large amount of Working Capital during peak season and much smaller amount of Working Capital once the season is over.

Temporary Working Capital can be financed through temporary sources of finance. E.g. short term loans, deposits, bank overdraft etc.

3) Balance sheet and Cash Working Capital

- **Balance Sheet Working Capital**

Working Capital is determined on the basis of the balances of current assets and current liabilities as per the closing balance sheet of the business. Such Working Capital which is computed on the basis of book values of current assets and current liabilities is called Balance Sheet Working Capital. Therefore, Balance Sheet Working Capital shows the amount of Net Current Assets as on the last day of accounting year of a concern. This concept of Working Capital helps in judging the liquidity and solvency of a concern.

- **Cash Working Capital**

It is that part of gross Working Capital which is essentially in liquid term. It is available in cash or cash resources. It is calculated from the items appearing in the Balance sheet. It shows the real flow of money at a particular time. It is considered to be the most realistic approach in Working Capital management. Cash Working Capital indicates the adequacy of the cash flow.

4) Positive and Negative Working Capital

- **Positive Working Capital**

When current assets exceed current liabilities, the Working Capital is said to be positive Working Capital. In other words when current assets are more than current liabilities, the net current asset is a positive figure and hence it is called Positive Working Capital. Such Working Capital indicates favourable liquidity and solvency position of the business.

- **Negative Working Capital**

When the current assets are less than the current liabilities, the Working Capital is said to be Negative Working Capital. In other words when current assets are less than current liabilities the net current asset is negative figure and hence it is called Negative Working Capital. Such Working Capital indicates lack of liquidity and adverse solvency position of the business.

12.5 FACTORS DETERMINING WORKING CAPITAL REQUIREMENTS

The amount of Working Capital required by a business organisation depends on many factors. They are as follows.

1) **Nature of Business :** The quantum of Working Capital required by a business organisation is related to the type and nature of its business activities. Public utilities (like railway companies) require less Working Capital as they sell services on cash basis only. But a trading organisation requires proportionately larger amount of Working Capital as it has to carry large inventories and allow credit to customers. Similarly, a manufacturing concern requires more Working Capital as compared to a firm engaged in trading. However, the requirement of Working Capital varies from industry to industry and from time to time in the same industry.

2) **Size of Business :** It is an important factor for determining the proportion of Working Capital. If the size of the business organisation in big, it require more Working Capital. On the other hand, small scale organisation requires less amount of Working Capital.

3) **Production Policies :** Production policies of a business organisation exert considerable influence on the requirement of Working Capital. But production policies depend on the nature of product. The level of production, decides the investment in current assets which in turn decides the quantum of working capital required.

4) **Terms of Purchase and Sale :** A business organisation making purchases of goods on credit and selling the goods on cash terms would require less Working Capital whereas an organisation selling the goods on credit basis would require more Working Capital. If the payment is to be made in advance to suppliers, then large amount of Working Capital would be required.

5) **Production Process :** If the production process requires a long period of time, greater amount of Working Capital will be required. But, simple and short production process requires less amount of Working Capital. If production process in an industry entails high cost because of its complex nature, more Working Capital will be required to finance that process and also for other expenses which very with the cost of production whereas if production process is simple requiring less cost, less Working Capital will be required.

6) **Turnover of Circulating Capital :** Turnover of circulating capital plays an important and decisive role in judging the adequacy of Working Capital. The speed with which circulating capital completes its cycle i.e. conversion of cash into inventory of raw materials, raw materials into finished goods, finished goods into debts and debts into cash decides the Working Capital requirements of an organization. Slow movement of Working Capital cycle requires large provision of Working Capital.

7) **Dividend Policies :** Dividend policies of a business organisation also influence the requirement of Working Capital. If a business is following a liberal dividend policy, it requires high Working Capital to pay cash dividends where as a firm following a conservative dividend policy will require less amount of Working Capital.

8) **Seasonal Variations :** In case of seasonal industries like Sugar, Oil mills etc. More Working Capital is required during peak seasons as compared to slack seasons.

9) **Business Cycle :** Business expands during the period of prosperity and declines during the period of depression. More Working Capital is required during the period of prosperity and less Working Capital is required during the period of depression.

10) **Change in Technology :** Changes in Technology as regards production have impact on the need of Working Capital. A firm using labour oriented technology will require more Working Capital to pay labour wages regularly.

11) **Inflation :** During inflation a business concern requires more Working Capital to pay for raw materials, labour and other expenses. This may be compensated to some extent later due to possible rise in the selling price.

12) **Turnover of Inventories :** A business organisation having low inventory turnover would require more Working Capital where as a business having high inventory turnover would require limited or less Working Capital.

13) **Taxation Policies :** Government taxation policy affects the quantum of Working Capital requirements. High tax rate demands more amount of Working Capital.

14) **Degree of Co-ordination :** Co-ordination between production and distribution policies is important in determining Working Capital requirements. In the absence of co-ordination between production and distribution policies more Working Capital may be required.

12.6 NEED FOR WORKING CAPITAL (IMPORTANCE OF WORKING CAPITAL)

'Working Capital' discussed in the earlier paragraphs mean excess of current assets over current liabilities. Such Working Capital is required to smooth conduct of business activities. It is as important as blood to body. An organisation's profitability depends on the quantum of Working Capital available to it. Adequate Working Capital is a source of energy to any business organisation. It is the life blood of an organisation.

The following points will highlight the need of Working Capital.

Adequate Working Capital :

a) Enables a company to meet its obligations.

b) Ensures the credit standing of a company.

c) Facilitates obtaining Credit from banks without any difficulty.

d) Ensures solvency of a company.

e) Enables a company to make prompt payments to its creditors and thereby take advantage of cash and quantity discounts offered by them.

f) Enhances the goodwill of a company as it can meet its operational expenses and maturing liabilities in time.

g) Improves the prospects of prosperity and progress of a company.

h) Enables an organisation to tide over difficult periods successfully.

Thus, adequate Working Capital is an important factor for prosperity and smooth running of a business organisation. It is rightly called as the “backbone” of the financial structure of a business organisation.

12.7 WORKING CAPITAL MANAGEMENT

Working Capital as it is explained in the earlier paragraphs, means excess of current assets over current liabilities. Working Capital management means all aspects of managing and controlling current assets and current liabilities. It is an attempt to solve the problems that arise in the management of current assets and current liabilities.

The main objective of Working Capital management is to manage the current assets and current liabilities of a business efficiently with the idea to bring about a satisfactory level of Working Capital so that the business can run smoothly. It aims to strike a judicious balance between individual items of current assets and current liabilities and thereby achieves a reasonable safety margin.

Working Capital management policies exercise strong influence on a company’s profitability, liquidity and its structural health. Estimating the amount of Working Capital required and identification of the source from which the required funds have to be raised, are the two main objectives of Working Capital management. Thus Working Capital management aims at best utilization of scarce resources to bring about satisfactory level of Working Capital and so that the business can run smoothly.

12.8 CHANGES IN WORKING CAPITAL

Working Capital means excess of current assets over current liabilities. It ensures the solvency of a company. It also ensures the credit standing of a company. But if the value of current assets increases, the Working Capital also increases and if value of current liabilities increases the Working Capital decrease. Therefore, change in current assets and current liabilities also change the Working Capital of the organisation.

The following list shows the effect of change in current assets or current liabilities on the Working Capital.

Change in Current Assets or Current Liabilities	Effects on Working Capital
Increase in Current Assets	Increase in Working Capital
Decrease in Current Assets	Decrease in Working Capital
Increase in Current Liabilities	Decrease in Working Capital
Decrease in Current Liabilities	Increase in Working Capital
Realization from Debtors	No change in Working Capital
Obtaining Bills Receivable from Debtors	No change in Working Capital
Bills payable issued to Creditors	No change in Working Capital
Sales of goods on credit	No change in Working Capital
Purchase of Stocks on credit	No change in Working Capital
Payment of cash to Creditors	No change in Working Capital
Payments of Cash against Bills Payable	No change in Working Capital
Collection of Cash on Bills Receivable	No change in Working Capital

12.9 KEY POINTS

- Working Capital is excess of Current Assets over Current Liabilities.
- Current Assets include Stock, Debtors, Work in Progress, Bills Receivables, Cash / Bank, Prepaid Expenses.
- Current liabilities include Creditors, Bills Payable, Bank Overdraft, and Outstanding Expenses.
- Operating cycle of a manufacturing organisation includes operational activities like purchase of raw materials, payment of wages and expenses, production of finished goods, sale of finished goods on cash and credit, collection from debtors.
- Operating cycle of a trading organisation includes operational activities like purchase of finished goods, sale of finished goods on cash and credit, collection from debtors.
- Classifications Working Capital
  - o Gross and Net Working Capital
  - o Permanent and Temporary Working Capital

- o Balance Sheet and Cash Working Capital
- o Positive and Negative Working Capital

o Determinants of Working Capital

12.10 ADDITIONAL READINGS

1) Introduction to Management Accounting by Chopade and Chaudhari

2) Introduction to Management Accounting by Ainapure.

12.11 EXERCISE

1) Define Working Capital. Explain the importance of Working Capital in business.
2) What is Working Capital and what are the types of Working Capital?
3) What is Working Capital? Explain the factors determining Working Capital requirements.
4) Write short notes on :
   a) Permanent and Temporary Working Capital
   b) Gross and Net Working Capital
   c) Balance Sheet and Cash Working Capital
   d) Positive and Negative Working Capital.
5) What is Working Capital? Explain the need for Working Capital.

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13

BUDGETING-I

Unit Structure:

13.0 OBJECTIVES

After studying the unit the students will be able to:

- Understand the meaning of Budget and Budgetary control.
- Know the purpose of Budget.
- Explain the types of Budget.
- Understand how to prepare cash budget.

13.1 MEANING OF BUDGET

Budget means a financial and quantitative statement prepared and approved prior to a defined period of time. It is plan of expected achievements based on most efficient operating standards in effect. It may be considered as a guide.

13.2 PURPOSE OF BUDGET

1. Planning
2. Co-ordination
3. Control

1. **Planning –** It helps in combining ideas of different management levels. So that maximum profitability is achieved.

2. **Co-ordination –** It brings different people together in accomplishing the organizational goals.

3. **Control –** It helps in comparing the actual results with the estimates and putting controls wherever required.

