Unit 13

Accounting Procedures of SHGs and NGOs

General Objective

After studying this Unit, you should be able to help participants in your training session to describe accounting procedures which can be followed by SHGs and NGOs.

Specific Objectives

After completing the training session, you should be able to enable the trainees to:

- suggest guidelines for an accounting system for self-help groups (SHGs);
- describe books of accounts;
- suggest guidelines for accounting entries for a loan to NGOs; and
- describe audit and book keeping and maintenance of books.

Planning

Time	:	3 hours
Training Methodology	:	Group discussion on case study and presentations
Training Materials	:	Case Study on "Suggested Guidelines for Accounting Entries for Rashtriya Mahila Kosh (RMK) Loan to NGOs"
Trainer's Preparation	:	Reading the background material, preparing the case study material on "Suggested Guidelines for Accounting Entries for RMK Loan to NGOs" for distribution to participants

Background Material

Suggested Guidelines for an Accounting System for Self-Help Groups (SHGs)

The common transactions which normally take place in a group include the following:

1. Deposits, receipts and payments;
2. Borrowing from NGOs/Others;
3. Loans, disbursements and repayments:
4. Interest received on loans and interest paid on deposits;
5. Interest earned on investments;
6. Expenses on stationery, TA/DA, salary, education and others;
7. Transfer of funds from one group to another group if that takes place;
8. Amount deposited and kept in the bank;
9. Amount payable, i.e. where money is due but has not been paid;
10. Amount receivable, i.e. amount due but not received.

The following books of accounts may have to be maintained by the Self-Help Group as suggested by the Rashtriya Mahila Kosh:

i) Cash Book/Day Book

a) This is a book of records, receipts and payments of all money under various Heads as and when these happen. A broad proforma of the column cash book is given in Appendix I. These accounts are maintained on a system called single entry system of book-keeping. While cash transactions will be recorded under the cash column, transactions with the bank will be recorded in the bank column. Whenever cash is deposited in the bank, it will be shown in two columns i.e. cash payments will be shown in the cash column of payment side and deposit in bank will be shown in the bank column on receipt side.

b) All the columns of the cash book should be totalled every month and progressive total of each month added up at the end of the year which will indicate the total receipts and payments under each of the important heads.

ii) Ledger

a) From various entries made in the Cash Book regarding the borrowing from the NGO under the RMK scheme/loans issued, saving etc. of the member, a separate ledger account will be opened for an RMK loan, as also for each of the borrowing members in respect of her savings and loans. Entries from the cash book will be transferred to the specific ledger account and no entry will be made direct in the ledger. A proforma each of the RMK borrowing account and ledger account to be opened for each of the borrowing members are given in Appendix II and III.

b) Interest on loans and deposits will be suitably incorporated in the relative columns in the cash book as indicated in the proforma.

c) There is, perhaps, no need for an SHG to have separate ledger accounts for furniture, expenses, interest, income etc. These can be separately recorded in a passbook and yearly position calculated by placing the opening balance as per last balance sheet and adding to it total receipts deducting all payments which will then depict the balance at the end of the year.

All accounts in the cash book relating to income and expenditure will go to income and expenditure account, while the accounts relating to assets and liabilities i.e. furniture, fixtures, cash balance, bank deposits, and loan accounts, RMK loans outstanding etc. will go to the balance sheet.

iii) ***Income and Expenditure Account***

This is prepared at the end of the year to show the total receipt of income/interest on the credit side and all expenses incurred and interest paid on debit side. An SHG should make an assessment of all its expenses/interest payable on deposits and borrowings at the end of the year as also its income/interest etc. receivable on loans which should also be shown in their Income and Expenditure Account and also in the balance sheet. Surplus of total income over expenditure will show the surplus of the year while the excess of expenses over income will show the loss.

iv) ***Balance Sheet:*** A balance sheet is a statement of the financial position of the SHG at the end of the year to give a precise picture of the actual financial position. The debit side of the balance sheet will indicate the own funds of the group, deposits and other liabilities, while the credit side will show the position of each of the assets like cash, bank balance, furniture, fixtures, loans outstanding, etc. All items of expenditure payable will be shown on the liabilities side, while those which are receivable (including interest receivable) will be shown on the assets side.

v) ***Pass Book:*** Every member should be issued a pass book to indicate to her the position of her total receipts and payments made by her under savings, loans, interest etc. The proforma of the pass book is given in Appendix IV.

vi) ***Members Register and Proceedings Book:*** In addition to the above, every self-help group also maintains a member's register and a proceedings book to keep a record of the discussion at the meetings. A proforma for these books are generally prescribed by the NGOs.

Let us now look at the purpose and points to keep in mind about audit and book-keeping.

Audit and Book-keeping

Book-keeping

The purpose of maintaining the books of accounts is to:

- Keep true and correct records of all the transactions of the group;
- Calculate the profit earned or losses incurred during the course of the business;
- Assess the value of assets and liabilities in the group; and
- Get credit from outside institutions in future.

A mature group will finally have the following set of books and records:

- Minutes book;
- Receipt and vouchers;
- Cash books;
- Ledgers;

- Members' pass book; and
- Loan book.

Since the members are usually illiterate, the group gives the responsibility of writing the books to the group accountant or the facilitator. Many conflicts could arise due to wrong entries in the books and lack of information sharing periodically.

Conflicts can be avoided by keeping the following points in mind:

- A local person should be appointed as facilitator so that the group can monitor her work.
- It should be made clear to the group that the responsibility of the facilitator is to write the books and not to maintain them.
- The facilitator should complete the entries in the books during the group meeting and she should read the accounts — receipts, payments and cash balances — to the members. If any other person is appointed to write the books, the group should pay the honorarium to her only after she completes the entries in the books of accounts.
- The Secretary should check the accounts with the help of educated members or other villagers.
- The treasurer should keep the cash in the cash box. The key should be with the secretary to avoid the misuse of cash by the Treasurer.
- The facilitator should not handle the cash.
- The money for repayment of loan or deposit of cash should be taken to the bank only by the leaders and the members by rotation. The bank counterfoils should be filed immediately.
- Facilitator should not be given the responsibility for withdrawing money. The leaders or members should withdraw the money. The withdrawals should be filed immediately and entered in the books.
- The leaders should check the bank pass book entries every month with the help of the facilitator.
- The decisions taken in the group should be immediately entered in the minutes book.
- Members should sign the minutes book in every meeting. They should know that they are approving the transactions and decisions taken during the meeting by signing in the minutes book.
- They should know that the resolutions should be passed only with the approval of all the members.
- The facilitator should enter the transactions in the member's pass book and explain the details in the meeting.
- The members should be informed about their loan outstanding each month.
- The facilitator should check the books at periodical intervals.

Auditing

All the books of accounts of the group have to be audited once in six months internally and once in a year externally. As the group has to establish a sustainable relationship with the bank and act as a financial intermediary, auditing is essential.

Conflicts that occur at the time of auditing

- While getting the confirmation report on outstanding loan and savings from the members, few of them may not accept their outstanding loan balance;
- The interest on savings will be calculated and added to the member's savings at the time of auditing. Interest will be calculated as per the rate fixed in the bye-laws; some members may not accept the fixed rate and insist that all the interest collected from the lending operations should be divided equally; and
- The groups have to pay auditor's fee. However, the group may refuse to pay the fees.

How to resolve conflicts

- The facilitator should confirm the loan outstanding with each member. If any error has occurred, it should be corrected.
- The facilitator should explain to the members that the interest earned on the lending operations builds up the common fund. The fund is used for meeting the group's expenses like transport, stationery, auditor's fees and the other activities and hence all the interest earned should not be distributed. The concept of self sustainability and need for cost coverage should be explained to the members; and
- There should be periodical sharing of information regarding accounts.

Appointment of group accountant

During the initial stages the facilitator will help the group in conducting the meeting and in writing the books of accounts. When the number of transactions increases, the group should appoint a local person to help them. Some of the members want their own relatives to be appointed, which may not be liked by the other members. The members may not be willing to pay the honorarium for the group accountant from the common fund.

How to resolve conflicts

- The conflict regarding selection of a group accountant can be avoided by the intervention of the facilitator. The facilitator should assess the capability of the group accountant and enable the members to appoint a capable person.
- The facilitator should clarify that the expenses of the group like honorarium will be met from the interest income earned from lending and not from their savings.
- They should understand that outside financial help could be provided only if the group does not have funds.

Cash Handling by the Group Accountant

A group accountant is appointed by the group to carry out the group level functions. Since most of the group consists of illiterate women, the group accountant could take undue advantage of his/her position and misuse the group funds. The most frequent misuse of funds happens when the group accountant is entrusted with depositing the cash in the bank. If the leaders are not checking the accounts, they will not come to know about the misuse for a long time.

- The group accountant should not handle cash.
- The group accountant should be a resident of the same village, so that the members can have control over her.
- The group representatives should take charge of the book-keeping and cash handling. The members should go to the bank on rotation basis instead of sending the group accountant.
- The payment of the group accountant should be decided by the group. The leaders should pay the honorarium after checking the accounts.

Maintenance of books

The number and types of books to be maintained are normally suggested by the NGO or prescribed under a particular project. It is important to ensure that the basic books are maintained which will promote healthy functioning and accountability in the group. The details of number of meetings held, decisions taken in the meetings, amount of savings of the members and loans taken by the members should be verifiable. NGOs normally impart training to literate members of the groups in maintenance of books. If the groups consist of only illiterate members, either the NGOs or literate community members can maintain the books on behalf of the group members.

The facilitator has to ensure that:

- details of meeting's proceedings and attendance are maintained;
- member-wise record of savings and credit are maintained;
- records are up-to-date;
- all the members are kept informed of their savings and credit balances from time to time;
- in case of illiterate groups, a system is followed by the group members or NGOs to verify the books maintained by an outsider; and
- systems have been developed to ensure safe custody of cash.

Record keeping is the maintenance of information concerning group activities and group funds. Record maintenance is very important for the reasons listed here.

- It helps members to remember what has happened.
- It builds the confidence of the members that their money is safe.
- It provides data and information to monitor progress of the group.
- It provides data and information for follow-up especially loaning and repayment.
- It provides a check on the leaders. The leaders have to follow the group decisions. When the decisions are recorded in the minutes book and signed by all the members, it is very easy to verify whether the leaders are acting on behalf of the group and their action is supported by group decision.
- It is the basis on which the group can approach outside agencies for support and resources. For example, a bank branch manager would like to go through the books and verify the regularity of meetings, savings,

repayments, etc. before she sanctions a loan to the group. When groups fail to keep records, it is difficult for members to recall what ideas they discussed, what they decided, and how they implemented their decisions. This could lead to confusion, suspicion and conflicts.

Record keeping should be done on a regular basis whenever meetings are held. Information should be kept in record books, not on loose sheets of paper. Information, agreements and finances are important and care should be taken to keep them safely. The details to be maintained by the groups are proceedings in meetings, attendance, savings, loans and repayment, and other activities of the group.

Records should be simple so that all the group members can understand them. Well-informed group members are likely to make better decisions than misinformed ones. In case of fully illiterate groups the members are dependent on an NGO/animator for maintaining the books of accounts. Some of the groups pay a nominal fixed amount to an outsider for maintenance of books. Sometimes the educated daughter/son of a member maintains the books. It should be ensured that the records are read out aloud before the members put their signature/thumb impressions.

What Should the Books Contain?

Minutes book

- The names of members;
- The rules or bye-laws and any changes therein.

These should be in the first few pages. Thereafter each group meeting should be recorded.

- Date of the meeting;
- Members who attended the meeting;
- Any action taken on decisions taken in previous meetings;
- Important decisions taken during the meeting including conflicts if any;
- Total savings collected;
- Loans sanctioned;
- Recovery of loans collected and penalties if any;
- Any other important matters; and
- The minutes should be signed by the members who attended the group meeting.

Savings and Loans Register

Some groups keep a savings and loans register separately. Some groups prefer to divide one register into two and keep the details of savings on one side and loans on the other.

The savings details to be maintained are:

- Individual-wise savings and total savings collected during the meeting; and
- Cumulative total amount collected from individual members since the beginning.

Loan details

The loan register should contain the following details:

- Member-wise folio is preferable;
- Date of loan;
- Loan amount;
- Purpose of loan;
- Repayment period fixed;
- Rate of interest;
- Amount of loan and interest collected;
- Balance amount; and
- Any delay in repayment can be highlighted with red ink to initiate follow-up action

Individual pass book to members

Each member should be given a pass book. Pages can be coloured – half in one colour and the other half in another colour. Colour will differentiate savings and loans.

Details should cover:

- Date of depositing savings and amount, cumulative total; and
- Loans taken, interest rate, date, repayment of loans, balance.

The members should bring their pass books to the meetings, get them updated and take them back.

Activity register

In case the group is taking up other activities they should also be recorded. Details of training programmes attended by members, exposure programmes, joint action taken by the group for their common benefit, etc. can be maintained.

Auditing of books

The books of accounts of a group should be audited every year. A member from one group can audit the books of another nearby group. She can be paid a small fee. Sometimes an outside person is engaged for auditing the books of all the groups in a block. The audit findings should be discussed in the group. The errors in accounts should be rectified.

Work Plan for Your Training Session

Divide the group into smaller groups of 5-6 members each. Distribute copies of the case study and ask them to discuss it among themselves. After discussion, their reactions and views can be presented to the entire group. Team leaders may be selected by the groups themselves to facilitate discussion and presentation.

Case Study: Suggested Guidelines for Accounting Entries for Rashtriya Mahila Kosh (RMK) Loan to NGOs

NGOs follow a different system of accounts. While some NGOs maintain

Receipt and Payment Account for each of the projects/activities undertaken by them, others maintain a consolidated cash book to record all transactions of receipts and payments on a daily basis. Again while bigger NGOs maintain accounts on double entry system of book keeping, i.e. for every debit there will be corresponding credit and the relative voucher will show both the debit and credit entries, some NGOs maintain accounts on the single entry system of book keeping i.e. they maintain only cash book and ledger without preparing voucher showing debit and credit of each transaction. Whatever may be the system of accounts maintained by the NGO, the borrowings raised from RMK and their disbursement to SHGs/members have to be shown distinctly in the books of accounts of the NGO taking loan from RMK. It needs to be clarified that RMK borrowings are not grants and, therefore, these have to be shown as an item of liability (if there are outstandings) under the Head-RMK borrowings. Similarly, all loans outstanding against SHGs/ members (when loans are given directly by the NGO to the members) have to be shown on the asset side of the balance sheet of an NGO. The NGOs will do well to get confirmation of the loans outstanding against SHGs or members at the end of every six months/year.

The accounting entries which may be passed by an NGO for RMK borrowings and their disbursement are indicated as follows by way of illustration

a) **When amounts are received as loan from RMK:**

i) The amount received should be debited to the bank account (where a draft has been received) and RMK loan account will be credited as under:

"Debit bank account .... Rs.