13.3 BUDGETORY CONTROL

It is a system of planning and controlling costs. It helps in comparing the actual results with budgeted estimates to secure by individual action the objective of that policy or to provide basis for its revision.

STEPS IN BUDGETORY CONTROL

1. **ESTABLISHMENT OF BUDGETS –** Budgets are prepared for each division and are well co-ordinated with each other to prepare the master budget of a firm.
2. **MEASUREMENT OF ACTUAL PERFORMANCE –** The actual results are measured to compare with the budgets.
3. **COMPARISON AND VARIANCES –** The actual results after comparing with standards, deviations are work out known as variances.
4. **ANALYSIS OF CAUSES OF VARIATION –** The deviations between budgeted and actual results are studied and analysed help in taking the right action in right time.

13.4 PREPARATION OF BUDGETS AND TYPES

13.4.1 MASTER BUDGET – It is defined as summary budget which includes different functional budgets and which is finally approved adopted and employed. It is defined as a budget which summarises all functional budgets when all functional budgets are prepared they are summarized to produce.

i. Profit & Loss Account and Profit & Loss Appropriation Account.
ii. Balance Sheet.

Master Budget takes the form of budged Profit & Loss Account and Balance Sheet. It is overall business plan and familiar to financial statements. The only difference is that the accountant here deals with expected future data rather than historical data.

The budget committee will prepare the master budget based on the functional budget. Once it is approved by the committee it becomes the target for the firm during the budget period.

13.4.2 FIXED BUDGET – Budget prepare at single level of activity are referred to as Fixed Budget. Such budgets focus only on a specific activity and a specific level. All adjustments are made considering only this level of activity.

13.4.3 FLEXIBLE BUDGET – Flexible Budget estimates cost of several level of activities. Instead of one estimates it contains several estimates in different assumed circumstances. The construction of flexible budget is similar to fixed budget is based on cost and other business operations at one level, the flexible budget consider several operations. The essence of flexible budget is the presentation of estimated cost date in a manner that permits there determination at various levels of volume. This means that all costs must be identified into fixed and variable. Fixed cost remain unchanged. They are fixed for a relevant range of volume for a given budget period.

Variable cost fluctuate in direct proportion to the activity/ volume with in relevant range for a given budget period. Mixed cost contents both fixed and variable element.

13.4.4 CASH BUDGET – A Cash Budget is a projected cash transaction in future that is utilized in controlling actual receipts and payments by mending for the variances. It starts with a given 'Cash Balance' which may be either big or small. But the said balance is, in any case, desired to be 'the optimum balance'. The sign of optimality for a given cash balance is obviously its ability to produce the highest rate of return for the minimum cost for mainly the said cash balance.

The main aim of Cash Budget is to ascertain whether there is excess or deficit of cash. It involves different steps.

i. The First element is selection of time period to be covered which is known as planning horizon. This coverage will differ from firm to firm depending upon its nature and degree of accuracy.

ii. The Second element is the factors affecting the cash flows. Non cash items such as, depreciation are excluded from Cash Budget. The cash flow is affected by two factors operating and financial. The operating category includes cash flow generated by operations of the firm and are known as operating cash flows. The other category is known as financial cash flow.

a) Operating Cash Flow contains the following.

INFLOW	**OUTFLOW**

1. Cash Sales	1. Cash Purchases
2. Collection from Debtors	2. Payment to Creditors
3. Sale of Assets	3. Purchase of Assets.
	4. Operating Expenses Paid

b) Financial Cash Flow contains the following.

INFLOW	OUTFLOW
1. Loans taken	1. Repayment of Loan
2. Sale of Investments	2. Purchase of Investment
3. Issue of Shares	3. Redemption of Shares
4. Interest, Divided, Rent Received.	4. Interest, Dividend, Rent Paid

13.5 METHODS OF PREPARATION OF CASH BUDGET

Methods used for cash forecasting – There are two recognized ways of preparing a cash forecasting.

13.5.1 The Receipt & Payment Method.

13.5.2 The Income Statement Cash Flow Method (Adjusted Profit & Loss method)

13.5.1 THE RECEIPT AND PAYMENT METHOD – Under this method, all expected cash receipts and payments during the period; under consideration are taken into account. The expected cash balance of a week or month will be equivalent to the difference between total expected Cash Receipts including opening balance, if any, and total expected Cash Payment during that period. The budget is generally prepared from various plans.

i. Cash Receipts from Customers, based on sales forecast, the term of sale, lag in payment etc. are generally taken into consideration.

ii. Cash Receipts from other sources, such as dividend on trade investments, rent, issue of capital, sale of; investment and fixed assets etc.

iii. Cash requirements for materials, wages and salaries and overhead expenses based on purchasing, personnel and overhead budgets. The policy of the business with regard to the payment of supplier's accounts, the term of cash discount, the lag in payment of wages etc. are given due consideration.

iv. Cash requirements for capital expenditure as per capital expenditure budget.

v. Cash requirement for other purposes, such as payment of dividend, income tax, fines, penalties etc.

FORMAT OF CASH BUDGET (Monthly / Quarterly)

Month/ Quarter Particulars	1	2	3	4	Total
Opening Balance	x				x
Cash Sales					
Collection from Debtors					
Income from Investments					
Loans					
Share Capital					
Others					
Total Receipts (A)					
Cash Purchases					
Creditors					
Salaries & Wages					
Overhead Expenses					
Dividend					
Income Tax					
Capital Expenditure					
Repayment of Loan					
Others					
Total Payments (B)					
Closing Balance (A-B)				y	y

13.5.2 THE INCOME STATEMENT CASH FLOW METHOD (ADJUSTED PROFIT & LOSS ACCOUNT) –

This method is based both on cash and non-cash transactions. Under this method, budgeted net profit is adjusted by adding back non-cash charges and deducting non-cash credits and adding or deducting changes in assets or liability accounts which affect cash. The theory is based upon the basic assumption that profit will be equivalent to cash, or in other words, the earning of profit brings equal amount of cash into the business. This also leads one to another assumption that the business will remain static. That is, there will not be wearing out or expansion of assets; balances of debtors, creditors, stock etc will remain unchanged. So that total cash available for distribution would be equal to the profit earned. But in practice a business does not remain stationery so that an adjustment will have to be made in respect of many items like fluctuations of stock, appropriation of profit, provisions, accruals etc.

Thus, the preparation of a cash budget under this method depends on the availability of the following information :-

a. Budgeted Profit & Loss Account for the budget period in respect of which the cash budget is to be prepared.
b. Budgeted Balance Sheet as at the end of the same period and
c. The Balance Sheet as at the end of the previous period.

This method may be employed for making long term cash forecasts.

(**Note:** First Method of Cash Budget is a part of the syllabus.)

13.6 EXERCISE

1. Define Budget. Explain the purpose of Budget.
2. Which are the types of Budget?
3. Explain the Methods of preparation of Cash budget.
4. Explain Cash Budget briefly.

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14

BUDGETING-II

Unit Structure:

14.0 OBJECTIVES

After studying the unit the students will be able to solve the practical problems of Cash Budget.

14.1 ILLUSTRATIONS

Illustration 1 : Prepare Cash Budget for the 6 months ending 31st December, 2003 from the monthly budgeted operating results of the company and other additional information is given below :

Month	Sales	Material Purchased & Consumed	Wages	Production	Adminis-tration	Selling	Distribu-tion	Research & Develop-ment
March	8,00,000	3,60,000	80,000	48,000	40,000	20,000	10,000	11,000
April	12,00,000	6,00,000	1,28,000	64,000	56,000	29,000	14,000	16,000
May	9,60,000	5,20,000	1,20,000	62,000	48,000	25,000	10,000	12,000
June	6,40,000	3,36,000	56,000	30,000	20,000	11,000	6,000	6,000
July	8,00,000	3,84,000	80,000	44,000	32,000	16,000	8,000	10,000
Aug.	8,80,000	4,00,000	96,000	49,000	40,000	21,000	10,000	12,000
Sept.	11,20,000	4,96,000	1,20,000	62,000	52,000	26,000	12,000	13,000
Oct.	12,80,000	6,00,000	1,04,000	54,000	40,000	20,000	10,000	12,000
Nov.	14,40,000	6,40,000	1,36,000	72,000	56,000	29,000	15,000	16,000
Dec.	16,00,000	8,00,000	1,52,000	74,000	58,000	30,000	16,000	17,000

1. New machinery which was installed in April at a cost of Rs. 120000 is to be paid on 1st August. Extension to the Research & Development Department amounting to Rs. 8,00,000 in total was contemplated from September, at the rate of Rs. 1,60,000 per month.
2. Rs. 2, 40,000 per month is to be paid under a hire purchase scheme agreement.
3. The Sales Commission of 4% on sales not included in Selling Overheads is to be paid within the month following actual sales.

4. The period of credit allowed by supplier is 4 months, and that allowed to customers is 3 months. The delay in the payment of overheads is 2 months and that in payment of wages is one-fourth of a month.
5. Preference Share Dividend of 8% on the capital of Rs. 1,60,00,000 is payable on 1st December.
6. 8% Calls on Equity shares at the rate of Rs. 9,60,000 is due on 1st July, 1st Sept, and 1st November.
7. Taxation of Rs. 8,00,000 is payable on 1st November. Dividend on investment amounting to Rs. 2,40,000 is expected on 1st July and 1st December. Cash sales of Rs. 80,000 per month are expected on which no commission is payable. This cash sales is not included in the details for sales given above.
8. Cash balance on 1st July was expected to be Rs. 2,00,000.

SOLUTION :

CASH BUDGET FOR 6 MONTHS ENDED 31ST December, 2003

Month/ Quarter	**JULY**	**AUG**	**SEPT**	**OCT**	**NOV**	**DEC**	
Particulars							
Opening Balance	2,00,000	8,44,600	7,35,600	12,48,400	10,99,600	11,07,400	
Cash Sales	80,000	80,000	80,000	80,000	80,000	80,000	
Collection from Debtors	12,00,000	9,60,000	6,40,000	8,00,000	8,80,000	11,20,000	
Share Capital	9,60,000	--	9,60,000	--	9,60,000	--	
Dividend on Investment	2,40,000	--	--	--	--	2,40,000	
Total Receipts (A)	**26,80,000**	**18,84,600**	**24,15,600**	**21,28,400**	**30,19,600**	**25,47,400**	
Creditors	3,60,000	6,00,000	5,20,000	3,36,000	3,84,000	4,00,000	
Wages	62,000	84,000	1,02,000	1,16,000	1,12,000	1,40,000	
Production overhead	62,000	30,000	44,000	49,000	62,000	54,000	
Administration overhead	48,000	20,000	32,000	40,000	52,000	40,000	
Selling overhead	25,000	11,000	16,000	21,000	26,000	20,000	
Distribution overheads	10,000	6,000	8,000	10,000	12,000	10,000	
Research & Development	12,000	6,000	10,000	12,000	13,000	12,000	
Machinery Purchase	--	1,20,000	--	--	--	--	
Extension to R & D	--	--	1,60,000	1,60,000	1,60,000	1,60,000	
Hire Purchase Installment	2,40,000	2,40,000	2,40,000	2,40,000	2,40,000	2,40,000	
Sales Commission	25,600	32,000	35,200	44,800	51,200	57,600	
Preference Dividend	--	--	--	--	--	12,80,000	
Taxation	--	--	--	--	8,00,000	--	
Total Payments (B)	**18,35,400**	**11,49,000**	**11,67,200**	**10,28,800**	**19,12,200**	**11,46,400**	
Closing Balance (A-B)	**8,44,600**	**7,35,600**	**12,48,400**	**10,99,600**	**11,07,400**	**14,01,000**	
Working Note :							
for Wages	**June**	**July**	**Aug**	**Sept**	**Oct**	**Nov**	**Dec**
Actual Wages	56,000	80,000	96,000	1,20,000	1,04,000	1,36,000	1,52,000
Paid 1/4 in Current Month	14,000	20,000	24,000	30,000	26,000	34,000	38,000
3/4 paid in next month	90,000	42,000	60,000	72,000	90,000	78,000	1,02,000
Wages Paid	1,04,000	62,000	84,000	1,02,000	1,16,000	1,12,000	1,40,000

Working Note:

	Mar	April	May	Jun	July	Aug	Sep	Oct	Nov
Material	Paid to Creditors								
Purchased	3,60,000	6,00,000	5,20,000	3,36,000	3,84,000	4,00,000	4,96,000	6,00,000	6,40,000
	1	2	3	4					
4 months Creditors	(March paid in July)				3,60,000	6,00,000	5,20,000	3,36,000	3,84,000
Debtors	Collection from Debtors								
Read									
Sales	8,00,000	12,00,000	9,60,000	6,40,000	8,00,000	8,80,000	11,20,000	12,80,000	14,40,000
3 months credit	1	2	3	80,00,000	12,00,000	9,60,000	6,40,000	8,00,000	8,80,000
	(March Received in June)								
Selling Overheads									
(4% of Sales)									
Commission	32,000	48,000	38,400	25,600	32,000	35,200	44,800	51,200	57,600
(Paid in the following month it means next months)									
Sales Commission	--	32,000	48,000	38,400	25,600	52,000	35,200	44,800	51,200
(Other overheads for e.g. Production oh./ Administration Overheads /Selling Distribution / Research & Development Exp.)									
(Overheads paid after 2 months)									
Production on	48,000	64,000	62,000	30,000	44,000	49,000	62,000	54,000	72,000
	1	2							
(March paid in May)									
			48,000	64,000	62,000	30,000	44,000	49,000	62,000

Illustration 2 : Prepare a Profit Budget and a Cash Budget for the 1st Quarter April – June 2004 for KG Industrial Ltd. From the following information:

a. The company produces two products and their unit sale prices and material contents are as under :-

	Sale Price	Material Content
Product A	Rs.75,000	60% of sale price
Product B	Rs.25,000	50% of sale price

(In addition Excise duty and sales tax as per item (f) below is recovered)

b. The production target has been fixed as under :

Month	Product A	Product B
April	50 Nos.	50 Nos.
May	60 Nos.	60 Nos.
June	70 Nos.	60 Nos.

Production for January, February and March 2004 was at 80% level of April 2004 production.

c. The monthly expenses are as under :

   i. Salaries & Wages Rs. 7.50,000 payable in the following month.

   ii. Variable overheads – 5% of sale value payable in the following month.

   iii. Fixed overheads – Rs. 2,00,000 payable 50% in the current month and 50% in the following month.

d. Payment for material is made in the third month from the month of procurement.

e. The company maintains a constant level of inventory. No Stock of finished goods is kept and the entire production is invoiced the same month. The company gives 30 days credit to its customers.

f. Company's products attract Excise Duty @ 15% and Sales Tax @ 2% on sales payable to the authorities in the following month.

g. The company enjoys a Cash Credit facility from its Banker to the extent of Rs. 35,00,000, which is fully drawn. The interest payable is @ 17% which is charged every quarter that is, June, September, December and March. The Company carries its banking operation presently through a Current Account.

SOLUTION :

Cash Budget

PARTICULARS	APRIL 04	MAY 04	JUNE 04
RECEIPTS :			
Debtors A	3519000	4398750	5278600
B	1173000	1466250	1759500
Total Receipts (1)	4692000	5865000	7038100
Payments :			
Creditors	2300000	2300000	2300000
Salaries & Wages	750000	750000	750000
Variable Overheads A	150000	187500	225000
B	50000	62500	75000

Fixed Overhead	200000	200000	200000
Excise Duty A	450000	562500	675000
B	150000	187500	225000
Sales Tax A	69000	86250	103500
B	23000	28750	34500
Total Payments (2)	4142000	4365000	4588000
Net (3 = 1-2)	550000	1500000	2450000
Add : Overdraft (Opening)	3500000	2950000	1450000
Overdraft (Closing)	2950000	1450000	1000000
	(-) Interest		111917
			888083

Working note

No.1

Interest on Overdraft

April - 35,00,000

May - 29,50,000

June - 14,50,000

79,00,000

Interest $79{,}00{,}000 \times 17\% \times \frac{1}{12} = 1{,}11{,}917$

No. 2

	Jan	Feb	Mar	April	May	June
Sales	(80% of 50					
A	(40 x 75,000)			(50 x 75000)	(60 x 75,000)	(70 x 75,000)
	30,00,000	30,00,000	30,00,000	37,50,000	45,00,000	52,50,000
B	(80% of 50)					
	(40 x 2,50,000)			(50x25,000)	(60x25,000)	(60 x 25,000)
	10,00,000	10,00,000	10,00,000	1,25,000	15,00,000	15,00,000

Collection from DB following month it means in the next month.

<u>Month Debtors collected in April</u>

Product A -	30,00,000	
(+) Excise duty @ 15% of 3,00,000	4,50,000	Receivable
(+) Sales Tax @ 2% of 34,50,000	69,000	Receivable

Collection from Debtors = **35,19,000**

Product B - **10,00,000**

(+) Excise Duty @ 15% of 10,00,000 1,50,000 Receivable

(+) Sales Tax @ 2% of 11,50,000 23,000 Receivable

Collection from Debtors **1,17,30,000**

Same as next month

Material Cost → Creditors

Purchases of Jan, Feb & March paid in April, May, June respectively.

Product A (80% of 50 Units)

75,000 x 40 x 60% → 18,00,000

B (80% of 50 Units)

25,000 x 40 x 50% → 5,00,000

Payment to creditors → **23,00,000**

Variable overheads 5% of sales value payable in the following month means next month. (March paid in April)

Product A → 75,000 x 40 x 5% → 1,50,000

B → 25,000 x 40 x 5% → 50,000

2,00,000

Illustration 3 : The following is the Balance Sheet of Amar Industries Ltd. As at 31st March, 2006.

Liabilities	**Rs. In Lakhs**
Capital & Reserves	1,650
12% Debentures	900
Creditors for Purchases	600
Creditors for Expenses	70
Provision for Bonus	30
Provision for Tax	100
Proposed Dividend	50
Total	**3,400**
Assets	**Rs. In Lakhs**
Fixed Assets at Cost	1,300
Less : Depreciation	- 400
Sundry Debtors	900

Stocks and Stores Loans and Advances Cash and Bank Balances	700 1,200 500 100

The projected Profit & Loss Account for the first four months in the year 2006-07 shows the followings:

Particulars	April	May	June	July
Sales	800	800	900	900
excise duty Recoveries	80	80	90	90
	880	880	990	990
Material				
opening stock	1,200	1,200	1,260	1,320
Add : Purchases	600	660	720	720
Less : Closing Stock	1,200	1,260	1,320	1,320
Net	600	600	660	7,200
Expenses	180	180	200	200
Excise Duty	80	84	88	90
TOTAL	**860**	**864**	**948**	**1,012**
Profit / Loss	20	16	42	(20)

The following are relevant additional information:

1. 10% of sales are for cash and the balance on 30 days credit.
2. Creditors for purchases are paid in 30 days.
3. Expenses include :
    a. Interest payable at the end of each quarter.
    b. Depreciation of Rs. 10 lakhs per month.
    c. Provision for bonus to workmen of Rs. 5 lakhs per month, payable only in October, 2006
    d. One half of the rest of the expenses payable in the month concerned and the following month.
4. Rs. 200 lakhs of debentures are redeemable by 30th June.
5. Provision for taxation includes Rs. 20 lakhs of surplus provisions carried forward earlier years besides the balance for the year 2005-06 payable before 31st May, 2006.
6. Annual General Meeting is to be held on 31st May, 2006.
7. Overdraft is permissible interest on which may be ignored.

You are required to prepare Cash Budgets for the months of April to July 2006 on a monthly basis.