Credit RMK borrowings account .... Rs."

ii) Entries like the above will be passed on receipt of each and every drawal from the RMK. If the drawals are by way of short-term (ST) loans, the word 'ST' will be added in the voucher. If they are by way of medium-term (MT) loan, the word "MT" will be added and separate ledger accounts maintained by the NGO for ST and MT borrowings.

b) **When amounts are disbursed to SHGs:**

i) "Debit SHG's account (name of SHG)…………………..Rs.
Credit bank or cash (as the case may be) …………………Rs.
(Bank will be credited only if cheques are issued by the NGO for payment of loans to the SHGs.)

ii) When loans are disbursed by the NGO directly to the borrower, each of the borrower's accounts (by name) will be debited indicating ST or MT loan and cash or bank account will be credited as in the above illustration.

c) **When recoveries are received from the SHGs/Members:**

"Debit cash or bank ………………………………..Rs.

(with the amount of recoveries) and

Credit SHG/ borrowing member's loan A/c……………………..Rs.

d) **When recoveries are remitted to the RMK:**

Depending on the situation whether the recoveries are remitted under the ST loans or MT loans, the relative account of RMK borrowings should be debited by crediting the amount to the bank account (since in most of these cases draft will be purchased by the NGO and sent to the RMK). The entry will be:

'Debit RMK' borrowings A/c (ST/MT) ………..Rs.

Credit Bank Account …………………………..Rs.

e) **When interest is levied by the NGO on the loans given to SHGs:**

i) The NGOs should have a system of levying interest at least at the end of every quarter. This should be done by debiting the SHG's interest A/c (interest column in the ledger account of NGO) and crediting interest on loan account. As soon as the amount of interest is received, SHG's interest A/c will be credited and cash/bank account will be debited. The entries will appear as under:

"Debit SHG's Interest A/c…………………..Rs.

Credit Interest on loan account. …………………..Rs."

On receipt of actual amount from the SHG, the bank account will be debited and credit will be given in SHG's Interest account in the loan ledger.

If the loans are given directly to the members, the above entries will be raised in Member's loan account in the column meant for interest.

f) **When interest is remitted to RMK:**

Interest amount will be debited by the NGO to the 'interest-paid account' and credit will be afforded in the bank account. Thus, the entry will be:

"Debit interest paid on loans …………………………..Rs.

Credit bank account …………………………………..Rs."

g) **Year-end entries for interest receivable from SHGs and interest payable to RMK:**

At the end of the year, there may be a broken period for which interest will have to be applied on the loan outstanding against SHG. In such cases, the calculation of interest shall be made and amount debited to "interest receivable" by crediting "interest on loan account". This entry will be reversed on receipt of actual interest in the next year when interest receivable will be credited and bank/cash will be debited. The entry thus will be:

"Debit interest receivable on loan ……………………………Rs.

Credit interest on loan …………………………………….Rs."

The reverse entry will be as under:

"Debit bank/cash………………………………Rs.

Credit interest receivable ……………………………Rs."

Interest payable to RMK at the year end:

Normally the RMK will advise interest payable by the NGO towards the end of last quarter of the year and if that amount was paid before the year end, there will be no need for making any calculation of interest payable to RMK for the broken period. If, however, the advice regarding interest payable to RMK is not received from the RMK's office, the NGO should make a calculation of the interest payable by it at the prescribed rate of interest and show it in its account as under:

"Debit Interest on borrowings ………………………………Rs.

Credit interest payable …………………………………..Rs."

When the actual amount of interest is paid, the above entry will be reversed by credit to the bank account and debit in the interest payable account. If there is a difference between the amount of interest calculated by NGO and interest calculations made by RMK, this should be reconciled and suitable entries passed for the difference by debiting or crediting to the interest paid on borrowings accounts.

Ledger Accounts

The ledger account to be opened by an NGO relating to the RMK borrowings should broadly be as under:

a) RMK loan account.

b) Individually an account of the SHGs/members

c) Pass book to be given to each SHG/member

A proforma of each of the above are given in Appendix IV, V and VI respectively.

Suggestions for accounting entries made earlier presupposes that the NGO is following the double entry system of book-keeping and passing vouchers for each and every transaction. In case, however, the NGO follows a single entry system of book-keeping to record all transactions through cash book only, the relative entries will be made for all the above transactions in the cash book while adjusting entries for levy of interest receivable/payable at the end of the quarter or year will have to be suitably passed through a separate register/pass book and included in the Income and Expenditure account/ balance sheet of the NGO. Whatever may be the system, the ledger accounts indicated earlier should be maintained. As stated earlier, NGO books should show the outstanding borrowings of RMK and interest payable to RMK as items of liabilities in its balance sheet and loans outstanding against SHG/ members and interest receivable as on item of asset.

Appendix I

PROFORMA OF CASH BOOK

Receipt Side

Amount in Rs.

Date	RMK loan from NGO	Opening balance	Common Fund	Deposits	Loans	Interest received	Other income	Withdrawal from Bank	Total

Payment Side

RMK loan from NGO	Deposits	Loans	Interest paid	Expenses		Amount remitted to bank	Closing balance
				Salary & TA/DA	Others		

Specimen of RMK Loan Account

	RMK Loan			Interest		
Date	Dr.	Cr.	Bal.	Dr.	Cr.	Bal.

Appendix III

Specimen of Individual Loan/Deposit Ledger

Name of the Account: **Membership No.**
Assets held:

Date	Deposits			Loans				Interest		
	Dr.	Cr.	Bal.	Dr.	Cr.		Bal.	Due on loans	Remitt-ed	Paid on deposit
					Due	Remi-tted				

Particulars of Instalment(s) Due

Month	Loan 1		Loan 2**		Total due		Total recd.	
	P*	I*	P	I	P	I	P	I
Jan.								
Feb.								
Mar.								
& so on								

*P = Principal
*I = Interest

** If there are more than two loans, the same should be added as Loan 3, Loan 4 and so on. The idea is to get month-wise position of the total installments due and actually received.

Specimen of RMK Loan Account

Date	RMK Loan						Interest		
	Dr.		Cr.		Bal.				
	ST	MT	ST	MT	ST	MT	Due	Paid	Bal

Particulars of Instalment(s) Due

Month	Loan 1		Loan 2**		Total due		Total recd.	
	P*	I*	P	I	P	I	P	I
Jan.								
Feb.								
Mar.								
& so on								

*P = Principal
*I = Interest

**If there are more than two loans, the same should be added as Loan 3, Loan 4 and so on. The idea is to get month-wise position of the total installments due and actually received.

Appendix V

Specimen of SHG's Loan/Ledger

Name of the Account: **Membership No.** **Assets Held:**

Date	Deposits			Loans					Interest		
	Dr.	Cr.	Bal.	Dr.		Cr.			Due on loan	Remit- ted	Paid on depo- sits
						Due	Remit- ted	Bal- ance			
				ST	MT	ST MT	ST MT	ST MT			

Particulars of Instalment(s) Due

Month	Loan 1		Loan 2**		Total due		Total recd.	
	P*	I*	P	I	P	I	P	I
Jan.								
Feb.								
Mar.								
& so on								

*P = Principal
*I = Interest

**If there are more than two loans, the same should be added as Loan 3, Loan 4 and so on. The idea is to get month wise position of the total installments due and actually received.

SHG's Pass Book for Loans

Name of SHG: **A/C No.:** **Membership Date:**

Date	Deposits			Loans						Interest on loans		Interest on Deposits	
	Dr.	Cr.	Bal.	Dr.		Cr.		Bal.		Due	Paid	Due	Paid
				ST	MT	ST	MT	ST	MT				

Sources of Information: Literature of Rashtriya Mahila Kosh; Project Report of Rashtriya Mahila Kosh; Management of Savings and Credit Programmes by NGOs by Shri R C Gupta; Training Material prepared by Rashtriya Mahila Kosh for Training at CYSD, Bhubaneshwar.

Annexures: A Note

The annexures we have provided you give you an opportunity for further reading on book-keeping and accountancy. They can also serve as additional background material/reference material. Use your originality to build them into your training sessions. The material has been adapted/ adopted from the following IGNOU course materials:

PCO-1 Preparatory Course in Commerce

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TRADING ACCOUNT

Contents

Final accounts are prepared primarily for ascertaining the operational result and the financial position of the business. They consist of (i) Profit and Loss Account, and (ii) Balance Sheet. The Profit and Loss Account reveals the profit made or loss suffered during an accounting year and the Balance Sheet indicates the financial position as at the end of the year.

The Profit and Loss Account is usually divided into two sections. The first section is called Trading Account and the second section is called Profit and Loss Account. The Trading Account is prepared for ascertaining the Gross Profit and the Profit and Loss Account to find out the Net Profit. In this discussion you will learn what Gross Profit is, how it is ascertained, and how a Trading Account is prepared.

1. What is Gross Profit?

We would like to know the profit earned or loss incurred during an accounting year. This is worked out in two stages. In the first stage the gross profit or gross loss is worked out, and in the second stage the net profit or net loss is ascertained. The net profit/net loss indicates the overall result of the business operations, whereas the gross profit/gross loss reveals the difference between the sales revenue and the cost of goods sold. If the amount of sales is higher that the cost of goods sold, the difference would indicate gross profit. Suppose a trader has purchased goods costing Rs. 50,000. She sold them for Rs. 75,000. The gross profit earned is Rs. 25,000, being the difference between the sales value (Rs. 75,000) and the cost of the goods sold (Rs. 50,000). In other words, **gross profit is the excess of sales value of the goods sold over their cost.** However, if the sales value of the goods sold is less than their cost, the result is gross loss. The purpose of working out gross profit/gross loss is to ascertain the profit or loss from trading operations alone. It indicates whether purchasing and selling of goods have proved to be profitable for the business or not.

1.1 Cost of Goods Sold

As stated above, the gross profit or gross loss is calculated by comparing the cost of goods sold with the sales. Hence, it is necessary to understand how the cost of goods sold is worked out. Let us take the case of a trader. If all the goods purchased have been sold out, the cost of goods sold will be equal to the cost of goods purchased. But normally all the goods bought in a particular period are not completely sold out by the end of that period. Some goods may remain unsold known as closing stock. Hence, the cost of goods sold is usually arrived at by adjusting the cost of closing stock in the cost of goods purchased. For example, during Year X, Suman bought goods worth Rs. 2,50,000. At the end of the year she had a closing stock (unsold goods) of Rs. 50,000. The cost of goods sold will be worked out as under:

Year X	**Rs.**
Cost of Goods Purchased	2,50,000
Less Closing Stock	50,000
Cost of Goods Sold	2,00,000

It is possible that Suman has some unsold stock from the previous year. It is called opening stock. This is added to cost of goods purchased. Assuming at the beginning of Year X she had goods worth Rs. 30,000 in stock (opening stock), the cost of goods sold will be worked out as under:

	Rs.
Cost of Opening Stock	30,000
Add Cost of Goods Purchased	2,50,000
	2,80,000
Less Cost of Closing Stock	50,000
Cost of Goods Sold	2,30,000

Thus, cost of goods sold is equal to **opening stock + purchases – closing stock.**

You should note that the closing stock of a particular year becomes opening stock of the next year. Suppose, the same trader purchased goods costing Rs. 3,20,000 during Year X and had at the end of Year X unsold goods worth Rs. 60,000. The cost of goods sold for Year X shall be as follows:

Year X	**Rs.**
Cost of Opening Stock	50,000
Add Purchases	3,20,000
	3,70,000
Less Cost of Closing Stock	60,000
Cost of Goods Sold	3,10,000

Cost of Goods Purchased: The term 'cost of goods purchased' means the total amount spent on purchases of goods. Hence, it also includes all expenses incurred till the goods are brought to the place of business. The expenses incurred in bringing the goods to the place of business are called direct expenses. Examples of such direct expenses are freight, import duty, dock dues, clearing charges, duty, cartage, etc. Suppose, a trader has purchased 10,000 units at Rs. 9 per unit and paid railway freight amounting to Rs. 9,600 and cartage Rs. 400. The cost of goods purchased will be calculated as follows:

		Rs.
Purchase Price (10,000 x 9)		90,000
Add Direct Expenses :		
Railway Freight	Rs. 9,600	
Cartage	Rs. 400	
		10,000
Cost of Goods Purchased (10,000 units)		1,00,000

Cost of Stock-in-hand: The valuation of stock is an important aspect because it affects the cost of goods sold and ultimately the gross profit of the business. The stock is usually valued at cost. But, if the market price on the date of valuation is less than the cost price, the stock of unsold goods should be valued at the market price. The fact that the market price has fallen implies that these goods can only be sold at a loss. So, the closing stock will be valued at the market price. **Thus the general rule for valuation of stock is 'cost or market price whichever is lower'.** But, in practice, the cost price is generally lower than the market price. So the stock is mostly valued at cost price.

Now the question arises as to how to arrive at the cost of stock. Does cost mean only the purchase price or shall it also include a certain portion of the direct expenses incurred in connection with purchases? The answer is that for ascertaining the cost of closing stock, the proportionate amount of direct expenses will also be included. In the above example, if 2,000 units remain unsold, the value of closing stock will be ascertained as follows:

	Rs.
Purchase Price of 2,000 units (@ Rs. 9 per unit)	18,000
Add Proportionate Expenses (Rs. 10,000/10,000 x 2000)	2,000
Cost of Closing Stock	20,000

Look at Illustration 1. You are given the amount of opening stock, purchases, direct expenses and closing stock. Note how cost of goods sold has been worked out.

Illustration 1

From the following particulars, work out the cost of goods sold.

	Rs.
Opening Stock	18,000
Purchases	1,20,000
Direct Expenses	12,000
Closing Stock	25,000

Solution

	Rs.
Opening Stock	18,000
Add Purchases	1,20,000
Direct Expenses	12,000
Cost of Goods available for sale	1,50,000
Less Closing Stock	25,000
Cost of Goods Sold	1,25,000

Note: It is assumed that the value of opening and closing stocks is inclusive of the proportionate expenses. The adjustment with regard to expenses is made only if stock is given in terms of number of units and the purchase price. In other words, if the total value of stock is given, no such adjustment is necessary.

1.2 Equation for Gross Profit

As discussed earlier the gross profit is worked out by deducting cost of goods sold from the sales revenue. Continuing Illustration 1, suppose the sales were Rs. 1,60,000 the gross profit will be as follows:

	Rs.
Sales	1,60,000
Less Cost of Goods sold	1,25,000
Gross Profit	35,000

We can present this in the form of an equation as follows:

Gross Profit = Sales – Cost of Goods Sold

Substituting the Cost of Goods sold by its constituents, the above equation can be revised as follows:

Gross Profit = Sales – (Opening Stock + Purchases + Direct Expenses – Closing Stock)

The above equation forms the basis for preparing the Trading Account.