SOLUTION :

Amar Industries Ltd.
Cash Budget

(Rs. In Lakhs)

Particulars	APRIL	MAY	June	July
Opening Balance	100	60	20	--
Cash Sales	88	88	99	99
Credit Sales	700	792	792	891
Overdraft	--	--	272	--
Total Receipts (1)	888	940	1183	990
Payments :				
Creditors	600	600	660	720
Expenses (1/2)	78	78	80	80
(1/2)	70	78	78	80
Interest Debentures	--		27	--
Debentures Redem	--		200	--
Dividend	--		50	--
Tax	--	80	--	--
Excise Duty	80	84	88	90
O/D Repayment	--	--	--	20
Total Expenses	828	920	1183	990
Closing Balance/ Overdraft.	60	20	--	- 252

Working Note

Collection from Debtors:

Balance of March 2006 paid in April

Sundry Debtors – 700

May- Sales of April 880

(-) 10% Cash Sales 88

792

June – Sales of May 880

(-) 10% Cash Sales 88

792

July – Sales of June 990

(-) 10% of Cash Sales 99

891

Creditors for purchases

Balance of march 2006 paid in April

Sundry creditors = 600

April paid in May = 600

May paid in June = 660

June paid in July = 720

Breaking of expenses:

Particulars	**April**	**May**	**June**	**July**
Total Expenses	180	180	200	200
(-) Non-Cash exp.				
Depreciation	10	10	10	10
Int on Debenture	9	9	9	9
Bonus	5	5	5	5
	24	**24**	**24**	**24**
Balance Exp	156	156	176	176
Half paid in concern month	78	78	88	88
Half in the next month	-	78	78	88
March half exp paid in April	70	-	-	-
Total Exp paid	**148**	**156**	**166**	**176**

Illustrations 4 : Prepare Cash Budget for April – October 2011 from the information supplied by Mahesh Stores.

Balance Sheet as on 31st March, 2011

Liabilities	**Amount**	**Assets**		**Amount**
Proprietors Capital	1,00,000	Cash		20,500
Outstanding Liabilities	17,000	Stock in trade		50,500
		Sundry Debtors		26,000
		Furniture	25,000	
		Less : Depreciation	5,000	20,000
	1,17,000			**1,17,000**

Expected for	Sales (Rs.)	Salaries (Rs.)
April	30,000	3,000
May	52,000	3,500
June	50,000	3,500
July	75,000	4,000
August	90,000	4,000
September	35,000	3,000

Other Expenses :- Rent Rs. 1000 pm.
Sales Commission – 1% of sales
Misc. Exp. Rs. 500 pm.

Sales – 80% on Credit and 20% on cash

Out of the Credit sales – 70% collected after one month and remaining in next month.

Gross margin is 70% purchases equal to requirement of next months sales are made for which payment is against delivery.

Debtor on 31^{st} March, 2011 included Rs.20,000 for February and remaining for January.

Cash on Hand should be Rs. 10000 at all times. The deficiency to be met by short term loans.

Prepare Cash Budget for April to August 2011 and ascertain the borrowing to be made from time to time.

SOLUTION:

M/s Mahesh Stores					
Cash Budget from April to August.					
Particulars	**April**	**May**	**June**	**July**	**Aug**
Opening Balance	20,500	10,000	10,000	10,000	10,000
Receipts:					
Debtors					
20% Cash sales	6,000	10,400	10,000	15,000	18,000
Out of 80% -70% Credit Sales	14,000	16,800	29,120	28,000	42,000
Out of 80% -30% Credit Sales	6,000	6,000	7,200	12,480	12,000
Total Receipts (1)	46,500	43,200	56,320	65,480	82,000

Payments :					
Outstanding Liabilities	17,000	--	--	--	--
Salaries	3,000	3,500	3,500	4,000	4,000
Rent	1,000	1,000	1,000	1,000	1,000
Sales Commission	300	520	500	750	900
Misc. Expenses	500	500	500	500	500
Cash Purchases	15,600	15,000	22,500	27,000	10,500
(Next month sales * 30%)					--
Short term loan repaid	--	900	--	--	--
Total Payments (2)	37,400	21,420	28,000	33,250	16,900
Short term loan taken	900	--	--	--	--
closing Balance of Cash (3)	10,000	21,780	28,320	32,230	65,100
Invested in Securities (1-2-3)	--	11,780	18,320	22,230	55,100

Working Note

Particulars	**April**	**May**	**June**	**July**	**Aug**	**Sep**
Sales	30,000	52,000	50,000	75,000	90,000	35,000
20% cash sales	6,000	10,400	10,000	15,000	18,000	7,000
80% creditors	24,000	41,600	40,000	60,000	72,000	28,000
70% in next month	14,000	16,800	29,120	28,000	42,000	50,400
30% in next to next	6,000	6,000	7,200	12,480	12,000	18,000
Creditors 30% of sales of the next month						
Creditor previous month of sales						
30%	52,000	50,000	75,000	90,000	35,000	-
	15,600	15,000	22,500	27,000	10,500	-
Sales commission	1% of sales of the respective months					
Commission Sales	300	520	500	750	900	350

Illustration 5: Microsoft Ltd. Wants you to prepare the cash budget of the company for the three months, April to June 2011. You are given the following information:

1) Operation

2011	Sales Rs.	Purchases Rs.	Wages Rs.	Other Rs.
April	60,000	20,000	15,000	10,000
May	50,000	20,000	15,000	10,000
June	80,0000	40,000	15,000	15,000
July	1,00,000	50,000	25,000	20,000
August	1,40,000	70,000	25,000	20,000
September	1,60,000	60,000	30,000	20,000

2) Sales are 20% cash and the balance at two months credit; purchases are at one months credit; subject to a cash discount of 5%.

3) Wages are paid ½ month in arrear and other expenses are paid one month in arrear.

4) During August the company pays a dividend of 15% on its equity capital of Rs. 2,00,000 and during September deferred payment installment (quarterly) of Rs. 25,000 will fall due.

5) It is expected that at the end of the June 2009 there will be cash balance of Rs. 14,000.

Prepare the cash budget as requested by the company.

Solution:

M/s Microsoft Ltd.			
Cash Budget from July to September 2011.			
Particulars	**July**	**Aug**	**Sept**
Opening Balance	14,000	1,000	- 29,500
Receipts			
Cash Sales	20,000	28,000	32,000
Collected from Debtors	40,000	64,000	80,000
Total Receipts (1)	74,000	93,000	82,500
Payments :			
Creditors	38,000	47,500	66,500
wages	20,000	25,000	27,500
Other Expenses	15,000	20,000	20,000
Dividend Paid	--	30,000	--
Deferred installment	--	--	25,000
Total Payments (2)	73,000	1,22,500	1,39,000
Closing Balance of Cash (3) (1 – 2)	1,000	- 29,500	- 56,500

Working Notes

Particulars	**April**	**May**	**June**	**July**	**Aug**	**Sep**
Sales given	60,000	50,000	80,000	1,00,000	1,40,000	1,60,000
20% Cash	**12,000**	**10,000**	**16,000**	**20,000**	**28,000**	**32,000**
80% credit	48,000	40,000	64,000	80,000	1,12,000	1,28,000
Collection from Debtors	-	-	48,000	4,00,000	64,000	80,000
Creditors	20,000	20,000	40,000	50,000	70,000	60,000
5% discount	1,000	1,000	2,000	2,500	3,500	3,000
Net payment to CB	19,000	19,000	38,000	47,500	66,500	57,000
One month credit	-	19,000	19,000	38,000	47,500	66,500
Wages	15,000	15,000	15,000	25,000	25,000	30,000
50% ½ month arrears	7,500	7,500	7,500	12,500	12,500	15,000
50% ½ next month	-	7,500	7,500	7,500	12,500	12,500
Total wages paid	**7,500**	**15,000**	**15,000**	**20,000**	**25,000**	**27,500**
Other Exp	10,000	10,000	15,000	20,000	20,000	20,000
Paid in next month	-	10,000	10,000	15,000	20,000	20,000

Illustration 6: Mr. Tushar promoted a company Tushar Enterprises Limited on 1st Oct 2011. It received certificate to commence business on 15th Nov.,2011.

On 1st December, 2011 the company issued 5000 Equity Shares of Rs. 10/- each at par to promoters against full cash payment In the same month allotted 20,000 shares to friends and relatives at par for full cash payment.

On 15th December, 2011, company bought premises costing Rs. 2,00,000 and equipment costing Rs. 3,00,000 On the same date a loan to the extent of 60% of cost of these assets was received from bank. The loan is to be repaid by twenty equal quarterly installments payable on 15th March, June, September, and December each year. Interest @ 15% p.a. on unpaid balance is to be paid with installment.

The commercial production began from 1st January, 2012. The target sales are as under:

Jan 1000 units

Feb 1500 units

March 2500 units

The cost and sales per units are as under:

Raw material Rs. 5 units @ Rs. 10/- 50 per unit

Wages 2 hour @ Rs. 20/- 40 per unit.

Factory Expenses

Variable Rs. 20 per unit.

Fixed Rs. 10,000 per month.

Administration Exp. Rs. 5,000 per month

Selling Expenses Rs. 20 per unit.

Sales Price Rs. 200 per unit.

The stock of raw materials is to be maintained at 5,000 units and of finished goods at 1,000 units. The purchase/ production for the stock should be effected in January.

The processing time may be ignored. The terms of credit are-

1. Cash sales will be 500 units per month and remaining sales will be on credit of one month.. It is expected that 60% will pay within credit period and remaining will pay a month later.
2. Payment for purchases of material is to be made as 25% on delivery and balance one month later.
3. Wages are to be paid fortnightly but after lapse of 3 days thereafter.
4. Fixed factory expenses are payable at the end of the month to which they relate.

5) Remaining factory and administration expenses are payable 60% in same month and balance in following month.

6) Selling expenses are to be paid a month after sales is effected.

You are required to prepare Cash budget for period from December-2011 to March -2012.

Solution :

Cash Budget from December to March 2012.

Particulars	Dec	Jan	Feb	March
Opening Balance	--		35,500	- 74,750
Receipts				
Equity Shares issued				
to promoters	50,000	50,000	--	--
to friends	2,00,000	--	--	--
Bank Loan	3,00,000	--	--	--
Cash Sales	--	1,00,000	1,00,000	1,00,000
Collected from Debtors	--	--	--	12,000
Collected from Debtors	--	--	60,000	40,000
Total Receipts (1)	5,50,000	1,50,000	1,95,500	1,85,250
Payments :				
Plant	2,00,000	--	--	--
Equipment	3,00,000	--	--	--
Bank Loan	--	--	--	15,000
Interest on Bank Loan	--	--	--	11,250
Creditors for	--	37,500	18,750	31,250
Material	--	--	1,12,500	56,250
wages	--	40,000	30,000	50,000
	--	--	40,000	30,000
Factory Exp (Fixed)	--	10,000	10,000	10,000
Factory Exp (Variable)	--	24,000	18,000	30,000
	--	--	16,000	12,000
Administration Expenses	--	3,000	3,000	3,000
	--	--	2,000	2,000
Selling Expenses	--	--	20,000	30,000
Total Payments (2)	5,00,000	1,14,500	2,70,250	2,80,750
closing Balance of Cash (3 = 1 - 2)	50,000	35,500	- 74,750	- 95,500

Working Note 1:-

Production of 1000 units of finished goods	-	5000 units.
Closing stock of 1000 units of finished goods	-	5000 units.
Closing stock of raw materials	-	5000 Units.
		15000 Units.