Illustration 2

From the following particulars calculate the Gross Profit.

	Rs.
Stock in hand on January 1, Year Y	50,000
Purchases	2,00,000
Purchases Returns	25,000
Direct Expenses	15,000
Sales	3,00,000
Sales Returns	50,000
Stock in hand on December 31, Year Y (Closing Stock)	75,000

Solution:

	Rs.	Rs.
Sales	3,00,000	
Less Sales Returns	50,000	
Net Sales		2,50,000
Cost of Goods Sold		
Opening Stock	50,000	
Add Purchases	2,00,000	
	2,50,000	
Less Purchases Returns	25,000	
	2,25,000	
Add Direct Expenses	15,000	
	2,40,000	
Less Closing Stock	75,000	
		1,65,000
Gross Profit		85,000

Questions for Discussion A

	True	False
1. State whether each of the following statements is True or False		
i) Final accounts are prepared at the end of the accounting year.	☐	☐
ii) Trading Account is prepared for ascertaining net profit.	☐	☐
iii) Gross Profit is the excess of sales over the cost of goods purchased.	☐	☐
iv) Cost of goods purchased includes all expenses incurred till goods are brought to the place of business.	☐	☐
v) Stock is valued at cost or market price whichever is less.	☐	☐
vi) Cost of closing stock does not include any part of direct expenses.	☐	☐

2. Ascertain the cost of goods purchased for the following data:

	Rs.
Opening Stock	10,000
Closing Stock	12,000
Purchases	60,000
Purchases Returns	5,000

3. Ascertain the cost of goods sold from the following figures:

	Rs.
Opening Stock	12,000
Purchases	92,000
Direct Expenses	6,400
Indirect Expenses	8,700
Closing Stock	14,000

2. Form of Trading Account

As started earlier, profit or loss is worked out in two stages. In the first stage we work out the gross profit or gross loss and in the second stage, the net profit or net loss. Hence the Profit and Loss Account is divided into two parts. The first part is known as Trading Account that is prepared for finding out the Gross Profit.

You have learnt the Equation for Gross Profit. This is also known as the Equation for Trading Account because all the items forming part of this equation are fully reflected in the Trading Account.

Look at Table 1. The Trading Account, like any other account in the ledger, has two sides—debit and credit. The opening stock, purchases (less returns) and all direct expenses are shown on the debit side of the Trading Account, and the sales (less returns) and closing stock on the credit side. The Gross Profit appears as the last item on the debit side. It is the excess of the total of the credit side over the total of the debit side. Let us now discuss the form of Trading Account and various items appearing in it.

Table 1
Form of Trading Account of Gayathri
(for the year ended December 31, Year X)

Dr. Particulars	Amount	Amount	Particulars	Amount	Cr. Amount
	Rs.	Rs.		Rs.	Rs.
To Opening Stock	....	....	By Sales	....	
To Purchases	....		Less Sales Returns	....	
Less Purchases Returns	....				
		....			....
To Direct Expenses		....	By Closing Stock		....
(specify individually)		....			
To Gross Profit (transferred to Profit and Loss Account)		....			
		....			....

2.1 Heading

The heading for the Trading Account is split into two parts. The first part indicates the name of the firm or proprietor. The second part (which is written on the next line) indicates the period for which it is being prepared. Suppose, Gayathri is a proprietor of a trading concern and she is interested in knowing the gross result of her business for the year X. The heading will be as follows:

Trading Account of Gayathri
for the year ended December 31, Year X

2.2 Amount Columns

The two amount columns provided on each side of the Trading Account are referred to as 'inner column' and 'outer column' respectively. The inner column is meant for making additions and subtractions, if any. For example, when the item Purchases Returns (Returns Outwards) is given in the Trial Balance, it is shown on the debit side of the Trading Account by way of deduction from the item Purchases as shown below:

	Rs.	Rs.
To Purchases	80,000	
Less Purchases Returns	4,000	
		76,000

The items, which do not require any adjustment, are directly shown in the outer column. Remember that for finding out the Gross Profit the figures shown in the outer column alone will be taken into account.

2.3 Items on the Debit Side

i) **Opening Stock:** We have seen that the closing stock of a particular year becomes the opening stock for the next year. Thus, the item Opening Stock refers to the goods lying unsold at the end of the previous year and brought into the current year for sale. Of course, there will be no opening stock in the first year of working.

ii) **Purchases:** This item refers to the goods purchased for resale, e.g., cloth purchased by cloth dealer, stationery purchased by a stationery dealer, etc. It includes both cash and credit purchases. **Purchases of assets such as machinery, furniture, etc., should not be included in the purchases of goods.** As already stated, purchases returns, if any, are shown by way of deduction from the total purchases and only the net purchases are shown in the outer column.

iii) **Direct Expenses:** As stated earlier, these are the expenses incurred on the goods purchased till they are brought to the place of business for sale. Expenses like freight, duty, carriage or cartage are normally paid for bringing the goods to the place of business. All these expenses are treated as direct expenses and shown on the debit side of the Trading Account. Freight carriage paid in relation to purchases are also called 'Freight Inwards' and 'Carriage Inwards' respectively. **The administrative expenses, selling and distribution expenses, interest paid, etc., are called indirect expenses and so excluded from the Trading Account.** These are to be shown in the Profit and Loss Account.

2.4 Items on the Credit Side

i) **Sales:** It includes both cash and credit sales of goods. Sales of fixed assets such as old typewriters, machinery, furniture, etc., should not be included in sales. If there are some sales returns (returns inwards), they will be deducted from the total sales in the inner column and only the net sales will be shown in the outer column.

ii) **Closing Stock:** As already stated, closing stock must be taken into account for determining the cost of goods sold. For finding out the amount of closing stock, each product lying unsold at the end of the year is physically counted and their complete list is prepared. Then each product is valued at cost price or the market price whichever is lower.

Thus the total value of closing stock is worked out at the end of the accounting year for the purpose of preparing the final accounts. This is called stock taking. Remember that the closing stock does not appear in the Trial Balance. It is an item of additional information which needs an adjustment at the time of preparing the final accounts. The closing stock is shown on the credit side of the Trading Account and also as an asset in the Balance Sheet. The following journal entry is passed in the Journal Proper to record the amount of closing stock.

Stock (Closing) Account Dr.

To Trading Account

(Being the value of closing stock brought into account)

2.5 Gross Profit or Gross Loss

It is the difference (in amount) between the two sides of the Trading Account. After placing the relevant items in the Trading Account, the two sides should be totaled. If the total of the credit side is more than the total of the debit side, the difference will be treated as Gross Profit and shown as 'To Gross Profit' on the debit side. If the total of the debit side is more than the total of the credit side, the difference will be treated as Gross Loss and shown as 'By Gross Loss' on the credit side.

The Gross Profit/Gross Loss thus worked out, is transferred to Profit and Loss Account, and the Trading Account is closed. Now let us prepare Trading Account based on Illustration 2.

Trading Account of ………
for the year ended December 31, Year X

Dr. Particulars	Amount	Amount	Particulars	Amount	Cr. Amount
	Rs.	Rs.		Rs.	Rs.
To Opening Stock		50,000	By Sales	3,00,000	
To Purchases	2,00,000				
Less Purchases Returns	25,000		Less Sales Returns	50,000	
		1,75,000			2,50,000
To Direct Expenses		15,000	By Closing Stock		75,000
To Gross Profit (transferred to Profit and Loss Account)		85,000			
		3,25,000			3,25,000

Illustration 3

From the following balance of Suhana, prepare Trading Account for the Year ended June 30, Year X

	Rs.
Stock on July 1, Year X	18,600
Purchases	1,85,000
Sales	2,90,000
Freight Charges	4,500
Carriage Inwards	800
Import Duty	12,500
Dock Dues and Clearing Charges	600

Returns Inwards	4,000
Returns Outwards	5,000
Value of Stock on June 30, Year Y	24,700

Solution

Trading Account of Suhana
for the year ended June 30, Year Y

Dr. Particulars	Amount	Amount	Particulars	Amount	Cr. Amount
	Rs.	Rs.		Rs.	Rs.
To Opening Stock		18,600	By Sales	2,90,000	
To Purchases	1,85,000		Less Return		
Less Purchases			Inwards	4,000	
Returns	5,000				
		1,80,000			2,86,000
To Direct Expenses			By Closing Stock		24,700
Import Duty	12,500				
Dock Dues and					
Clearing Charges	600				
Freight Charges	4,500				
Carriage Inwards	800				
		18,400			
To Gross Profit (transferred to Profit and Loss Account)		93,700			
		3,10,700			3,10,700

Questions for Discussion B

1. Name any two items appearing on the debit side of a Trading Account.

   ....

   ....

   ....

2. Name the two items appearing on the credit side of a Trading Account.

   ....

   ....

   ....

3. Give Journal entry by which closing stock is brought into books.

   ....

   ....

   ....

4. What do you mean by direct expenses?

   ....

   ....

   ....

3. Closing Entries

You learnt that all nominal accounts representing expenses and incomes are closed at the end of the year by transfer to either the Trading Account or the

Profit and Loss Account. The journal entries passed for such transfer are called 'Closing Entries'. Thus the purpose of closing entries is simply to close all the nominal accounts in the ledger. **The closing entries are passed in the Journal Proper.**

You are aware that accounts relating to expenses and losses always show debit balances and those representing incomes or gains shows credit balances. In order to close an account which shows a debit balance we shall credit it with an amount equal to the balance and debit the Trading Account. For example, the Carriage Account is showing a debit balance of Rs. 800. The closing entry for this will be as follows:

		Rs.	**Rs.**
Trading Account	Dr.	800	
To Carriage Account			800

Similarly, if an account shows a credit balance, it shall be debited with an amount equal to the balance and credited to the Trading Account.

Let us now discuss the journal entries required for closing the accounts of various items which are to appear in the Trading Account.

Of the various items that are shown in the Trading Account, the accounts relating to stock (opening), purchases, sales returns and direct expenses show debit balances, while the accounts relating to sales and purchases returns show credit balances. As already stated, only net purchases (total purchases minus purchases returns) and net sales (total sales minus sales returns) are shown in the Trading Account. Hence, Purchases Returns Account and Sales Returns Account are, in the first instance, transferred to Purchases Account and Sales Account respectively. The remaining accounts will be transferred to the Trading Account directly by passing the closing entries as follows:

i) **For Purchases Returns Account**

Purchase Returns Account Dr.

To Purchase Account

ii) **For Sales Returns Account**

Sales Account Dr.

To Sales Returns Account

iii) **For Opening Stock, Purchases and Direct Expenses Accounts**

Trading Account Dr.

To Stock Account (opening)

To Purchases Account (net amount)

To Direct Expenses Accounts (individually)

iv) **For Sales Returns**

Sales Account (net amount) Dr.

To Trading Account

Note : As mentioned earlier, closing stock is brought into books by an adjustment entry wherein the Trading Account is credited. No closing entry is required. After passing the adjustment entry the closing stock balance is shown as an asset in the Balance Sheet.

v) **For Gross Profit**

Trading Account Dr.

To Profit and Loss Account

Note : If there is Gross Loss, the closing entry will be just the reverse of the above entry i.e. Profit and Loss Account will be debited and the Trading Account credited. When the closing entry is passed for the Gross Profit or Gross Loss, the Trading Account stands closed.

Illustration 4

The following balances were taken from the books of Chandra on December 31, Year Y.

	Rs.
Stock on January 1, Year Y	25,000
Purchases	2,10,000
Carriage Inwards	5,200
Sales	3,15,000
Purchases Returns	6,300
Sales Returns	7,500

The value of stock of December 31, Year Y was Rs. 19,000. Pass the necessary closing entries and prepare the Trading Account for the year ended December 31, Year Y.

Solution

Journal

Date	Particulars	L.F.	Amount	Amount
Year Y Dec.31	Purchases Returns A/c Dr. To Purchases A/c (Being the transfer of Purchases Returns Account to Purchases Account)		6,300	 6,300
" 31	Sales A/c Dr. To Sales Returns A/c (Being the transfer of Sales Returns Account to Sales Account)		7,500	 7,500
" 31	Trading A/c Dr. To Stock A/c To Purchases A/c To Carriage Inwards A/c (Being the transfer of the above Accounts to Trading Account)		2,33,900	 25,000 2,03,700 5,200
" 31	Sales A/c Dr. To Trading A/c (Being the transfer of Sales Account to Trading Account)		3,07,500	 3,07,500

" 31	Trading A/c Dr.		92,600	
	To Profit and Loss A/c (Being the transfer of gross profit to Profit and Loss Account)			92,600

Trading Account of Chandra for the year ended December 31, Year Y

Dr. Particulars	Amount	Amount	Particulars	Amount	Cr. Amount
	Rs.	Rs.		Rs.	Rs.
To Opening Stock		25,000	By Sales	3,15,000	
To Purchases	2,10,000		Less Sales Return	7,500	
Less Purchase Returns	6,300				
					3,07,500
		2,03,700	By Closing Stock		19,000
To Carriage Inwards		5,200			
To Gross Profit (transferred to Profit and Loss Account)		92,600			
		3,26,500			3,26,500

1. The Trading Account is prepared to find out the Gross Profit or Gross Loss for the year.
2. Gross Profit is the excess of sales over the cost of goods sold.
3. Cost of goods sold is equal to opening stock plus purchases minus closing stock.
4. While preparing the Trading Account the opening stock, purchases (net) and direct expenses are shown on the debit side, and sales (net) and closing stock are shown on the credit side.
5. Purchases returns are deducted from the total purchases and sales returns are deducted from the total sales.
6. The balance of the Trading Account represents Gross Profit or Gross Loss. If the credit side total is greater than the debit side total, the difference is Gross Profit. In case the total of the debit side is more than the total of the credit side, the difference is Gross Loss.
7. The Gross Profit or Gross Loss is transferred to Profit and Loss Account.
8. Closing entries are passed in the Journal Proper for transferring various items that are to be included in the Trading Account.

Some Terms

Closing Stock: Goods remaining unsold at the end of the accounting year

Cost of Goods Sold: Difference between the cost of goods available for sale and the value of unsold goods.

Direct Expenses: Expenses incurred on the goods purchased till they are brought to the place of business for sale.

Gross Loss: Excess of the cost of goods sold over sales.

Gross Profit: Excess of sales over the cost of the goods sold.

Opening Stock: Goods lying unsold at the end of the previous year and brought into the current year for sale.