Feb 2012	1500 * 5	7500 Units.
Mar 2012	2500 * 5	12500 Units.

Finished goods to be produced

Jan 2012 Production 1000 Units

Closing Stock <u>1000 Units.</u>

Feb 2012 2000 Units.

Mar 2012 2500 Units.

Working Note 2:

Jan – Sales 1,000

Closing stock <u>1,000</u>

2,000 – Production. Jan

1,500 – Feb

2,500 – Month

Particulars	**Jan**	**Feb**	**March**
Production (op stock + cl. stock + Production)	3,000	1,500	2,500
Raw material per unit	50	50	50
Total creditors	1,50,000	75,000	1,25,000
*25% against delivery	37,500	18,750	31,250
*75% in next month	-	1,12,500	56,250
Wages (units)	2,000	1,500	2,500
Per unit	40	40	40
Total wages	80,000	60,000	1,00,000
* 50% paid in the month	40,000	30,000	50,000
* 50% paid in the next month	-	40,000	30,000
Sales			
Cash sales (Units)	500	500	500
Selling price per unit	200	200	200
* Total cash sales	1,00,000	1,00,000	1,00,000
Total sales units	1,000	1,500	2,500
(-) cash sales units	500	500	500
Balance credit sales	500	1,000	2,000
Selling price per units	200	200	200
	1,00,000	2,00,000	4,00,000
*60% in the next month	-	60,000	1,20,000
* 40% in next-next month	-	-	40,000

Factory expenses-variable @ 20 per unit	40,000	30,000	50,000
*60% in same month	24,000	18,000	30,000
*40% in next month	-	16,000	12,000
Administrative overheads 5000 p.m.			
* 60% in same month	3,000	3,000	3,000
* 40% in next month	-	2,000	2,000

Illustration 7 : Asha Limited is incorporated to take over running business of Nish and Co. from 1st January, 2000. The tangible assets of Nisha and co. comprises Premises Rs. 25,000; Plant Rs. 10,000 Equipment Rs. 5,000 and Stock Rs. 6,000.

The consideration is settled by issue of 5,000 Equity shares of Rs. 10/- each par.

In addition, to provide working capital for initial period of operations, it issued for cash consideration 500 Equity Shares of Rs. 10 each and 12% Debentures of same face value. The above transaction were completed in January, 2000.

a. The expected Sales for January are Rs.16,000. Therefore it is expected to increase @ 25% over sales of previous month for February and March thereafter @ 20% of sale of preceding month till June 2000.
b. The cost of goods sold is @ 60% of sales.
c. The 20% of sales and purchases are for cash and rest on credit of one month.
d. Preliminary expenses will be Rs.10,000 payable 50% in February and balance in April.
e. Stock level is to remain unchanged.
f. Administration expenses will be Rs. 3,000 for first one month and Rs.5,000 thereafter of these 50% is payable in same month and balance in the following month.
g. Selling expenses expected @10% of sales payable two months after sales.

Prepare cash budget for January to June 2000.

Solution :

Cash Budget from January to June.						
Particulars	**Jan**	**Feb**	**Mar**	**April**	**May**	**June**

Opening Balance	--	9,780	7,500	9,300	7,700	12,680
<u>Receipts</u>						
Cash Sales	3,200	4,000	5,000	6,000	7,200	8,640
Collected from Debtors	--	12,800	16,000	20,000	24,000	28,800
Equity Shares Capital	5,000	--	--	--	--	--
12% Debentures	5,000	--	--	50,000	--	--
Total Receipts (1)	13,200	26,580	28,500	1,50,000	38,900	50,120
<u>Payments :</u>						
Cash Purchases	1,920	2,400	3,000	3,600	4,320	5,184
Creditors	--	7,680	9,600	12,000	14,400	17,280
Administration Expenses	1,500	4,000	5,000	5,000	5,000	5,000
Selling Expenses	--	--	1,600	2,000	2,500	3,000
Preliminary Expenses	--	5,000	--	5,000	--	--
Total Payments (2)	3,420	19,080	19,200	27,600	26,220	30,464
closing Balance of Cash (3 = 1 - 2)	9,780	7,500	9,300	7,700	12,680	19,656

Working note

Particulars	**April**	**May**	**June**	**July**	**Aug**	**Sep**
Sales	16,000	20,000	25,000	30,000	36,000	43,200
(increase)		+25%	+20%	+20%	+20%	+20%
20% cash sales	3,200	4,000	5,000	6,000	7,200	8,640
80% credit	12,800	16,000	20,000	24,000	28,800	34,560
Collection from Debtors next month	-	12,800	16,000	20,000	24,000	28,800
Cost of goods sold (60% of sales)	9,600	12,000	15,000	18,000	21,600	25,920

20 % cash purchase	1,920	2,400	3,000	3,600	4,320	5,184
80% on month credit	-	7,680	9,600	12,000	14,400	17,280
Preliminary Exp	-	5,000	-	5,000	-	-
Selling expenses 10% of sales	-	-	1,600	2,000	2,500	3,000

Illustration 8 : MG Ltd. Deals in a single product which is sold @ Rs 150 p.m.

a. The cost of goods sold is 80% of sales which includes material cost @ 25% of sales and wages @ 36% of sales. The remaining portion of cost represents manufacturing and administration expenses.

b. The sales are seasonal as under –

   March to June @ 1000 units per month.

   September to December @ 1500 per month.

   Remaining months @ 800 units per month.

c. The sales pattern is as under –
   i. Cash Sales – 20%
   ii. One months credit -40%
   iii. Against bill of exchange for 60 days. Bills to be discounted immediately subject to discount charges @ 5%.

d. Wages to be paid on 7th of the following month

e. The purchase pattern is as under –
   i. Cash purchases -30%
   ii. One months credit -70%

f. Manufacturing and administration includes fixed expenses @ Rs. 10,000 per month, payable at the end of month to which it relates. The remaining expenses are subject to credit of half a month.

g. The capital of the company comprises 12% preference Capital Rs. 5,00,000. The dividend for previous year @ 15% is to be paid I

November. The current year dividend on preference shares is to be paid in March.

h. Cash on hand at the end of October is Rs. 20,000. It is the policy of the company to have minimum balance of Rs. 10,000 and maximum balance of Rs. 30,000. Excess balance to be invested and shortfall to be met by en-cashing investment.

Prepare Cash budget for November to March.

Solution :-

In the books of MG Ltd.

Cash Budget from November to March.					
Particulars	**Nov**	**Dec**	**Jan**	**Feb**	**Mar**
Opening Balance	20,000	10,000	30,000	27,450	30,000
Receipts					
Cash Sales	45,000	45,000	24,000	24,000	30,000
Collected from Debtors	90,000	90,000	90,000	48,000	48,000
Bills discount	85,500	85,500	45,600	45,600	57,000
Total Receipts (1)	2,40,500	2,30,500	1,89,600	1,45,050	1,65,000
Payments :					
Wages	81,000	81,000	81,000	43,200	43,200
Cash Purchases	16,875	16,875	9,000	9,000	11,250
Creditors	39,375	39,375	39,375	21,000	21,000
Fixed Manu. & Adm. Overheads	10,000	10,000	10,000	10,000	10,000
Manu. & Adm. Overheads (50%)	16,375	16,375	6,400	6,400	9,250
(50%) of previous month	16,375	16,375	16,375	6,400	6,400
Preference Dividend	75,000	--	--	--	60,000
Total Payments (2)	2,55,000	1,80,000	1,62,150	96,000	1,61,100
closing Balance of Cash (3 = 1 - 2)	- 14,500	50,500	27,450	49,050	3,900
Investment Sold	24,500	--	--	--	6,100
Investment Purchased	--	20,500	--	19,050	--
Closing Balance	10,000	30,000	27,450	30,000	10,000

Working Note 1:

Cost Sheet (Per Unit)	% to Sale	Cost per unit (Rs.)
Material	25%	37.50
Wages	36%	54.00
Overhead	19%	28.50
Cost of Goods Sold	80%	120
Add : Profit	20%	30
Sales	100%	150

Working note 2:

Particulars		Nov	Dec	Jan	Feb	Mar
Sales (Units)		1,500	1,500	800	800	1,000
(Per unit selling price)		150	150	150	150	150
Total sales		2,25,000	2,25,000	1,20,000	1,20,000	1,50,000
20% cash sales		45,000	45,000	24,000	24,000	30,000
40% one month credit		90,000	90,000	90,000	48,000	48,000
40% Bills of exchange (-days) same as Sap, Oct, Nov sales) 1500 x 150= 2,25,000		85,500	85,500	45,600	45,600	60,000
Wages (units)	Sep 1,500	1500	1500	800	800	1000
Per unit	54	54	54	54	54	54
Paid in next month	81,000	81,000	81,000	43,200	43,200	54,000
	-	81,000	81,000	81,000	43,200	43,200

Particulars	Oct	Nov	Dec	Jan	Feb	Mar
Units Produced	1,500	1,500	1,500	800	800	1,000

(Material cost per unit)	37.50	37.50	37.50	37.50	37.50	37.50
Total Amount	**56,250**	**56,250**	**56,250**	**30,000**	**30,000**	**37,500**
30% Cash Purchase	16,875	16,875	16,875	90,000	90,000	11,250
70% on month credit	-	39,375	39,375	39,375	21,000	21,000
Overheads (per unit)	28.50	28.50	28.50	28.50	28.50	28.50
Total Overheads	42,750	42,750	42,750	22,800	22,800	28,500
50% of same month	16,375	16,375	16,375	6,400	6,400	9,250
50% of next month	-	16,375	16,375	6,400	6,400	9,250
Fixed Exp	10,000	10,000	10,000	10,000	10,000	10,000
Total overheads – Fixed expenses and Balance will be distributed as 50% of the same month & 50% to the next month.						

14.2 EXERCISES

Q.1 B. Ltd has anticipated sales as under –

January to March Rs. 4,00,000 pm.