Answers to Questions for Discussion

A. 1. i) True ii) False iii) True iv) True v) True vi) False

2. Rs. 53,000

3. Rs. 96,400

Exercises

1. Prepare Trading Account of Shanti from the following information:

	Rs.
Stock on April 1, Year X	36,500
Purchases	3,24,600
Purchases Returns	6,300
Sales	5,62,400
Import Duty	11,000
Freight	21,500
Dock Dues and Clearing Charges	1,800
Sales Returns	7,500
Value of Stock on March 31, Year Y	42,100

(**Answer:** Gross Profit Rs. 2,07,900)

2. Prepare Trading Account for the year ending December 31, Year X from the following figures obtained from the books of Mohini. Also give closing entries.

	Rs.
Stock on January 1, Year X	27,400
Purchases	2,36,800
Returns Outwards	8,200
Duty	1,200
Carriage Inwards	2,400
Sales	3,92,700
Returns Inwards	7,300
Value of Closing Stock	31,500

(**Answer:** Gross Profit Rs. 1,57,300)

MANUFACTURING ACCOUNT

Contents

We discussed about the Trading Account of firms engaged in trading activity only. Such concerns, called trading concerns, can find out the cost of goods sold and the gross profit by preparing a Trading Account directly. But a manufacturing concern has to find out the cost of goods produced before it can work out the cost of goods sold and the gross profit. So the manufacturing concerns first prepare Manufacturing Account for finding out the cost of goods produced (also called Cost of Production), and then prepare a Trading Account to ascertain the cost of goods sold and the gross profit. We will discuss how to ascertain the cost of goods produced and how to prepare the Manufacturing and Trading Account of a manufacturer.

1. Cost of Goods Produced (Cost of Production)

As stated above, a manufacturing concern has to work out the cost of goods produced (cost of production) before finding out the cost of goods sold and gross profit. Let us now learn how the cost of goods produced is ascertained. The manufacturing concerns purchase raw materials from the market and convert them into finished goods for sale. For example, a cotton textile mill buys cotton (raw material) and converts it into cloth in its factory. Similarly, a sugar mill purchases sugar cane (raw material) and produces sugar. Thus the cost of goods produced includes two major costs: (i) cost of raw materials consumed, and (ii) cost of conversion. These are explained in the following sections.

Cost of Raw Materials Consumed: The cost of raw materials consumed represents the cost of raw materials used during manufacture. When you work out the cost of goods sold, you adjust the costs of opening and closing stocks of finished goods in the cost of goods purchased. Similarly, to work out the cost of raw materials consumed, you have to adjust the costs of opening and closing stocks of raw materials in the cost of raw materials purchased. For example, a firm purchased raw materials worth Rs. 5,60,000 during Year A and spent Rs. 5,400 on freight, cartage, etc. The cost of raw material on January 1, Year A (opening stock) was Rs. 80,000 and on December 31, Year A (closing stock) Rs. 90,000.

The cost of raw materials consumed during Year A will be worked out as follows:

	Rs.
Opening Stock of Raw Materials	80,000
Add Purchases of Raw Materials during the year	5,60,000
Expenses on Purchases (Freight, cartage, etc.)	5,400
	6,45,400
Less Closing Stock of Raw Materials	90,000
Cost of Raw Materials Consumed	5,55,400

Cost of Conversion: This includes all expenses incurred in the factory for converting raw materials into finished goods. Examples are wages paid to workers who are directly involved in the production of goods (called manufacturing wages or productive wages), motive power (steam, electricity or gas consumed in the course of manufacturing), coal, gas and water, oil and grease, etc. Factory rates and taxes, factory lighting, factory insurance, repairs to the factory building, repairs to plant and machinery, depreciation on factory building, depreciation on plant, and other factory expenses are also treated as manufacturing expenses. These are debited to the Manufacturing Account along with the expenses incurred on purchases of raw material such as freight, import duty, dock dues, clearing charges, etc.

For calculating the cost of goods produced there are two more items that are taken into account. These are (i) scrap, and (ii) Work-in-Progress. Let us understand their meaning and relevance to cost of production.

Scrap: Scrap is waste material coming out of the manufacturing processes. For example, cuttings of cloth in ready-made garment factories, metal cuttings in engineering factories, etc. Any amount realized from its sale should be treated as income and adjusted in the cost of goods produced.

Work-in-progress: It is quite likely that at the end of the year there may be certain goods which are still in the process of manufacture. In other words, some work still remains to be completed in respect of these goods. Take the case of a furniture manufacturer. She may have some chairs and tables which are still to be polished. Such goods in respect of which the work is incomplete as at the end of the year are called 'semi-finished goods' or 'work-in-progress'. The cost of semi-finished goods or work-in-progress as at the end of the year should also to be taken into account while working out the cost of goods produced. It is done by deducting the cost of semi-finished goods from the total costs incurred during the year. Just as you have some semi-finished goods at the end of the year, you may have some semi-finished goods at the beginning of the year. Such goods will be completed and sold during the current year. So, the cost incurred on them during the previous year should also be taken into account for the purpose of finding out the cost of all goods completed during the current year. Therefore, we add the cost of opening work-in-progress to the costs incurred during the year and deduct therefrom the cost of closing work-in-progress.

Now let us see how cost of goods produced will be worked out after taking into account all the above items. The following statement will make this clear to you.

			Rs.
Cost of Raw Materials Consumed		....	
Add Manufacturing Expenses			
	....	....	
	....	....	
	....	....	
			....
Less Sale Value of Scrap			....
			....
Gross Cost of Goods Produced			....
Add Opening Stock of Work-in-progress			....
Less Closing Stock of Work-in-progress			....
			....
Cost of Goods Produced			....

Look at Illustration 1 and study how the cost of goods produced has been arrived at.

Illustration 1

The following figures have been extracted from the books of a manufacturing concern. Find out the Cost of Goods Produced during the year ended December 31, Year B.

	Rs.
Stock on January 1, Year B	
Raw Materials	10,000
Work-in-progress	5,000
Stock on December 31, Year B	
Raw Materials	5,000
Work-in-progress	15,000
Purchases of Raw materials	50,000
Carriage Inwards	5,000
Direct Wages	10,000
Motive Power	5,000
Depreciation on Machinery	5,000

Solution

		Rs.
Opening Stock of Raw Materials		10,000
Add Purchases of Raw Materials		50,000
Add Carriage Inwards		5,000
		65,000
Less Closing Stock of Raw Materials		5,000
Cost of Raw Materials Consumed		60,000
Add Wages	10,000	
Motive Power	5,000	
Depreciation on Machinery	5,000	20,000

Gross Cost of Goods Produced	80,000
Add Opening Work-in-progress	5,000
	85,000
Less Closing Work-in-progress	15,000
Cost of Goods Produced	70,000

Questions for Discussion A

1. What is Work-in-progress?

   ....

   ....

   ....

   ....

   ....

2. What is Scrap?

   ....

   ....

   ....

   ....

   ....

3. Work out the cost of materials consumed from the following data.

	Rs.
Opening stock of raw materials	8,000
Closing stock of raw materials	10,000
Purchases of raw materials	75,000
Carriage and freight inwards	7,000

4. Fill in the blanks.

   i) Opening work-in-progress is .... for calculating cost of goods produced.

   ii) Closing work-in-progress is .... for calculating cost of goods produced.

   iii) Value of scrap is .... for calculating cost of goods produced.

   iv) Depreciation on .... is also taken into account for calculating cost of goods.

   v) Cost of goods produced is also called ....

5. Name two items which can be regarded as manufacturing expenses.

   ....

   ....

   ....

   ....

   ....

2. Form of Manufacturing Account

You have already learnt how cost of goods produced can be worked out by preparing a statement. You will now learn how a manufacturing concern prepares the Manufacturing Account for ascertaining the cost of goods produced (cost of production). Look at Table 1 and study the form of Manufacturing Account and see how various items related to cost of production appear in the Manufacturing Account.

Table 1
Manufacturing Account of ……………..
for the period ended ……………

Dr. Particulars	Amount	Amount	Cr. Particulars	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
To Work-in-progress at the beginning		…	By Sale of Scrap		…
To Raw Materials Consumed:			By Work-in-progress at the end		…
Opening Stock of Raw Materials	…				
Add Purchases of Raw Materials	…		By Cost of Goods Produced (transferred to Trading Account)		…
Less Closing Stock of Raw Materials	…	…			
To Carriage Inwards	…				
To Freight, Import Duty, Dock Dues, etc.		…			…
To Manufacturing Wages		…			
To Motive Power		…			
To Coal, Gas and Water		…			
To Oil and Grease		…			
To Factory Lighting & Heating		…			
To Factory Insurance		…			
To Repairs to Factory Building		…			
To Repairs to Plant and Machinery		…			
To Depreciation on Factory Building		…			
To Depreciation on Plant and Machinery		…			
		…			…

Let us now prepare Manufacturing Account from the figures given in Illustration 1.

Manufacturing Account of ……..
for the year ending December 31, Year——

Dr. Particulars	Amount	Amount	Cr. Particulars	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
To Work-in-progress at the beginning		5,000	By Work-in-progress at the end		15,000
To Raw Materials Consumed:			By Cost of Goods Produced (transferred to Trading Account)		70,000
Opening Stock	10,000				
Add Purchases of Raw Materials	50,000				
	60,000				
Less Closing Stock	5,000				
		55,000			
To Carriage Inwards		5,000			
To Direct Wages		10,000			
To Motive Power		5,000			
To Depreciation on Machinery		5,000			
		85,000			85,000

After studying the form of Manufacturing Account as given in Table 1 and the Manufacturing Account as prepared above, you will observe the following points:

i) All items of expenses have been shown on the debit side and income from scrap on the credit side.

ii) The heading of Manufacturing Account, as in the case of Trading Account, indicates the name of the firm and the period for which it is prepared.

iii) Opening and closing stocks of raw materials have been adjusted in the cost of raw materials consumed on the debit side itself.

iv) Opening stock of work-in-progress has been shown on the debit side and closing work-in-progress on the credit side.

v) Expenses on purchases of raw materials have been shown on the debit side separately. They are adjusted in the cost of raw materials consumed.

vi) Cost of production has been shown on the credit side which makes the totals on both sides equal. Thus, cost of production is the excess of the debit side total over the credit side total.

Illustration 2

From the following balances prepare the Manufacturing Account of Mohan for the year ended March 31, Year B.

	Rs.
Work-in-progress	
April 1, Year A	9,500
March 31, Year B	7,800
Materials consumed	1,29,800
Sale of Scrap	2,500
Productive Wages	30,000
Carriage Inwards	2,500
Power	4,500
Other Factory Expenses	8,400

Solution

Manufacturing Account of Mohan
for the year ending December 31, Year A

Dr. Particulars	Amount	Amount	Particulars	Amount	Cr. Amount
	Rs.	Rs.		Rs.	Rs.
To Work-in-progress			By Sale of Scrap		2,500
at the beginning		9,500	By Work-in-progress		
To Materials		1,29,800	at the end		7,800
Consumed					
To Carriage Inwards		2,500	By Cost of Goods		
To Productive Wages		30,000	Produced		
To Power		4,500	(transferred to		
To Other Factory			Trading		
Expenses		8,400	Account)		1,74,400
		1,84,700			1,84,700

3. Form of Trading Account of a Manufacturing Concern

After preparing the Manufacturing Account, a manufacturer has to prepare the Trading Account for working out Gross Profit or Gross Loss. The following is the form of the Trading Account of a manufacturing concern.

Trading Account of ……..
for the period ended …………

Dr. Particulars	Amount	Amount	Particulars	Amount	Cr. Amount
	Rs.	Rs.		Rs.	Rs.
To Opening Stock of			By Sales of		
Finished Goods		…	Finished Goods	…	
To Cost of Goods					
Produced					
(transferred					
from Manufac-					
turing Account)		…	Less Sales		
			Returns	…	
					…
To Gross Profit			By Closing Stock		
(transferred to Profit			of Finished Goods		…
and Loss Account		…			
		…			…

You will notice that the Trading Account of the manufacturer shows fewer items as compared to the Trading Account of a trader. It is because most of the direct expenses have already been included in the Manufacturing Account. The Trading Account now shows only the cost of goods produced, opening and closing stocks of finished goods, and the net sales. However, if the manufacturer also purchases some finished goods for resale directly from the market, this can also be debited to the Trading Account. Look at Illustration 3. You will understand more clearly the preparation of the Trading Account of a manufacturer.

Illustration 3

On December 31, Year A, the following balances appeared in the books of Ravi:

	Rs.
Balance on January 1, Year A	
Raw Materials	12,400
Work-in-progress	10,600
Finished Goods	24,000
Purchases of Raw Materials	86,000
Freight Inwards	3,500
Manufacturing Wages	36,000
Import Duty	6,000
Dock Dues	1,200
Motive Power	5,000
Oil, Grease, etc.	300
Factory Insurance	500
Factory Rent	12,000
Repairs to Plant and Machinery	600
Depreciation on Plant and Machinery	3,000
Sales of Finished Goods	2,15,000
Sale of Scrap	2,800
Balances on December 31, Year A	
Raw Materials	10,800
Work-in-progress	9,200
Finished Goods	32,000

Prepare the Manufacturing Account and the Trading Account for the year ended December 31, Year A

Solution

Manufacturing Account of Ravi
for the year ending December 31, Year A

Dr. Particulars	Amount	Amount	Particulars	Amount	Cr. Amount
	Rs.	Rs.		Rs.	Rs.
To Work-in-progress at Commencement		10,600	By Sale of Scrap		2,800
			By Work-in-Progress		
To Raw Materials Consumed:			at the end		9,200
Opening Stock	12,400		By Cost of Goods Produced (transferred To Trading Account)		1,54,300
Add Purchases	86,000				
	98,400				
Less Closing Stock	10,800				
		87,600			
To Freight Inwards		3,500			
To Import Duty		6,000			
To Dock Dues		1,200			
To Manufacturing Wages		36,000			

To Motive Power		5,000			
To Oil, Grease, etc.		300			
To Factory Rent		12,000			
To Factory Insurance		500			
To Repairs to Plant & Machinery		600			
To Depreciation on Plant & Machinery		3,000			
		1,66,300			1,66,300

Trading Account of Ravi
for the period ended December 31, Year A

Dr. Particulars	Amount	Amount	Particulars	Amount	Cr. Amount
	Rs.	Rs.		Rs.	Rs.
To Opening Stock of Finished Goods		24,000	By Sales		2,15,000
To Cost of Goods Manufactured		1,54,300	By Closing Stock of Finished Goods		32,000
To Gross Profit (transferred to Profit and Loss Account)		68,700			
		2,47,000			2,47,000

Questions for Discussion B

1. Why is a Manufacturing Account prepared?

....

....

2. Name the items shown in the Trading Account of a Manufacturer.

....

....

	True	False
3. State whether the following are True or False.		
i) Manufacturing Account is prepared in case of traders.	☐	☐
ii) Closing Stock consists of stocks of raw materials, semi-finished goods and finished goods.	☐	☐
iii) Closing Stock of all items is shown in the Manufacturing Account.	☐	☐
iv) Royalty based on production is shown in the Manufacturing Account.	☐	☐
v) Sale of Scrap is shown on the debit side of the Manufacturing Account.	☐	☐

vi) Repairs to Plant and Machinery are shown in the Manufacturing Account. ☐ ☐

vii) Repairs to Office Building are shown in the Profit and Loss Account. ☐ ☐

viii) Depreciation of Factory Building is shown in the Profit and Loss Account. ☐ ☐

4. Trading Account Without Manufacturing Account

Sometimes, you are asked to prepare only the Trading Account of a manufacturer without preparing the Manufacturing Account. In that case, all expenses on purchases of raw materials, the manufacturing expenses, the cost of raw materials consumed, and the opening and closing work-in-progress are also shown in the Trading Account. **In this case, it is necessary to notice that items like repairs to plant and machinery and factory building are, conventionally, shown in the Profit and Loss Account and not in the Trading Account.** Illustration 4 deals with this type of a situation.

Illustration 4

From the following balances extracted from the books of Nitya, prepare her Trading Account for the year ended December 31, Year A

	Rs.
Opening Stock	60,000
Purchases less Returns	2,25,000
Freight and Dock Charges	21,600
Direct Wages	30,000
Coal, Gas and Water	13,600
Other Manufacturing Expenses	4,200
Repairs to Machinery	2,100
Depreciation on Machinery	4,000
Sales less Returns	3,56,000

Closing Stock was valued at Rs. 82,000

Trading Account of Nitya
for the period ended December 31, Year A

Dr. Particulars	Amount	Amount	Particulars	Amount	Cr. Amount
	Rs.	Rs.		Rs.	Rs.
To Opening Stock		60,000	By Sales less Returns		3,56,000
To Purchases less Returns		2,25,000	By Closing Stock		82,000
To Freight and Dock Charges		21,600			
To Direct Wages		30,000			

To Coal, Gas and Water		13,600			
To Other Manufacturing Expenses		4,200			
To Gross Profit (transferred to Profit and Loss Account)		83,600			
		4,38,000			4,38,000

Note: As already stated, the items of 'Repairs to Machinery' and 'Depreciation on Machinery' are to be shown in the Profit and Loss Account because the Manufacturing Account is not being prepared in this case.

1. Cost of production of (a) cost of materials consumed, and (b) cost of conversion (all manufacturing expenses).
2. Manufacturing Account is prepared to find out the cost of goods produced (cost of production).
3. Manufacturing Account is debited with the value of opening work-in-progress, cost of raw materials consumed, expenses on purchases of raw materials and all manufacturing expenses.
4. Sale of scrap and the closing work-in-progress are shown on the credit side of the Manufacturing Account.
5. The balance of the Manufacturing Account represents the cost of the goods produced during the period. It is transferred to the Trading Account.
6. After ascertaining the cost of goods produced, the Trading Account is prepared to find out the Gross Profit and Gross Loss.

Cost of production: It is the cost of goods produced which includes cost of raw materials consumed and all manufacturing expenses.

Manufacturing Account: An account prepared for ascertaining the cost of production.

Manufacturing Expenses: Expenses incurred in the factory for converting raw materials into finished goods.

Scrap: Waste material which arises in the course of manufacture.

Work-in-Progress: Goods in respect of which some work still remains to be done. It is also called semi-finished goods.

Answers to Questions for Discussion

A. 3. Rs. 80,000

4. (i) added (ii) deducted (iii) deducted (iv) machinery
(v) cost of production

B. 3. (i) False (ii) True (iii) False (iv) True
(v) False (vi) True (vii) True (viii) False

Exercises

1. From the following balances extracted from the books of Mani, prepare Manufacturing Account and Trading Account for the year ended March 31, Year A.

	Rs.
Stock on April, Year A	
Raw Materials	10,800
Semi-finished Goods	8,400
Finished Goods	21,000
Purchases of Raw Materials	75,000
Purchases Returns	4,000
Carriage Inwards	2,500
Sales	1,90,000
Sales Returns	6,000
Direct Wages	24,000
Power	4,800
Factory Heating and Lighting	600
Depreciation on Machinery	7,000
Depreciation on Factory Building	2,000
Sundry Factory Expenses	2,800
Stock on March 31, Year B	
Raw Materials	14,500
Semi-finished Goods	15,000
Finished Goods	26,000

(**Answer:** Cost of Goods Produced Rs. 1,04,400; Gross Profit Rs. 84,600)

2. From the following balances, you are required to prepare Manufacturing Account and Trading Account of Shanti for the year ended September 30, Year A.

	Rs.
Balances on October 1, Year A	
Raw Materials	24,000
Work-in-progress	8,900
Finished Goods	32,000
Purchases of Raw Materials	1,24,000
Freight	8,600
Octroi	500
Wages	48,000
Motive Power	4,000
Repairs to Machinery	600
Factory Rent & Taxes	15,000
Sale of Scrap	3,000
Depreciation on Machinery	8,000
Sundry Manufacturing Expenses	3,600
Sales of Finished Goods	3,50,000
Balances on September 30, Year B	
Raw Materials	15,000
Work-in-progress	18,000
Finished Goods	22,000

(**Answer:** Cost of Goods Produced Rs. 2,09,200; Gross Profit Rs. 1,30,800)

3. Prepare Trading Account for the year ended December 31, Year A, from the books of M. Mukherjee.

	Rs.
Stock on January 1, Year A	13,600
Purchases	89,200
Carriage	8,000
Sales	2,34,100
Returns Inwards	1,400
Returns Outwards	1,200
Wages	24,000
Fuel and Power	12.600
Sundry Factory Expenses	6,800
Stock on December 31, Year A	14,500

(**Answer:** Gross Profit Rs. 94,200)

PROFIT AND LOSS ACCOUNT

Contents

You know that an income statement is prepared to ascertain the overall result of business activities for an accounting year. You also know that it is divided into two sections. The first section called 'Trading Account' is prepared to work out the Gross Profit/Gross Loss. The second section, known as the 'Profit and Loss Account', is prepared for ascertaining the Net Profit/Net Loss. You learnt about the preparation of Trading Account of a trader as well as that of a manufacturer. We will now discuss how a Profit and Loss Account is prepared and the Net Profit/Net Loss ascertained. We shall also discuss the closing entries required for the preparation of a Profit and Loss Account.

1. Profit and Loss Account

After having ascertained the Gross Profit/Gross Loss by preparing a Trading Account, the businesswoman proceeds to prepare the Profit and Loss Account to know the Net Profit or Net Loss. It starts with Gross Profit transferred from the Trading Account which is shown on the credit side of the Profit and Loss Account. In case the Trading Account reveals Gross Loss, it will be shown on the debit side of the Profit and Loss Account. The Trading Account takes into account only direct expenses i.e., expenses relating to purchases and manufacturing of goods. All the remaining expenses (called indirect expenses) and the losses relating to normal activities of the business are shown on the debit side of the Profit and Loss Account. Usually, the office and administrative expenses such as salaries, rent and taxes, postage and telegrams, printing and stationery, legal expenses, etc. are shown first. These are followed by selling and distribution expenses such as advertising, commission paid, travelling expenses, carriage outwards, warehousing expenses, etc., the financial expenses such as interest paid and the revenue losses such as loss by fire, loss by theft, etc. All incomes and gains (other than sales) such as rent received, interest received, commission received, discount received, etc., are shown on the credit side of the Profit and Loss Account. **The difference between the two sides of the Profit and Loss Account represents either Net Profit or Net Loss.**

In case the total of the credit side is higher than the total of the debit side, the difference is called Net Profit. Thus, Net Profit is the excess of gross profit and incidental incomes over the expenses and losses relating to the normal activities of the business. If, however, the expenses and losses are more than the gross profit and incidental incomes, the difference is called Net Loss. In other words, if the total of the debit side is more than the total of the credit side, the result is Net Loss. The Net Profit or Net Loss belongs to the proprietor and therefore it is transferred to his or her Capital Account.

Thus the Profit and Loss Account is closed. Let us now see how the Profit and Loss Account is prepared.

2. Form of Profit and Loss Account

The Profit and Loss Account is generally prepared as shown in the following Table.

Table 1
Profit and Loss Account …………
for the period ended ………

Dr.			Cr.
Particulars	**Amount**	**Particulars**	**Amount**
	Rs.		**Rs.**
To Gross Loss, if any (transferred from Trading Account)		By Gross Profit (transferred from Trading Account	
To Salaries		By Interest Received	
To Rent, Rates and Taxes		By Discount Received	
To Postage and Telegrams		By Rent Received	
To Telephone Charges		By Commission Received	
To Printing and Stationery		By Dividend Received	
To Legal Expenses		By Other Incomes and Gains	
To Insurance		By Net Loss (transferred to Capital Account)	
To Office Lighting			
To Entertainment Expenses			
To Charity			
To Advertising			
To Travelling Expenses			
To Discount Allowed			
To Interest Paid			
To Repairs and Renewals			
To Loss by Fire			
To Loss by Theft			
To Other Expenses and Losses, if any			
To Net Profit (transferred to Capital Account)			

Notes:

1. The heading for the Profit and Loss Account, as in the case of the Trading Account, indicates the name of the business or proprietor and the period for which it is being prepared.
2. In addition to the items shown in the above form, there are certain items such as depreciation, bad debts, provision for doubtful debts, interest on capital, interest on drawings, etc., which appear in the Profit and Loss Account as a result of the adjustment entries.
3. The two sections of the Income Statement viz., the Trading Account and the Profit and Loss Account, may by prepared either separately or in a combined manner. Normally, the latter course is followed. In such a case, the combined account will be headed as

Trading and Profit and Loss Account of ………..
for the period ended ………

Look at Illustration 2. It shows a combined Trading and Profit and Loss Account.

3. Some Important Points

While preparing the Trading and Profit and Loss Account the following points regarding the treatment of certain items are to be noted carefully.

1. **Wages and Salaries:** The item ‘Wages’ usually represents the remuneration paid to workers who are directly engaged in the production of goods. It is, therefore, shown on the debit side of the Trading Account (or Manufacturing Account, if prepared) as it is a direct expense. The item ‘Salaries’ usually represents the remuneration paid to employees working in the office. It is an indirect expense and is, therefore, shown in the Profit and Loss Account. The difficulty arises when wages are clubbed with salaries and the Trial Balance includes a single amount for ‘Wages and Salaries’. In such a situation the amount may be shown in the Trading Account. It is based on the assumption that the item includes the salaries of the supervisory staff in the factory itself. But, if the item in the Trial Balance reads ‘Salaries and Wages’, it will be taken to the Profit and Loss Account on the assumption that the item includes wages of the office staff such as messengers, watchmen, etc.

   Note that wages paid to workers engaged for the construction of building or for installation of machinery are a capital expenditure and should therefore be added to the cost of the asset concerned. These are not to be shown in the Trading Account.

2. **Carriage:** Normally, carriage is the amount paid for bringing the goods purchased to the place of business. It is called Carriage Inwards and shown in the Trading Account. But, when it relates to the goods sold it is called Carriage Outwards. This is treated as a distribution expense and charged to Profit and Loss Account.

   However, if it is not indicated whether the expenditure on carriage relates to purchases or sales, it is to be treated as carriage inwards and so charged to Trading Account.

3. **Trade Expenses:** This item represents various small and miscellaneous expenses incurred in the business. It is transferred to the debit side of Profit and Loss Account. They are also called General Expenses or Sundry Expenses or Miscellaneous Expenses.

4. **Packing:** The cost of packing materials such as polythene bags, wrapping materials, etc. used for packing the items for delivery is a distribution expense and hence charged to Profit and Loss Account. Where, however, packing is essential to make the products fit for sale in the market as in the case of cigarettes, biscuits, medicines, oil etc., it is called ‘packing’ and such expenditure is charged to the Trading Account.

5. **Samples:** Generally, samples of goods are distributed free of charge to increase sales. The cost of such samples should be treated as a selling expense and so debited to Profit and Loss Account.

6. **Insurance:** Generally, assets are insured to cover the risk of loss, say, by fire. Premium paid to the insurance company should be treated as a business expense. When assets such as factory building, factory machinery etc. are insured, the insurance premium should be debited to Trading Account. If, on the other hand, the premium is paid for insurance of assets in the office, such as office building, office furniture, etc., it should be charged to Profit and Loss Account.

Sometimes, it is not indicated whether the premium paid relates to factory assets or office assets. The same should be shown in the Profit and Loss Account.

7. **Rent, Rates and Taxes:** These are charges levied by the municipal bodies on the house property. It is a common item of indirect expenses debited to the Profit and Loss Account.
8. **Royalties:** Royalties refer to the payments made for the use of a copyright or a patent. The amount of royalty is generally based on the quantity **produced.** It is, therefore, treated as a direct expense and charged to the Trading Account. But, if it is calculated on the basis of quantity **sold** as in the case of books, it is shown in the Profit and Loss Account.
9. **Income Tax:** It is the tax payable by a person on her income. In the case of a sole trading concern, the tax paid by the proprietor on the profit of the business is treated as a personal expense. Hence, it should be added to drawings or directly deducted from capital.

Illustration 1

From the following balances of Kamla prepare Profit and Loss Account for the year ended June 30, Year X.

	Rs.
Salaries and Wages	30,000
Office Expenses	2,640
Postage and Telephone Charges	3,200
Advertising	1,500
Legal Charges	2,500
Rent, Rates, and Taxes	10,400
Travelling Expenses	1,250
Interest Received	300
Insurance	1,200
Stationery	600
Office Lighting	750
Repairs	460
Miscellaneous Income	400
Commission Paid	2,000
Bank Charges	100

The Gross Profit for the year was Rs. 36,500

Solution

Profit and Loss Account of Kamla
for the year ended June 30, Year X

Dr. Particulars	Amount	Particulars	Cr. Amount
	Rs.		**Rs.**
To Salaries and Wages	30,000	By Gross Profit (transferred from Trading Account)	36,500
To Rent, Rates and Taxes	10,400	By Interest Received	300
To Postage and Telephone Charges	3,200	By Miscellaneous Income	400
To Stationery	600		

To Office Lighting To Office Expenses To Legal Charges To Insurance To Bank Charges To Advertising To Travelling Expenses To Commission Paid To Repairs	750 2,640 2,500 1,200 100 1,500 1,250 2,000 460	By Net Loss (transferred to Capital Account)	19,400
	56,600		56,600

Questions for Discussion A

1. What is Profit and Loss Account?

   ....

   ....

2. What is Net Profit?

   ....

   ....

3. Fill in the blanks:

   i) The Net Profit made during an accounting year is ascertained by preparing ....

   ii) The Profit and Loss Account starts with .... on the credit side.

   iii) Carriage .... is shown in Profit and Loss Account.

   iv) When royalties are paid on the basis of output, they are shown on the debit side of ....

   v) Salaries and Wages are charged to ....

   vi) Cost of samples distributed free of cost are treated as a .... expense.