April to August Rs. 6,00,000 pm.

September to December Rs. 2,00,000 pm

The Material cost is 25% and Labour cost is 15% of sales. The production overhead 20% of Sales.

The sales commission is 5% on sales and general overhead are @ 10% on sales.

The credit period for sales is 1 ½ month and purchases is 1 month.

The Labour Cost is payable at the end of month. The other expenses have credit period of ½ month.

The minimum cash balance is Rs. 50,000.

Irregular payments–

a. Income Tax instrument in June, September, December @ Rs. 50,000

b. Dividend Rs. 2,00,000 in August

c. Interest on borrowing Rs. 1,00,000 in September and March.

Prepare Cash Budget for April to September for 6 months.

Q.2 Prepare Cash Budget for January – June from the following information:

a. The estimated sales are as follows :

Nov	Dec	Jan	Feb
2,00,000	2,20,000	1,20,000	1,00,000
March	April	May	June
1,50,000	2,40,000	2,00,000	2,00,000

b. 20% of the sales are on cash basis and the balance on credit.

c. The Firm has gross margin of 25% on sales.

d. 50% of the credit sales are collected in the month following the sales, 30% in the second months and 20% in the third month.

e. Material for sales of each month is purchased on month in advance on a credit for two months.

f. The time lag in the payment of wages and salaries is one third of a month and miscellaneous expenses one month.

g. Debentures worth Rs. 40,000 were issued in January.

h. Cash balance at the end of December is Rs. 60,000.

i. Salaries and office Expenses are Rs. 30,000 p.m. in November, December and April and 80% of the same January to March and 90% in May and June.

j. Dividend is payable in June Rs. 20,000.

k. Selling expenses @ 10% on sales payable one month after sales.

l. The firm can maintained minimum balance should be Rs. 40,000 and the firm can borrow from bank @ 12% pa in multiples of Rs. 1,000. Interest payable at the time of repayment. The borrowing and repayment should be resorted to as and when required.

Q.3 Prepare a Cash Budget for three months ending 30thJune, 2006 from the information given below :

a)

Month	**Sales**	**Materials**	**Wages**	**Overheads**

February	Rs. 14,000	9,600	3,000	1,700
March	Rs. 15,000	9,000	3,000	1,900
April	Rs. 16,000	9,200	3,200	2,000
May	Rs. 17,000	10,000	3,600	2,200
June	Rs. 18,000	10,400	4,000	2,300

b) i. Credit terms are:

Sales/ Debtors 10% sales are on Cash basic.

50% of credit sales are collected next month and balance in the following month.

ii. Creditors Materials 2 Months

Wages 1/4th Month

Overhead ½ Month

c) Cash and bank balance on 1st April 2006 is expected to be Rs. 6,000.

d) Other relevant information is :

i) Plant and machinery will be installed in February, 2006 at a cost of Rs. 96,000. The monthly installment of Rs. 2,000 is payable from April onwards.

ii) Dividend @ 5% on preference share capital of Rs. 2,00,000 will be paid on 1st June.

iii) Advance to be received for sales of vehicle Rs. 9,000 in June.

iv) Dividend from investment amounting to Rs.1,000 are expected to be received in June.

v) Income Tax (advance) to be paid in June is Rs. 2,000.

Q.4 Prepare Cash Budget for July-December from the following information.

1. Estimated Sales, expenses etc. are as follows (Rs. In lakhs)

	June	**July**	**Aug**	**Sept**	**Oct**	**Nov**	**Dec**
Sales	35	40	40	50	50	60	65
Purchases	14	16	17	20	20	25	28
Wages & Salary	12	14	14	18	18	20	22

Misc. Exp.	05	06	06	06	07	07	07
Int. Received	02	--	--	02	--	--	02
Sales of Shares	--	--	20	--	--	--	--

2. 20% of the sales are on cash and the balance on credit.
3. 1% of the Credit Sales are returned by Customers, 2% of the Total Accounts Receivable constitute bad debt Losses. 505 of the good accounts receivable are collected in the month of the sales and the rest in the next month.
4. The times lag in payment of miscellaneous expenses and purchases in one month. Wages and salaries are paid fortnightly with a time lag of 15 days.
5. The company keeps minimum cash balance of Rs. 5 lakhs. Cash in Excess of Rs. 7 lakhs in invested in Government Securities in the multiple of Rs. 1 lakh. Short falls in minimum cash balance are made good by borrowing from banks. Ignore interest received and paid.

Q. 5. From the information given below prepare cash budget of 'X' Ltd.

From January 2006 to March 2006.

Particulars	Dec	Jan	Feb	Mar	April
Sales budge units	60	60	65	75	80
Selling Price per unit Rs.	1000	1000	1000	1000	1000
Off season discount	20%	20%	10%	--	--
End of month inventory units	10	12	15	25	25

1. Half of the sale proceeds are collected in the month of sales and other half in the month following.
2. Materials amounting to Rs. 300 per unit manufactured are purchased one month in advance of manufacture and paid for in cash, earning 5% discount of half of material purchased.
3. Direct labour budget was Rs. 50 per unit and variable overheads Rs. 100 per unit.
4. Indirect labour budget was Rs. 6000 per month.
5. Depreciation was provided uniformly at Rs. 3000 per month.
6. Fixed overhead budget was Rs. 6000 per month during off season and Rs. 7000 per month during the season. Out of this, the Quarterly premium for life insurance amounting to Rs. 600 was payable in the first month of each quarter.
7. Dividends for the year 2006 amounting to Rs. 20,000 were expected to be declared in March 2006 and payments were to be spread over March and April equally.

8. A machine was sold for Rs. 10000 in December, 2005 on 3 months credit.
9. The company had overdraft arrangement with Bank up to Rs. 50,000.

Q.6 The following information is available in respect of Padmavati Textiles Ltd.

Particulars	Jan	Feb	Mar	April	May	June
Sales	40	50	60	60	60	40
Purchase (R. M)	15	16	18	18	18	16
Direct Labour	6	7	8	8	8	6
Manufacturing Expenses	13	13	14	14	14	13
Administrative Expenses	2	2	2	2	2	2
Distribution Expenses	2	3	4	4	4	2

The following financial flows are expected during the period.

- Interest to be received in January Rs. 2,00,000.
- Dividend to be received during March Rs. 2,00,000.
- Sale of investment in June Rs. 60,00,000.
- Interest to be paid in February Rs. 1,00,000
- Dividend to be paid in April Rs. 4,00,000
- Installment payment on Machine to be paid in June Rs. 20,00,000.

Assume that 10% of the sales are on cash, the balance 90% are on credit. The terms and credit experience of the company are :

1. No cash discount.
2. 1% of credit sales is returned by the customers.
3. 1% of the total accounts receivable is bad debt.
4. 50% of all accounts that are going to pay, do so within 30 days.
5. 100% of all accounts that are going to pay, so within 60 days.
6. Raw materials are purchased on 30 day's credit.

Balance is to be maintained by the end of the month by borrowing temporarily from bank in multiples of Rs. 10,000 (ignore interest).

Prepare a Cash Budget for six months.

Q.7 A newly established company manufacturing two products furnished the cost sheet as under –

Particulars	Product L	Product B
Direct Material	40	20
Direct Labour	30	15
Variable Overhead	14	7
Selling Price	100	50

Fixed overheads excluding bank interest amount to Rs. 6,00,000 p.a. spread over evenly throughout the year.

Sales forecasts is as under –

Product	July	Aug	Sept	Oct	Nov.
L units	4200	4600	3600	4000	4500
B Units	2100	2300	1800	2000	1900

Production: 75% of each months sales will be produced in the month of sales and 25% in the previous month.

Sales Pattern –

Product L -

- One third of sales will be on cash basis on which cash discount of 2% is allowed.
- One third will be on documents against payment basis. The documents will be discounted by the bank in the month of sales itself.
- Balance of one third on documents against acceptance basis.
- The payments under this scheme will be received in third month e.g. sales in September payment will be received in November.

Product B –

- 80% of the sales will be against cash to be received in the month of sales and the balance.
- 20% will be received in the following month.

Direct Materials – 50% of the direct materials required for each month's production will be purchased in the previous month and the balance in the month of the production itself. The payments will be made in the month following the purchases.

Direct Wages – 80% of the direct wages will be paid in the month of use of direct labour for production and the balance in the following month.

Variable Overheads – 50% to be paid in the month of incurrence and the balance in the following month.

Fixed Overheads – 40% will be paid in the month of occurrence and the other 40% in the following month. The balance 20% represents depreciation.

The bill discounting charges payable to the bank in the month in which the bills are discounted. The Cash balance of Rs. 1,00,000 will be maintained on 1st July.

Prepare Cash Budget monthwise for July, August and September.

Q. 8 The following results are expected by XYZ Ltd. For Jan. to July 2004, from which you are required to prepare Cash Budget.

1. The estimated sales, expenses etc. are as follows:

Particulars	Jan	Feb	Mar	Apr	May	Jun	Jul
Sales	70	80	80	100	100	120	130
Purchases	28	32	34	40	40	50	56
Wages and Salaries	24	28	28	36	36	40	44
Sundry Expenses	10	12	12	12	14	14	14
Receipt of Rent	4	--	--	4	--	--	4
Sale of Asset	--	--	40	--	--	--	--

2. 20% of the sales are on cash and balance on credit.
3. 1% of the Credit sales are returned by the customers, 2% debts are uncollectable, 50% of the good accounts receivables are collected in the month of the sales and the rest during next month.
4. The time lag in payment of Sundry Expenses and Purchase is of one month. Wages and salaries are paid fortnightly with a time lag of 15 days.
5. The company started its commercial activities in Jan 2004 with cash balances of Rs. 10 lakhs.
6. The company keeps a minimum cash balance of Rs. 10 lakhs. Cash in excess of Rs. 14 lakhs is invested in Govt. Bonds in multiples of Rs. 1 lakh. Short fall in the minimum cash balance is made good by borrowings from the bank. Ignore interest received/ paid on these accounts.

Q.9 Sankalp Products Ltd. Who commenced business in March 2004 submits to you the following estimates :

Month	Estimated production (Units)	Sale Price (Per Unit)
March	30,000	40
April	36,000	44
May	28,000	44
June	20,000	45
July	28,000	46
August	34,000	48
September	35,000	48

You are provided the following information:

1. 20% of the current months production is held as closing stock.
2. Raw material pricing is 50% of the sales price for the month.
3. There is no wastage or spoilage of raw materials. Raw materials is not held in stock. Raw material purchases equals the number of units produced in that month.
4. 20% of the materials are purchased on cash basis, 50% of the suppliers are paid in next month and the balance suppliers are paid in the month after next.
5. 10% of the sales are on cash basis. The company provides one months credit to 40% of its customers. The balance 50% of the customers pay up in the second month after sale.
6. Wages account for 20% of the sales price and workers are paid on the seventh day of the next month for the previous months production.
7. Variable overheads account for 5% of the sales price and are paid in the month of production.
8. Fixed overheads are 18,000 per month and are paid in the next month.
9. It is anticipated that there would be a debenture issue of Rs. 5,00,000 in the month of June 2004 and debenture issue expenses to the tune of 10% there of would be incurred in May 2004.
10. The cash balance on 1.04.2004 is Rs. 40,000.
11. The company would acquire trade investments of Rs. 5,00,000 in June 2004 and Rs. 2,00,000 in September, 2004. Ignore interest on trade investment.
12. If there is any deficit during any month, there is a standing cash credit facility, which will be utilized so as to maintain minimum cash balance of Rs. 40,000.
13. Any surplus over Rs. 40,000 during a particular month is first utilized to wipe of the cash credit and then the balance is

converted into temporary Bank Fixed Deposit in multiples of Rs. 1000/- (Ignore interest on Cash Credit and Bank FD).

As Finance Manager of Sankalp Products Ltd., you are required to prepare monthly based estimated Cash Budget for the six months period from April 2004 upto September , 2004.

Q.10 M/s Sudesh sales corporation is a trading concern with three partners. The sales estimated are as under.

- August to October Rs. 1,00,000 per month.
- March to May Rs. 1,20,000 per month.
- November to February Rs. 80,000 per month.
- June and July Rs. 60,000 per month.

The cost of purchases is 60% of sales. The stock level remains unchanged. Other expenses are as under :

Office Expenses Rs. 5,000 per month.

Selling expenses Rs. 5% of sales.

The partners withdraw for personal use @ Rs. 5,000 per partner per month. The terms of credit are as under :

a. Sales – 20% of cash,

40% against Bill of Exchange payable 30 days later. Bill are discounted with bank immediately, discounting charges being 2%.

40% on one month credit.

b. Purchases 30% on cash and balance on one month credit.

c. Selling expenses two month after sale.

The other transactions are as under :

i. Income tax payable Rs. 60,000 in three equal installments due on Septmber, December and March.

ii. A portion of the premises is let out at a rent of Rs. 5,000 per month receivable at the end of the relevant month for May to August.

iii. In April one delivery van is purchased at a cost of Rs. 1,20,000. This is financed to extent of 75% by loan taken from bank and balance payable immediately. Loan is repayable in three years with quarterly installment of Rs. 7,500 commencing from July. Interest @ 12% p.a. is payable separately. You are required to prepare cash budget from April to December, 2001.

Q.11 M. ltd. Has anticipated Sales are as under :

January to March Rs. 2,00,000 p.m.

April to August Rs. 3,00,000 p.m.

September to December Rs. 1,00,000 p.m.

The material cost is 25% and Labour cost is 15% of sales. The production overhead 20% of sales.

The sales commission is 5% on sales and general overheads are @ 10% on sales. The credit period for sales is 1 ½ months and purchases is 1 month.

The labour cost is payable at the end of month. The other expenses have credit period of ½ month.

The minimum cash balance is Rs. 25,000.

Irregular payments:

a. Income tax installment is June, September and December @ Rs. 25,0000.

b. Dividend Rs. 1,00,000 in August.

c. Interest on borrowings Rs.50,000 in September and March.

Prepare cash budget for April to September.

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Question Paper

M.C.A. Semester-II

Accounting and Financial Management

(Revised Course)

3 Hours **Total Marks: 100**

N.B. : 1) Question No. 1 is **compulsory.**
2) Attempt any **two** questions from Question Nos. **2 to 4**.
3) Attempt any **two** questions from Question Nos. **5 to 7**.
4) Answers to the questions should be **grouped** and written **together**.
5) **Figures** to the **right** indicate full **marks** assigned to the question.

Q.1 a) What is the need of a fund flow statement for an organization? **(10)**

b) From the following Trial balance, prepare trading, profit and loss account and balance sheet of Ujwala enterprises for the year ended on 31st March 2009. **(10)**

Debit balance	Rs.	Credit balance	Rs.
Power and fuel	500	Purchase return	3,700
Land and building	70,000	Sundry creditors	32,000
Plant and machinery	50,000	Sales	1,20,000
Sundry expenses	2,600	Capital	1,78,000
Sales return	6,000	Interest on Investments	2,000
Investments	10,000	Loan	32,300
Insurance	1,600		
Purchases	98,000		
Carriage outward	1,000		
Salary	19,300		
Furniture	16,000		
Printing & Stationery	1,500		
Cash in hand	5,800		
Stock (1-4-08)	20,000		
Sundry debtors	28,000		
Legal charges	500		
Drawings	800		
Bad debts	1,400		
Wages	13,000		
Cash in hand	20,000		
Carriage inward	2,000		
	3,68,000		**3,68,000**

Adjustments: Stock on 31st March 2009 cost price Rs. 25,000/- market price Rs. 30,000/-

Q.2 a) i) What is the difference between a debit note and credit note? **(8)**

ii) What is the difference between trade discount and cash discount?

b) Journalise the following transactions in the journal of Mr. Shashi Raja for the month of June 2008: **(12)**

June 1 Mr. Shashi commenced his business with cash Rs. 10,000/-, building Rs. 1,50,000 and Bank balance Rs. 43,000/-

3 Bought goods worth Rs. 21,000 on credit from 'Avi' with trade discount at 5%.

4 Sold goods of Rs. 5,600/- with a cash discount of Rs. 600/-.

5 Paid wages Rs. 2,000/-.

6 Goods costing Rs. 500/- were distributed as free samples.

10 Paid Insurance premium for business office Rs. 350/- and for the life of the owners life Rs. 500/- by cheques.

14 Invested Rs. 5,000/- by cheque in debentures of XYZ Co. Ltd.

30 Settled Avi's account by issuing a cheque of the necessary amount after deducting cash discount at 3%.

Q.3 a) What is Bank reconciliation statement? And explain different reasons for differences in balances. **(8)**

b) From the following transactions in sonu's cash book with cash, bank and discount columns: **(12)**

May

2002 1 Opening cash balance Rs. 25,000 and bank balance Rs. 18,000.

2 Purchased goods worth Rs. 25,000 at 10% trade discount and 5% cash discount term. Half of the amount paid in cash and half the amount by cheque.

3 Cash sales Rs. 22,000 at 10% TD and 5% CD.

4 Received a cheque of Rs. 5,750/- from Manohar and deposited the same into bank.

7 Paid to Jyoti by cheque Rs. 4,900 and earned discount of Rs. 100/-.

8 Cheque received from Manohar returned dishonored by Bank.

9 Drawn from Bank Rs. 4,000/- for office use.

10 Deposited all the cash in bank in excess of Rs. 500/-

Q.4 a) Explain trading account and profit and loss account with specimen form. **(8)**

b) What is an account and explain different types of accounts with examples. **(12)**

Q.5 a) What is Cost Accounting and What are elements of cost Accounting? **(8)**

b) i) Calculate the stock turn-over ratios from the following data: **(12)**

Opening stock Rs. 8,000, closing stock Rs. 10,000, Sales Rs. 54,000 and Profit 20% on cost.

ii)Calculate the creditors turn over ratio and the payment period from the following:

Credit purchase – Rs. 6,00,000

Creditors – Rs. 1,00,000

Q.6 a) What are accounting ratios? How can the accounting ratios be classified? Enumerate any two ratios covered by each classification. **(8)**

b) Following details are available from the records of a India Ltd. Prepare cash Budget for the three months ending on 30th June 2008: **(12)**

Month	**Sales Rs.**	**Materials Rs.**	**Wages Rs.**	**Overheads Rs.**
February	42,000	28,800	9,000	5,100
March	45,000	27,000	9,000	5,700
April	48,000	27,600	9,600	6,000
May	51,000	30,000	10,800	6,600
June	54,000	31,000	12,000	6,900

Additional information:

1) 10% sales are on cash basis.
2) 50% of the credit sales are collected in the next month and balance in the following month.
3) Delay in payment of overheads is one month.
4) Delay in payment of wages by ¼ month.
5) Period of credit allowed by suppliers is two months.
6) Advance income tax is to be paid in the month of June 2008 Rs. 5,000/-.

Q.7 a) Short Notes: **(8)**
i) Batch costing
ii) Contract costing

b) What is working capital and what are the types of working capital? **(12)**

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Question Paper

M.C.A. Semester-II

Accounting and Financial Management

(Revised Course)

3 Hours **Total Marks: 100**

N.B. : 1) Question No. 1 is **compulsory.**
2) Attempt any **two** questions from Question Nos. **2 to 4**.
3) Attempt any **two** questions from Question Nos. **5 to 7**.
4) Attempt **all** the questions in **same** answer sheet only.
5) Use **legible** hand writing. Use a **blue/black** ink pen to write answers. Use of **pencil** should be done only to draw **diagram** and **graphs.**
6) **All** questions carry **equal** marks.

Q.1 a) Explain fund flow and cash flow. **(10)**

b) From the following Trial balance of Ms. Sahana, Prepare trading and profit and loss account for the year ended 3-3-08 and balance sheet as on that date: **(10)**

Particulars	Debit Balance Rs.	Particulars	Credit Balance Rs.
Cash in hand	2,400	Capital	2,00,000
Sales returns	200	Bills payable	40,000
Purchases	2,40,000	Sundry creditors	48,000
Stock (1 April, 07)	25,000	Sales	3,00,200
Sundry debtors	1,10,000	Commission	800
Plant and Machine	1,20,000	Bank OD	2,500
Furniture	40,000	Rent received	2,000
Bills receivable	30,000	Interest received	4,000
Rent and taxes	4,000	Income received	2,500
Insurance	3,000		
Commission	2,000		
Interest	1,500		
Wages	21,000		
Carriage inward	900		
	6,00,000		**6,00,000**

The stock of goods on hand on 31st March 08 was valued at Rs. 1,25,000.