4. State whether each of the following statements is True or False.

	True	False
i) Profit and Loss Account is charged with all indirect expenses.	☐	☐
ii) Insurance Premium paid on factory building is charged to Profit and Loss Account.	☐	☐
iii) Remuneration paid to indirect labour is always charged to Profit and Loss Account.	☐	☐
iv) Cost of packaging is charged to Trading Account.	☐	☐
v) Cost of packing is a distribution expense and so charged to Profit and Loss Account.	☐	☐
vi) Income Tax paid in case of a proprietary concern is charged to Profit and Loss Account.	☐	☐

4. Closing Entries in Respect of Profit and Loss Account

As already stated, closing entries are passed at the end of the year for transferring the nominal accounts to the Trading Account or the Profit and Loss Account. Earlier you learnt about the closing entries with regard to the items which are shown in the Trading Account. You will now learn the closing entries in respect of the items that appear in the Profit and Loss Account.

i) For Various Expenses and Losses
Profit and Loss Account Dr.
  To Expenses/Losses Accounts
   (to be created individually)

ii) For Various Incomes and Gains
Incomes/Gains Accounts Dr.
(to be debited individually)
  To Profit and Loss Account

iii) For Net Profit
Profit and Loss Account Dr.
  To Capital Account

iv) For Net Loss
Capital Account Dr.
  To Profit and Loss Account

Let us see how closing entries for the items given in Illustration 1 will be passed for preparing the Profit and Loss Account. These are as follows:

Journal

Date	Particulars	L.F.	Amount	Amount
Year X June 30	Trading A/c Dr. To Profit and Loss A/c (being Gross Profit transferred to Profit and Loss Account)		36,500	 36,500
" 30	Profit and Loss A/c Dr. To Salaries To Rent, Rates, and Taxes A/c To Postage and Telephone Charges A/c To Stationery A/c To Office Lighting A/c To Office Expenses A/c To Legal Charges A/c To Insurance A/c To Bank Charges A/c To Advertising A/c To Travelling Expenses A/c To Communication A/c To Repairs A/c (being transfer of the above nominal accounts to Profit and Loss Account)		56,600	 30,000 10,400 3,200 600 750 2,640 2,500 1,200 100 1,500 1,250 2,000 460
" 30	Interest Received A/c Dr. Miscellaneous Revenue Receipts A/c Dr. To Profit and Loss A/c (being transfer of the above nominal accounts to Profit and Loss Account)		300 400	 700
" 30	Capital A/c Dr. To Profit and Loss A/c (being net loss transferred to Capital Account)		19,400	 19,400

Illustration 2

From the following balances of L. Narayani, prepare the Trading and Profit and Loss Accounts for the year ended March 31, Year Y.

	Rs.
Stock on April 1, Year X	12,800
Salaries	36,000
Sundry Expenses	2,400
Depreciation on Plant and Machinery	10,000
Repairs to Plant and Machinery	5,000
Rent and Taxes	15,000
Purchases	1,12,000
Freight Inwards	7,500
Returns Outwards	4,000
Sales	2,50,000
Returns Inwards	5,000
Discount Allowed	1,500
Discount Received	2,000
Advertising	1,000
Carriage Outwards	1,800
Manufacturing Expenses	15,000

The stock on March 31, Year Y was valued at Rs. 15,400.

Solution

Trading and Profit and Loss Account of L. Narayani for the year ended March 31, Year Y

Dr. Particulars		Amount	Particulars	Cr. Amount
		Rs.		Rs.
To Opening Stock		12,800		
To Purchases	1,12,000		By Sales	2,50,000
Less Returns Outwards	4,000	1,08,000	Less Returns Inwards	5,000
				2,45,000
			By Closing Stock	15,400
To Freight Inwards		7,500		
To Manufacturing Expenses		15,000		
To Gross Profit c/d		1,17,100		
		2,60,400		2,60,400
To Salaries		36,000	By Gross Profit b/d	1,17,100
To Rent and Taxes		15,000	By Discount Received	2,000
To Sundry Expenses		2,400		
To Advertising		1,000		
To Carriage Outwards		1,800		
To Discount Allowed		1,500		
To Depreciation on Plant and Machinery		10,000		
To Repairs to Plant and Machinery		5,000		
To Net Profit (transferred to Capital Account)		46,400		
		1,19,100		1,19,100

Illustration 3

On December 31, Year A, the following balances appeared in the books of Rani:

	Rs.
Stock on January 1, Year A	
Raw Materials	6,500
Work-in-progress	14,500
Finished Goods	30,000
Manufacturing Wages	30,000
Purchases of Raw Materials	89,500
Factory Rent	15,000
Carriage of Raw Materials	8,500
Sundry Factory Expenses	6,000
Free Samples distributed	4,000
Office Rent	6,000
Salaries	12,000
Postage and Telegrams	1,000
Printing and Stationery	800
Advertising	1,500
Sundry Office Expenses	700
Depreciation on Plant and Machinery	5,000
Depreciation on Office Furniture	1,000
Sales of Finished Goods	2,10,000

Stock on December 31, Year A were as follows:

Raw Materials	Rs. 14,500
Work-in-progress	Rs. 11,500
Finished Goods	Rs. 35,000

Prepare Manufacturing Account, and Trading and Profit and Loss Accounts for the year ended December 31, Year A.

Solution

Manufacturing Account of Rani
for the year ended December 31, Year A

Dr. Particulars		Amount	Particulars	Cr. Amount
		Rs.		Rs.
To Opening Work-in-progress		14,500	By Closing Work-in-progress	11,500
To Materials Consumed:			By Cost of Goods Produced (transferred to Trading & Profit and Loss Account)	1,49,000
Opening Stock	6,500			
Add Purchases	89,500			
	96,000			
Less Closing Stock	14,500			
		81,500		
To Carriage on Raw Materials		8,500		
To Manufacturing Wages		30,000		
To Factory Rent		15,000		
To Depreciation on Plant and Machinery		5,000		
To Sundry Factory Expenses		6,000		
		1,60,500		1,60,500

Trading and Profit and Loss Account of Rani
for the year ended December 31, Year A

Dr. Particulars	Amount	Particulars	Cr. Amount
	Rs.		Rs.
To Opening Stock of Finished Goods	30,000	By Sales	2,10,000
To Cost of Goods Produced	1,49,000	By Closing Stock of Finished Goods	35,000
To Gross Profit c/d	66,000		
	2,45,000		2,45,000
To Salaries	12,000	By Gross Profit b/d	66,000
To Office Rent	6,000		
To Postage and Telegrams	1,000		
To Printing and Stationery	800		
To Sundry Office Expenses	700		
To Advertising	1,500		
To Free Samples	4,000		
To Depreciation on Office Furniture	1,000		
To Net Profit (transferred to Capital Account)	39,000		
	66,000		66,000

1. The Profit and Loss Account is prepared to find out the Net Profit or Net Loss for the accounting year.
2. The Gross Profit transferred from the Trading Account is shown on the credit side of the Profit and Loss Account. In case the Trading Account reveals Gross Loss, it will be on the debit side of the Profit and Loss Account.
3. All expenses and losses other than those already debited to the Trading Account, are transferred to the debit side of the Profit and Loss Account.
4. All incomes and gains (other than sales) are transferred to the credit side of the Profit and Loss Account.
5. If the credit side total of the Profit and Loss Account is more than the debit side total, the difference represents Net Profit. If the total of the debit side is higher, it means Net Loss.
6. The Profit and Loss Account is closed by transferring the Net Profit/Net Loss to the Capital Account of the proprietor.

Indirect Expenses: All expenses other than direct expenses. These include expenses incurred in connection with general administration, financial matters, and selling and distribution of goods.

Net Loss: Excess of indirect expenses and losses over the gross profit and other incomes.

Net Profit: Excess of gross profit and other incomes over the indirect expenses and losses of the business.

Profit and Loss Account: An account prepared to find out the net profit or net loss of the business.

Answers to Questions for Discussion

A. 3. (i) Profit and Loss Account (ii) Gross Profit
(iii) Outwards (iv) Trading Account/Manufacturing Account
(v) Profit and Loss Account (vi) Selling

4. (i) True (ii) False (iii) False (iv) True (v) True
(vi) False

Exercises

1. From the following balances of Neena you are required to prepare the Profit and Loss Account for the year ended March 31, Year B. Also pass the necessary closing entries:

	Rs.
Salaries	32,000
Carriage Outwards	3,400
Insurance	2,600
Office Rent	4,000
General Expenses	9,200
Advertisement	1,800
Depreciation	4,500
Unproductive Wages	800
Packing Charges	1,600
Entertainment Expenses	500
Commission Received	1,000
Interest Received	600

The Gross Profit for the year amounted to Rs. 39,200
(**Answer:** Net Loss Rs. 19,600)

2. From the following figures prepare Trading and Profit and Loss Account of M/s Lakshmi & Co. for the year ended December 31, Year Y.

	Rs.
Stock on January 1, Year Y	40,000
Purchases	98,000
Commission Received	650
Rent, Rates and Taxes	8,600
Salaries & Wages	12,000
Sales	1,62,100
Returns Inwards	2,400
Returns Outwards	3,000
Sundry Expenses	2,500
Bank Charges	50
Discount Received	750
Carriage on Purchases	2,000
Discount Allowed	530
Carriage on Sales	1,700
Lighting and Heating	2,200
Postage	300
Income from Investments	500
Commission Paid	1,000
Interest paid on a bank loan	550

The Stock on December 31, Year Y was valued at Rs, 26,000
(**Answer:** Gross Profit Rs. 48,700; Net Profit Rs. 21,170)

3. The following balances were extracted from the books of account M/s Ramprasad & Co. for the year ended September 30, Year Y. Prepare Manufacturing Account, and Trading and Profit and Loss Account.

	Rs.
Work-in-Progress:	
October 1, Year X	8,600
September 30, Year Y	10,400
Stock of Finished Goods:	
October 1, Year X	24,000
September 30, Year Y	39,000
Raw Materials Consumed	1,24,300
Freight and Carriage Inwards	10,500
Salaries	18,000
Wages	24,000
Sundry Manufacturing Expenses	12,400
Postage and Telephones	3,000
Sale of Scrap	4,700
Depreciation on:	
Plant and Machinery	6,000
Factory Building	5,000
Office Building	2,500
Office Furniture	1,500
Repairs of Plant and Machinery	4,200
Sales of Finished Goods	2,00,000
Power	3,600
Discount Allowed	1,500
Discount Received	1,800
Travelling Expenses	1,400
Loss by Fire	4,000
Sundry Office Expenses	5,200

(**Answer:** Cost of Goods Produced Rs. 1,83,500; Gross Profit Rs. 31,500; Net Loss Rs. 3,800).

BALANCE SHEET

Contents

You know that the final accounts consist of (1) an income statement called 'Trading and Profit and Loss Account', and (2) a position statement called 'Balance Sheet'. You learnt about the Trading and Profit and Loss Account which is prepared to find out the profit or loss for an accounting year. Now you will learn about the Balance Sheet, which is prepared for ascertaining the financial position of the business as at the end of an accounting year. You will also learn how various assets and liabilities are classified and shown in the Balance Sheet.

1. What is a Balance Sheet?

Having prepared the Trading and Profit and Loss Account, and ascertained the net profit or net loss, the businesswoman proceeds to prepare a statement called 'Balance Sheet'. The purpose is to ascertain the final position of a business i.e., what it owns and what it owes on a certain date, usually, at the end of the accounting year. Hence, it is also called a Position Statement. It shows all assets and liabilities of the business as at the end of an accounting year.

The Committee on Terminology of the American Institute of Certified Public Accountants defined Balance Sheet as **a list of balances in the asset and liability accounts. This list depicts the position of assets and liabilities of a specific business at a specific point of time.**

You have learnt earlier that the final accounts are prepared with the help of a Trial Balance. All items of expenses and incomes appearing in the Trial Balance are transferred to the Trading and Profit and Loss Account. The remaining items in Trial Balance represent the balances of personal and real accounts. Of these, the accounts showing debit balances represent assets and those which are showing credit balances represent liabilities. Hence all these balances are transferred to the Balance Sheet.

Another point is that the Balance Sheet is prepared only after preparing the Trading and Profit and Loss Account. You know the Profit and Loss Account is closed by transferring Net Profit/Net Loss to the Capital Account which is shown on the liabilities side of the Balance Sheet.

2. Form of a Balance Sheet

The Balance Sheet is vertically divided into two parts. In practice, capital and various liabilities (what the business owes) are shown on the left-hand side, and various assets (what the business owns) are shown on the right hand side. Thus, the Balance Sheet is a blown-up version of the accounting equation viz., Capital + Liabilities = Assets. The first part of the equation is presented on the left-hand side of the Balance Sheet called 'liabilities' side and the second part of the equation is presented on the right hand side of the Balance Sheet called 'assets' side. **As the total value of assets is always equal to the total claims of the proprietor (capital) and the outsiders (liabilities), the two sides of the Balance Sheet must tally.** Look at the following Table for the form of a Balance Sheet.

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

Liabilities	Amount	Assets	Amount
	Rs.		**Rs.**
Bank Overdraft	....	Cash in hand	....
Bills Payable	....	Cash at bank	....
Sundry Creditors	....	Bills Receivable	....
Loans	....	Sundry Debtors	....
Capital	....	Stock in trade	....
		Vehicles	....
		Furniture	....
		Plant & Machinery	....
		Land & Building	....
		Goodwill	....
Total	....	Total	....

You should remember that the Balance Sheet is prepared to know the financial position 'at a particular point of time' and not 'for a period'. Hence, the heading of the Balance Sheet always reads as 'Balance Sheet as on .... (a specific date)'. Thus, a Balance Sheet with the heading 'Balance Sheet as on December 31, Year X' indicates the financial position of the business on December 31, Year X. This is because the balances keep on changing. The balances on December 31 will be different from those on December 30, and so also from those on January 1 of the following year. Even a single transaction can effect a change in the values of assets and liabilities. Suppose, the total value of assets on December 31, Year X is Rs. 1,00,000. Capital on that date is Rs. 60,000 and various liabilities Rs. 40,000. Now the firm purchased goods worth Rs. 10,000 on credit on January 1, the following year. The effect of this credit purchase of goods would increase the value of stock (an asset) by Rs. 10,000 and so also the amount of creditors (a liability) by Rs. 10,000. Thus the position of assets and liabilities on January 1, Year Y is different from what it was on December 31, the previous year, Year X. Hence it is necessary to write the last date of the accounting year to which the balance actually relates.