Q.2 a) What is cash book? What are the types of cash books. **(8)**

b) Journalise the following transaction in the books of Vallari:
2008 **(12)**

Jan	1	Vallari commenced business with cash	Rs. 40,000
	2	Purchased goods for cash	Rs. 500
	3	Sold goods for cash	Rs. 15,000
	6	Paid cartage	Rs. 110
	7	Received commission	Rs. 600
	8	Withdrawn cash for personal use	Rs. 300
	9	Paid salary	Rs. 5,000
	10	Yogita paid us on account Rs. 590 after Deducting cash discount of Rs. 10	
	11	Borrowed a loan at 10% form Samant	Rs. 10,000
	12	Deposited into Bank	Rs. 2,500

Q.3 a) Explain the accounting concepts and accounting conventions. **(8)**

b) Why is bank reconciliation statement prepared? And what are the usual reasons for disagreement between the cash book balance and pass book balance. **(12)**

Q.4 a) i) Differentiate between a debit note and credit note and **(8)**

ii) Differentiate between a Trade discount and cash discount.

b) From the following transactions, prepare a cash book with three columns of Ms. Hansika : **(12)**

2008

Jan 1 Cash balance Rs. 10,000
Bank overdraft Rs. 20,000

2 Received a cheque for Rs. 800 from Savita and deposited it into bank.

3 Gave a cheque of Rs. 1,580 in full settlement of 1,600 to Puri.

4 Received interest Rs. 140 by cheque.

5 Deposited into bank the cheque of Rs. 1400.

7 Goods worth Rs. 15,000 were sold for cash, half of which was banked immediately.

Q.5 a) What is Cost Accounting and What are elements of Cost Accounting? and What are the methods of Cost? **(8)**

b) From the following details supplied by Eastern Ltd, prepare a cash budget from September 1, 2007 to December 31, 2007: **(12)**

Month	Credit Purchases Rs.	Credit Sales Rs.	Wages Rs.	Selling expenses Rs.	Overheads Rs.
July	85,000	1,60,000	32,000	8,000	10,000
August	92,000	1,85,000	37,000	9,500	11,500
September	1,00,000	2,10,000	42,000	10,500	13,000
October	1,20,000	2,45,000	49,000	12,500	14,500
November	90,000	1,78,000	35,500	8,900	10,500
December	98,000	1,82,000	36,000	9,000	11,000

Additional information:

1. Cash balance on September 1, 2007 Rs. 10,500.
2. Period of credit allowed to debtors 1 month.
3. Period of credit allowed by creditors 1 month.
4. Time lag in payment of wages, selling expenses and overheads 1 month.
5. Selling commission @ 2% on credit sales is payable one month after sales.
6. Expenses on machinery, worth Rs. 50,000 is payable in October, 2007.
7. Expected cash sales per month Rs. 15,000.
8. No commission is payable on cash sales.

Q.6 a) Explain the advantages and limitations of Ratio analysis. **(8)**

b) From the following details prepare a summarized balance sheet of ABC Ltd, as at December 31, 2007: **(12)**

Fixed assets to net worth	0.75 : 1
Current ratio	5 : 2
Acid test ratio	3 : 2
Reserves to proprietor's funds	1 : 4
Current liabilities	Rs. 2,00,000
Cash at bank	Rs. 10,000
Fixed assets	Rs. 6,00,000

Q.7 a) State the advantages of preparing a cash budget for an organization. **(8)**

b) What points must be considered while estimating Working Capital requirements of an organization? **(12)**

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Question Paper

M.C.A. Semester-II

Accounting and Financial Management

(Revised Course)

3 Hours **Total Marks: 100**

N.B. : 1) Question No. 1 is **compulsory.**
2) Attempt any **two** questions from Question Nos. **2 to 4**.
3) Attempt any **two** questions from Question Nos. **5 to 7**.
4) Attempt **all** the questions in **same** answer sheet only.
5) Use **legible** hand writing. Use a **blue/black** ink pen to write answers. Use of **pencil** should be done only to draw **diagram** and **graphs.**
6) **All** questions carry **equal** marks.

Q.1 a) Explain the advantages and limitations of ratio analysis. **(10)**

b) From the following Trial balance, prepare Trading, Profit and Loss Account and Balance Sheet of Ankita Enterprises for the year ended on 31st March, 2008 **(10)**

Particulars	Debit Rs.	Particulars	Credit Rs.
Opening Stock	50,000	Sales	16,00,000
Purchases	7,50,000	Return Outwards	5,000
Carriage Inwards	5,000	Creditors	50,000
Wages	75,000	Capital	3,80,520
Printing & Stationery	25,550		
Conveyance	500		
Fees, Licences & Subscriptions	3,755		
Salaries	1,35,765		
Return Inwards	50,000		
Office Expenses	8,950		
Rent (Rs. 1000 p.m.)	11,000		
Machinery	3,50,000		
Debtors	1,75,000		
Investments (Long Term)	1,00,000		
Bank	2,95,000		
	20,35,520		**20,35,520**

Additional Information:

i) Market value of Closing Stock as on 31st March, 2008 was Rs. 85,000. Its cost on the same day was Rs. 57,500.

Q.2 a) What do you mean by Accounting Concepts? Explain in detail any two accounting concepts. **(8)**

b) Journalise the following transactions in books of Rikhi Enterprises. **(12)**

1) Commenced business with following on January 1: Cash 20,000, Bank 28,000, Stock of Goods 4,000, Machinery Rs. 10,000, Furniture 1,000 & Amount due from customer Veeru & Co. Rs. 1,500.
2) Bought goods on credit from Sahana & Co. Rs. 1,000.
3) Sold Goods to Dhi & Co. Rs. 4,000.
4) Sold Goods to Veeru & Co. Rs. 10,000 on credit.
5) Received from Veeru & Co. Rs. 1,450 in full settlement of the amount due on Jan 15.
6) Purchased goods from ABC & Co. Rs. 10,000 for cash.
7) Sold goods to Pinku worth Rs. 10,000 to earn a profit of Rs. 3,500.
8) Sold old Furniture for cash Rs. 800.
9) Purchased Machinery by cheque Rs. 15,000.
10) Depreciate Machinery @ 10% on cost.
11) Purchased Goods of Jansy Bros. Rs. 5,000 on credit.
12) Paid Freight on the above goods Rs. 75.
13) Received cheque from Veeru & Co. Rs. 10,000 & deposited in our bank.
14) The Bank informs that the bank has returned the above cheque dishonored.
15) Withdrew from bank for private use Rs. 1,000.

Q.3 a) What is meant Ledger? Why is it necessary to prepare a Ledger? **(8)**

b) Give Balance Sheet format in as much details as is possible. **(12)**

Q.4 a) What is meant by Cash Book? What are the different types of cash book? **(8)**

b) Prepare a Three Column Cash Book for the following transactions and balance the same: **(12)**

2008	**Rs.**
Jan 1 Started business with cash	80,000
Jan 2 Deposited cash in Bank	60,000
Jan 3 Bought goods from Pinku on credit	30,000
Jan 6 Sent him a cheque for balance amount in final settlement	29,500
Jan 7 Cash Sales	16,000
Jan 7 Credit sales to Ridhi & Sons	25,000
Jan 10 Received from Ridhi & Sons cash	5,000
Jan 11 Received a cheque from Ridhi & Sons in final settlement	19,750
Jan 12 Conveyance Expenses paid to office clerk	200
Jan 13 Sent Free samples of goods to a prospective customer	750
Jan 14 Gave away in charities	501
Jan 15 Paid for traveling expenses in cash to office salesman	750
Jan 20 Withdrew from bank for office use	5,000
Jan 21 Used goods for domestic consumption by the proprietor	1,000
Jan 25 Paid for office cleaning	200
Jan 26 Distributed sweets for anniversary Function in Office	1,000
Jan 31 Paid Staff Salary by cheque	6,500

Q.5 a) What is meant by Cost Accounting? Explain in brief three different ways of cost classification. **(8)**

b) From the following budgeted data, prepare a Cash Budget for the quarter ending 30th June, 2008. **(12)**

Months	**Sales Rs.**	**Purchase Rs.**	**Wages Rs.**	**Manufacturing Exp (Rs.)**	**Selling Expenses**
Jan'08	70,000	45,000	16,000	4,000	2,200
Feb' 08	60,000	43,000	16,600	4,200	2,400
Mar'08	64,000	45,000	17,000	4,300	2,500
April'08	80,000	55,000	17,400	4,500	2,700
May' 08	84,000	59,000	18,400	5,200	3,400
June'08	76,000	45,000	19,000	5,000	3,000

The expected cash balance as on 1 April is Rs. 30,000. Other information is as follows:

1) Purchases & expenses are to be paid with a lag of one month.

2) Wages are to be paid during the month in which they are incurred.
3) 40% of the credit sale is collected in the month of sale, 40% in the following month and balance in the month thereafter.
4) 5% sales commission is to be paid within the month following actual sales.
5) Equity Share Capital Call Money of Rs. 10,000 is receivable in each of the three months under consideration.
6) Manufacturing Overheads include Rs. 1,000 as depreciation.

Q.6 a) Distinguish between Fund Flow and Cash Flow. **(8)**

b) The following are the extracts of Balance sheets of Efficient Ltd. **(12)**

Liabilities	2006	2007	Assets	2006	2007
Creditors	25,000	30,000	Stocks	10,000	25,000
Bills Payable	15,000	20,000	Debtors	20,000	20,000
Bank Overdraft	-	2,000	Bills Receivable	10,000	5,000
9% Debentures	5,00,000	5,00,000	Prepaid Expenses	2,000	-
			Cash on Hand	18,000	15,000

Additional Information:

Sales 2006: Rs. 3,50,000 & Gross Profit 70,000
Sales 2007: Rs. 3,00,000 & Gross Profit 50,000

Calculate the following Ratios for both the years:
i) Current Ratio
ii) Liquid Ratio
iii) Stock to Working Capital Ratio
iv) Debtors Turnover Ratio & Debtor's Velocity

Q.7 a) Explain cash budget briefly. **(8)**

b) Define Working Capital. Explain the importance of working capital in business. **(12)**

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