3. Classification of Assets

Assets may be classified into various categories as follows:

i) **Current Assets:** Assets, which are held for purposes of resale, consumption or conversion into cash as early as possible, are called current assets. Examples of such assets are stocks of Raw Materials, Partly Finished Goods, Finished Goods, Bills Receivable, Sundry Debtors, Short-term Investments, etc. The current assets are also called ‘Floating Assets’ since they constantly change with business operations. Cash in hand and cash at bank are also included in current assets.

ii) **Liquid Assets:** These are assets which are already in the form of cash or which are convertible into cash quickly. Examples are Cash in hand, Cash at bank, Government Securities, etc. Liquid assets are also a part of current assets.

iii) **Fixed Assets:** Assets, which are acquired for use in the business over a long period, are called fixed assets. They are held more or less permanently for the purpose of earning revenue and are not meant for resale. Land, Building, Plant and Machinery, Furniture and Fixtures are some of the examples of fixed assets. The fixed assets of a concern are collectively called ‘Block’.

iv) **Tangible Assets:** Tangible assets are those assets, which can be seen and touched. Land, Building, Stock of Goods, Cash, etc. are some examples of tangible assets.

v) **Intangible Assets:** Intangible assets are those assets, which cannot be seen and touched e.g., Goodwill, Patents, Copyrights, Trade Marks, etc. These are in the form of rights represented by some documents. Note that these assets have value although without physical form.

vi) **Wasting Assets:** Natural resources such as oil wells, mines, quarry etc. which get exhausted after extraction of their contents is called wasting assets. A mine becomes valueless as soon as all the minerals have been extracted.

vii) **Fictitious Assets:** These are the assets not represented by any tangible or intangible property. They are shown as assets in the Balance Sheet simply because their accounts show debit balances. **They usually represent unwritten off expenses and losses.** For example, expenses incurred at the time of formation of a company (called preliminary or formation expenses) are not charged in full to Profit and Loss Account in the same year in which they are incurred. The unwritten off portion of such an expense will be shown as an asset in the Balance Sheet. Other examples of fictitious assets are: discount on issue of shares or debentures, expenditure on advertising campaign or any other deferred revenue expenditure.

4. Classification of Liabilities

The term ‘liabilities’ covers the amount due to creditors and the amount owing to the proprietor (capital). Hence, liabilities of a business may be broadly classified into two categories:

i) Liabilities to the proprietor; and

ii) Liabilities to outsiders

What do these terms mean?

i) **Liabilities to the proprietor** refer to the claims of the proprietor in the form of capital and reserves (undistributed profits). They are also called 'Proprietor's Equity'.

ii) **Liabilities to outsiders** are the amounts owing to various creditors such as creditors for goods supplied, loan on mortgage, bills payable, etc. They are also referred to as 'Outsiders' Equity'.

Liabilities to outsiders may be sub-divided into (a) short-term liabilities, and (b) long-term liabilities.

Short-term Liabilities: Liabilities which are payable in the near future, usually within one year from the date of the Balance Sheet, are called short-term liabilities. Bills payable, creditors for goods supplied, bank overdraft are some of the examples of short-term liabilities. They are also called 'current liabilities'.

Long-term Liabilities: These are the liabilities, which are not to be paid in the near future. They are to be paid after a long period of time such as loans taken on mortgage of assets, fixed deposits accepted by a concern, debentures issued by a company, etc. Thus, all liabilities other than short-term liabilities fall into this category. They are also called 'fixed liabilities'.

Questions for Discussion A

1. Fill in the blanks.

a) Balance sheet is a statement of .... and liabilities.

b) Assets represent .... balances of real and personal accounts.

c) Liabilities represent .... balances of all personal accounts.

d) Assets are shown on the .... side of the balance sheet.

e) Capital is shown on the liabilities side of the ....

f) Total of assets and liabilities are always ....

g) All liabilities which become due within one year are classified as .... liabilities.

h) All liquid assets are a part of .... assets.

2. Classify the following assets as current or fixed assets.

	Assets	Type of Assets
i)	Stock in Trade	....
ii)	Plant and Machinery	....
iii)	Short-term Investment	....
iv)	Furniture and Fixtures	....
v)	Loose Tools	....
vi)	Bills Receivable	....

vii) Cash at Bank	....
viii) Goodwill	....
ix) Vehicles	....
x) Sundry Debtors	....

3. Classify the following liabilities as current and long-term liabilities.

Assets	Type of Assets
i) Bills Payable	....
ii) Bank Overdraft	....
iii) Loan on Mortgage	....
iv) Sundry Creditors	....
v) Debenture	....
vi) Wages Payable	....

4. What are Wasting Assets?

   ....

5. What are Fictitious Assets?

   ....

5. Arrangement of Assets and Liabilites in the Balance Sheet

As already stated, assets appear on the right hand side of the Balance Sheet and liabilities on left hand side. The various assets and liabilities should be shown in the Balance Sheet in proper order. This is known as 'marshalling'.

The assets may be arranged in the following two ways:

i) In the order of liquidity; and

ii) In the order of permanence.

According to liquidity, cash and those assets that can be readily convertible into cash are shown first and those that cannot be so readily converted into cash are shown later. Thus, the most liquid asset is shown at the top of the list and the most permanent asset is shown at the bottom. According to performance, the above sequence is reversed. In other words, the asset, which is most permanent, is shown at the top and the asset, which is most liquid, is shown at the bottom.

Marshalling of Assets

Order of Liquidity	Order of Permanence
Cash in hand	Goodwill
Cash at bank	Land & Building
Bills Receivable	Plant & Machinery
Sundry Debtors	Furniture and Fittings
Stock of Goods	Vehicles
Vehicles	Stock of goods

Furniture & Fittings	Sundry Debtors
Plant & Machinery	Bills Receivable
Land & Buildings	Cash at bank
Goodwill	Cash in hand

Liabilities can also be arranged in the following two ways:

i) In the order of dischargeability; and

ii) In the order of permanence.

According to dischargeability, short-term liabilities are arranged first and long-term liabilities are shown later. In other words, the liability which is payable in the immediate future is shown at the beginning of the list and the liability which is the most permanent is shown at the bottom. If the order of permanence is followed, this arrangement is reversed.

Look at the following Table and note how various liabilities, when arranged according to the above two orders, would appear:

Marshalling of Liabilities

Order of Dischargeability	**Order of Permanence**
Bank Overdraft	Capital
Bills Payable	Reserves
Sundry Creditors	Loans
Fixed Deposits (accepted)	Fixed Deposits
Loans	Sundry Creditors
Reserves	Bills Payable
Capital	Bank Overdraft

Look at Illustration 1 and study how Balance Sheet of a sole trader is prepared and how various assets and liabilities have been shown.

Illustration 1

Rajni has earned a net profit of Rs. 34,200 for the year ended March 31, Year X. The following are the other balances in her ledger.

	Rs.
Stock on March 31, Year X	24,000
Cash in hand	4,500
Cash at bank	14,200
Bills Payable	8,500
Bills Receivable	10,600
Sundry Debtors	18,400
Sundry Creditors	19,700
Furniture	36,000
Plant and Machinery	54,000
Drawings	12,000
Loan on Mortgage	40,000
Capital	71,300

Prepare the Balance Sheet as on March 31,Year X.

Solution:

Balance Sheet of Rajni
as on March 31, Year X

Liabilities	Amount	Assets	Amount
	Rs.		**Rs.**
Credit Liabilities:		*Current Assets:*	
Bills Payable	8,500	Cash in hand	4,500
Sundry Creditors	19,700	Cash at bank	14,200
Long-term Liabilities:		Bills Receivable	10,600
Loan on Mortgage	40,000	Sundry Debtors	18,400
Capital :		Stock-in-trade	24,000
Balance on 1-4-Yr.	71,000	*Fixed Assets:*	
Add Net Profit		Furniture	36,000
for the year	34,200	Plant & Machinery	54,000
	1,73,700		
Less Drawings	12,000		
	1,61,700		1,61,700

6. Distinction Between Profit and Loss Account and Balance Sheet

The following are the main differences between the Profit and Loss Account (Income Statement) and the Balance Sheet (Position Statement).

i) The purpose of the Profit and Loss Account is to find out the net result of business activities, whereas the Balance Sheet is prepared to ascertain the financial position of the business.

ii) The Profit and Loss Account is prepared for a certain period, usually a year. The Balance Sheet, on the other hand, is prepared to know the financial position 'on a certain date' and not for a period.

iii) The Profit and Loss Account is prepared with balances of nominal accounts. But the Balance Sheet contains the balances of personal and real accounts.

iv) The Profit and Loss Account is prepared in the form of an account, whereas the Balance Sheet is prepared in the form of a statement.

Let us now take up some comprehensive illustration involving the preparation of the Trading and Profit and Loss Account and the Balance Sheet.

Illustration 2

From the following Trial Balance of Sarla prepare Trading and Profit and Loss Account for the year ended June 30, Year X and Balance Sheet as on that date.

Trial Balance as on June 30, Year X

Name of the Account	Dr. Balances	Cr. Balances
	Rs.	**Rs.**
Capital		80,000
Drawings	15,000	
Stock on July 1, Year X	16,000	
Purchase	94,500	
Sales		1,80,000
Carriage Inwards	4,600	
Returns Inwards	4,000	
Returns Outwards		3,000
Wages	14,000	
Plant and Machinery	60,000	
Furniture and Fittings	15,000	
Coal, Gas and Water	4,200	
Power	4,000	
Salaries	18,000	
Discount Allowed	1,500	
Discount Received		1,200
Office Rent	4,800	
Factory Rent	6,000	
Postage and Telephone	1,800	
Insurance	500	
Sundry Expenses	1,600	
Trade Debtors	40,000	
Trade Creditors		54,300
Cash in hand	1,400	
Cash in bank	8,200	
Carriage Outwards	3,400	
Total	**3,18,500**	**3,18,500**

The stock on June 30, Year X was valued at Rs. 18,500.

Solution :

Trading and Profit and Loss Account of Sarla for the year ended June 30, Year X

Dr. Particulars		Amount	Particulars		Cr. Amount
		Rs.			**Rs.**
To Opening Stock		16,000	By Sales	1,80,000	
To Purchases	94,500		Less Returns Inwards	4,000	
Less Returns Outwards	3,000				1,76,000
		91,500	By Closing Stock		18,500
To Carriage Inwards		4,600			
To Wages		14,000			
To Power		4,000			
To Coal, Gas & Water		4,200			
To Factory Rent		6,000			
To Gross Profit c/d		54,200			
		1,94,500			1,94,500
To Salaries		18,000	By Gross Profit b/d		54,200
To Office Rent		4,800	By Discount Received		1,200
To Postage & Telephone		1,800			
To Insurance		500			
To Sundry Expenses		1,600			
To Carriage Outwards		3,400			
To Discount Allowed		1,500			
To Net Profit (Transferred to Capital Account)		23,800			
		55,400			55,400

**Balance Sheet of Sarla
as on June 30, Year X**

Liabilities	Amount	Assets	Amount
	Rs.		Rs.
Current Liabilities:		*Current Assets:*	
Trade Creditors	54,300	Cash in hand	1,400
Long-term-Liabilities:		Cash at bank	8,200
Capital		Trade Debtors	40,000
Balance on 1-7-Yr	80,000	Stock	18,500
Add Net Profit		*Fixed Assets:*	
for the year	23,800	Furniture & Fittings	15,000
		Plant & Machinery	60,000
	1,58,100		
Less Drawings	15,000		
	1,43,100		1,43,100

Illustration 3

From the following Trail Balance of Bipasha Banerjee prepare the Manufacturing Account, and Trading and Profit and Loss Account for the year ended December 31, Year Y and Balance Sheet as on that date.

Trial Balance as on December 31, Year Y

Name of the Account	Dr. Balances	Cr. Balances
	Rs.	Rs.
Stock on January 1, Year Y		
Raw Materials	3,600	
Work-in-Progress	2,400	
Finished Goods	20,000	
Land and Buildings	76,000	
Plant and Machinery	28,500	
Office Furniture	9,000	
Purchases of Raw Materials	32,000	
Sales		1,26,500
Direct Wages	24,000	
Indirect Wages	2,000	
Freight Inwards	2,500	
Factory Expenses	4,600	
General Expenses	6,200	
Salaries	12,000	
Repairs to Plant and Machinery	600	
Lighting	3,000	
Repairs to Office Furniture	250	
Depreciation on		
Land and Buildings	4,000	
Plant and Machinery	1,500	
Office Furniture	1,000	
Sundry Debtors	30,000	
Sundry Creditors		35,000
Cash at bank	16,500	
Sale of Scrap		2,500
Commission		450
Advertising	3,000	
Reserve		40,000
Capital		88,200
Drawings	10,000	
Total	**2,92,650**	**2,92,650**

1. Stock on December 31, Year Y were as follows :

	Rs.
Raw Materials	6,000
Work-in-Progress	3,500
Finished Goods	32,000

2. Depreciation on land and buildings and lighting are to be charged 2/3 to factory and 1/3 to office.

Solution:

Manufacturing Account of Bipasha Banerjee
for the year ended December 31, Year Y

Dr. Particulars		Amount	Particulars	Cr. Amount
		Rs.		Rs.
To Opening Work-in-Progress		2,400	By Sales of Scrap	2,500
To Raw Materials Consumed:			By Closing Work-in-progress	3,500
Opening Stock	3,600		By Cost of Goods Manufactured	
Add. Purchases	32,000		(Transferred to Trading Account)	63,867
	35,600			
Less: Closing Stock	6,000			
		29,600		
To Freight Inwards		2,500		
To Direct Wages		24,000		
To Lighting (2/3)		2,000		
To Factory Expenses		4,600		
To Repairs to Plant & Machinery		600		
To Depreciation on:				
Land & Building (2/3)		2,667		
Plant & Machinery		1,500		
		69,867		69,867

Trading and Profit and Loss Account of Bipasha Banerjee
for the year ended December 31, Year Y

Dr. Particulars	Amount	Particulars	Cr. Amount
	Rs.		Rs.
To Opening Stock of Finishing Goods	20,000	By Sales	1,26,500
To Cost of goods Manufactured	63,867	By Closing Stock of Finished Goods	32,000
To Gross Profit c/d	74,633		
	1,58,500		1,58,500
To Salaries	12,000	By Gross Profit b/d	74,633
To Lighting (1/3)	1,000	By Commission Received	450
To Indirect Wages	2,000		
To General Expenses	6,200		
To Advertising	3,000		

To Repairs to Office Furniture		250			
To Depreciation on:					
Land & Building (1/3)	1333				
Office Furniture	1000				
		2333			
To Net Profit (Transferred to Capital Account)		48,300			
		75,083			75,083

Balance Sheet of Bipasha Banerjee
as on December 31, Year Y

Dr. Particulars	Amount	Particulars		Cr. Amount
	Rs.			Rs.
Current Liabilities:		*Current Assets:*		
Sundry Creditors	35,000	Cash at bank		16,500
Long-term Liabilities:		Sundry Debtors		30,000
Reserve	40,000	Stock-in-trade		
Capital:		Raw Materials	6,000	
Balance on 1-1-Yr	88,200	Work-in-progress		3,500
Add: Net Profit for the year	48,300	Finished Goods	32,000	41,500
		Fixed Assets:		
		Office Furniture		9,000
	2,11,500	Plant & Machinery		28,500
Less: Drawings	10,000	Land & Buildings		76,000
	2,01,500			2,01,500

7. Vertical Presentation of Final Accounts

Trading and Profit and Loss Account and the Balance Sheet have so far been presented as a two-sided statement. But, in practice, you do not necessarily have to present the final accounts in this form. Now-a-days many firms present them in a simpler and more intelligible form which is called a narrative style or vertical presentation. According to this style, the Trading and Profit and Loss Account is also presented in the form of a statement. It shows first the various sources of incomes and then all the expenses. Similarly, the Balance Sheet first shows various assets owned by the business and then shows the liabilities. This form of presentation is adopted by many companies for publication of their final accounts. This helps the users of such financial information to appreciate the significance of different items without any difficulty. They can easily interpret the data and judge the profitability and the financial position of the company.

Look at the following Table and study how various items are shown in the Trading and Profit and Loss Account and the Balance Sheet in vertical form.

Trading and Profit and Loss Account of
for the year ended December 31, Year A

	Rs.	Rs.
SALES		
Less Cost of Goods Sold :		....
Opening Stock	....	
Add Purchases	....	
Add Direct Expenses	....	
	....	
Less Closing Stock	....	....
GROSS PROFIT		....
Add Other Income		....
		....
Less Indirect Expenses:		
Salaries	....	
Rent	....	
Sundry Expenses	....	
Insurance	....	....
NET PROFIT		....

Balance Sheet of ....
as on December 31, Year A

		Rs.	Rs.
Fixed Assets:			
Land and Buildings		....	
Plant and Machinery		....	
Furniture and Fixtures		....	
Vehicles		....	
			....
Current Assets:			
Stock-in-hand		....	
Debtors		....	
Cash at bank		....	
Cash in hand		....	
		....	
Less Current Liabilities:			
Creditors	....		
Bills Payable	....		
		....	
			....
			....
Financed by:			
Capital:			
Balance as on 1.1. Year A		....	
Add Net Profit for the year		....	
		....	
Less Drawings		....	
			....
Loans			....
			....

Look at Illustration 4 and study how Trading and Profit and Loss Account and the Balance Sheet have been prepared for vertical presentation.

Illustration 4

From the following Trial Balance of Chandra Ramachandran, prepare in vertical form the Trading and Profit and Loss Account for the year ended December 31, Year X and Balance Sheet as on that date.

Trial Balance of Chandra Ramachandran
For the year ended December 31, Year X

Name of the Account	Dr. Balances	Cr. Balances
	Rs.	Rs.
Capital		23,560
Stock on January 1, Year X	8,123	
Sales		46,155
Purchase	28,450	
Carriage	263	
Advertising	277	
Rates and Insurance	1,675	
Motor Expenses	1,300	
Salaries	5,375	
Premises	13,750	
Vehicles	3,000	
Debtors	4,875	
Creditors		3,845
Cash at bank	4,134	
Cash in hand	100	
Drawings	2,238	
Total	73,560	73,560

Stock on December 31, Year X was Rs. 6,370

Trading and Profit and Loss Account of Chandra Ramachandran
for the year ended December 31, Year X

	Rs.	Rs.
Sales		46,155
Less Cost of Goods Sold:		
Opening Stock	8,123	
Add Purchases	28,450	
Add Direct Expenses	263	
	36,836	
Less closing stock	6,370	
		30,466
GROSS PROFIT		15,689
Add Other Income		………
		15,689
Less Indirect Expenses:		
Salaries	5,375	
Rates and Insurance	1,675	
Motor Expenses	1,300	
Advertising	277	8,627
NET PROFIT		7,062

Balance Sheet of Chandra Ramachandran
as on December 31, Year X

	Rs.	Rs.
Fixed Assets:		
Premises	13,750	
Vehicles	3,000	
		16,750
Current Assets:		
Stock-in-hand	6,370	
Debtors	4,875	
Cash at bank	4,134	
Cash in hand	100	
	15,479	
Less Current Liabilities:		
Creditors	3,845	
Working Capital		11,634
		28,384
Financed by:		
Capital:		
Balance as on 1.1.Year——	23,560	
Add Net Profit for the year	7,062	
	30,622	
Less Drawings	2,238	
		28,384
		28,384

1. The Balance Sheet is prepared to know the financial position of the business on a certain date.
2. The Balance Sheet is vertically divided into two parts. Various assets are shown on the right-hand side. Capital and various liabilities are shown on the left-hand side.
3. The two sides of the Balance Sheet must always tally.
4. Assets are classified into: (i) Fixed Assets, (ii) Current Assets, (iii) Liquid Assets, (iv) Tangible Assets, (v) Intangible Assets, (vi) Wasting Assets, and (vii) Fictitious Assets.
5. Liabilities are classified into: (i) Liabilities to the Proprietor, and (ii) Liabilities to Outsiders. Liabilities to outsiders are sub-divided into (a) Short-term liabilities, and (b) Long-term liabilities.
6. The assets may be arranged in the Balance Sheet either in the order of liquidity or in the order of permanence.
7. The liabilities can also be arranged either in the order of dischargeability or in the order of permanence.
8. The final accounts can also be presented in a narrative style.

Balance Sheet: A statement showing assets and liabilities of the business as at the end of an accounting year.

Block: Total fixed assets.

Current Assets: Assets held for purposes of resale, consumption or conversion into cash.

Current Liabilities: Liabilities which are payable in the near future.

Fictitious Assets: Expenses and losses not yet written off and shown as assets in the Balance Sheet.

Fixed Assets: Assets acquired for use in the business for a long period.

Intangible Assets: Assets in the form of rights which cannot be seen and touched.

Liquid Assets: Assets in the form of cash or those which can be readily converted into cash.

Long-term Liabilities: Liabilities payable after a long period of time.

Marshalling of Balance Sheet: Arrangement of assets and liabilities in the Balance Sheet in a proper order.

Tangible Assets: Assets which have physical form and can be seen and touched.

Wasting Assets: Assets which get exhausted as a result of extraction of their contents.

Answers to Questions for Discussion

A.	1.	(a)	Assets	(b)	Debit	(c)	Credit	(d)	Righthand
		(e)	Balance Sheet	(f)	Equal	(g)	Current	(h)	Current
	2.	(i)	Current	(ii)	Fixed	(iii)	Current	(iv)	Fixed
		(v)	Fixed	(vi)	Current	(vii)	Current	(viii)	Fixed
		(ix)	Fixed	(x)	Current				
	3.	(i)	Current	(ii)	Current	(iii)	Long-term	(iv)	Current
		(v)	Long-term	(vi)	Current				

Exercises

1. For the year ending September 30, Year X Shyama has earned a net profit of Rs. 27,600. Other balances in her ledger are given below:

	Rs.
Cash in hand	2,400
Bank Overdraft	5,600
Stock-in-trade	18,700
Sundry Creditors	24,400
Buildings	19,500
Machinery	60,000
Investments	40,000
Reserves	10,000
Drawings	20,000
Capital	6,000
Furniture	5,000
Life Insurance Premium	1,200

(Hint : Life Insurance Premium should be treated as Drawings)
(Answer : Total of Balance Sheet Rs. 1,55,600)

2. From the following Trial Balance of Shankarlal, prepare Trading and Profit and Loss Account for the year ended March 31, Year B and Balance Sheet as on that date.

Trial Balance as on March 31, Year B

Name of the Account	Dr. Balances	Cr. Balances
	Rs.	Rs.
Capital		48,800
Cash in hand	700	
Bank Loan		20,000
Purchases and Sales	80,000	1,90,000
Returns	3,000	1,500
Carriage	3,400	
Stock on April 1, Year C	13,000	
Bills Receivable	8,000	
Bills Payable		6,000
Rent and Taxes	7,200	
Salaries	24,000	
Wages	12,000	
Office Expenses	1,200	
Trade Expenses	800	
Discount	700	600
Sundry Debtors	29,600	
Sundry Creditors		13,000
Machinery	72,000	
Furniture	18,000	
Drawings	4,800	
Advertising	600	
Bank Charges	100	
Insurance	800	
Total	2,79,900	2,79,900

Closing stock was valued at Rs. 20,000.
(Answer: Gross Profit Rs. 1,00,100; Net Proft Rs. 66,100; Total of Balance Sheet Rs. 1,49,100)

3. From the following Trial Balance of Harsha, prepare Manufacturing Account and Profit and Loss Account for the year ended September 30, Year Y and Balance Sheet as on that date.

Trial Balance as on March 31, Year Y

Name of the Account	Dr. Balances	Cr. Balances
	Rs.	Rs.
Purchases of Raw Materials	80,000	
Stock on October 1, Year X		
Raw Materials	5,400	
Work-in-progress	12,000	
Finished Stock	20,000	
Freight Inwards	6,000	
Wages	30,000	
Power and Fuel	8,000	
Sundry Manufacturing Expenses	5,600	
Plant and Machinery	85,000	
Furniture and Fittings	22,000	
Capital		47,700
Drawings	18,000	
Sales		2,95,000
Carriage on Sales	2,000	
Sundry Debtors	34,000	
Sundry Creditors		32,000
Sale of Scrap		5,900
Salaries	24,000	
Repairs to Plant and Machinery	2,000	
Legal Expenses	1,000	
Travelling Expenses	1,200	
Carriage on Purchases	1,400	
Factory Rent	8,000	
Office Rent	4,000	
Cash in hand	2,600	
Cash at bank	8,400	
Total	3,80,600	3,80,600

Stock on September 30, Year Y were as follows:

Raw Materials	3,600
Work-in-progress	15,000
Finished Goods	24,000

(Answer: Cost of Goods Manufactured Rs. 1,33,900; Gross Profit Rs. 1,65,100; Net Profit Rs. 1,32,900; Total of Balance Sheet Rs. 1,94,600.)

LEDGER

Contents

You learnt that all business transactions are recorded in the books of account in two stages: (1) Journalizing, and (2) Posting into Ledger. You have learnt the first stage of journalizing various transactions. Now you will learn about the second stage i.e. recording in the ledger. This involves posting journal entries into various accounts in the ledger, balancing the accounts periodically, and preparing a Trial Balance to check the arithmetical accuracy of all accounting entries.

1. What is a Ledger?

A ledger is a book that contains all accounts affected by various transactions in a business. As you have learnt earlier, an account is a classified and summarized record of all transactions relating to a particular person or an item. Hence, a ledger can be termed as a classified and summarized record of business transactions relating to all personal, real and nominal accounts.

All transactions, which are first recorded in the journal, must invariably be posted into the concerned accounts in the ledger. This is necessary because a Journal is just a chronological record of transactions, identifying the accounts to be debited and credited. It does not help us to know the net effect of various transactions affecting a particular account. This can only be achieved by recording the effect of all transactions on each account at one place. Let us illustrate this. Suppose we take the example of Mohan Brothers who have been selling goods on credit to Sumita. Suresh is allowed to make part payments and make further purchases even before the old balance is cleared. No doubt, all transactions relating to the goods sold to him and the amounts received from him would be duly recorded in the journal (or its sub-divisions). But the journal, by, itself, will not be in a position to readily provide information as to whether Sumita, at a given point of time, owes them any money and if so, how much. This is because the entries for transactions with her have been made at different places in the journal and you will have to go through all entries to obtain the required information. If however, all sales made to Sumita and the amounts received from her are shown at one place, say, in Sumita's Account in the ledger, the required information would be readily available. This is true of all accounts, be they personal accounts, real accounts or nominal accounts.

A Ledger, therefore, is a book where all accounts are maintained and into which all journal entries are posted. As all transactions must ultimately be recorded in the respective accounts, the ledger is called the 'Book of Final Entry'. It is also called the 'Principal Book of Accounts'. In fact transactions can even be directly recorded into various ledger accounts. But, normally, this is not done because in that case we will not have any date wise record of all transactions and the details thereof. Such a record is necessary for future reference.

To sum up (i) the ledger contains all the personal, real and nominal accounts, (ii) the ledger is a permanent, ultimate and up-to-date record of all transactions, and (iii) the ledger provides a means of easy and ready reference.

The ledger is a bound volume with the pages numbered consecutively. Alphabetical index is also shown at the beginning so that the page in which an account appears can be easily ascertained. In certain modern businesses, loose-leaf ledgers are maintained, instead of one bound volume. Banks maintain loose-leaf ledgers for customer's deposit accounts.

2. Form of a Ledger Account

As stated earlier, an account is the summarized record of all the transactions relating to a particular person or an item. The form of an account is given below:

Name of the Account

Dr. **Date**	**Particulars**	**Folio**	**Amount**	**Date**	**Particulars**	**Folio**	**Cr.** **Amount**
			Rs.				**Rs.**

You are already familiar with the 'T' form of an account. A page is folded vertically in the middle to make it into two halves. Actually, folding is not necessary— usually pre-printed books are available. Sometimes, two pages are taken together as a unit. In that case the entire page on the left hand side is combined as the debit side and the other page on the right hand side is treated as the credit side.

The columns in a ledger account are very much similar to those in the journal. In the journal you have two amount columns because the dual aspect of each transaction has to be analyzed and presented side by side. In the ledger account the first three columns of the journal, viz., date, particulars and folio, appear on both the debit and the credit side and so also the amount column. However, the column meant for entering the page number in the ledger is merely called 'folio', whereas in the journal it is called 'ledger folio'. It is important to note this similarity at the outset, as it would make ledger posting an easy task.

Let us look at the form of a ledger account once again. In the middle of the top of the account the 'Name of the Account' is given. It will be written as 'Shyama's Account', or 'Furniture Account' or 'Rent Account', as the case may be. You also find that Dr. and Cr. appear at the two extreme ends of the top line of the account. The left hand side is designated as debit side and is indicated by writing 'Dr.' on the left hand top corner. Similarly, 'Cr.' is written on the right hand top corner to indicate the credit side. When an account is to be debited, the entry is made on the debit side and when it is to be credited, the entry is made on the credit side.

3. Posting into a Ledger

The journal entries form the basis for recording in the ledger accounts, and the process of entering a transaction in the ledger is called 'Posting'. When a journal entry has to be posted in the concerned ledger accounts, the following procedure is adopted.

1. Each journal entry will have to posted into all those accounts which have been debited and credited in the journal entry. For example, for cash sales, Cash Account is debited and Sales Account is credited in the journal. When this entry is posted in the ledger, it must be posted in Cash Account as well as in Sales Account.
2. Posting will be made on the debit side of the account that has been debited in the journal, and the credit side of the account that has been credited in the journal. In case of the example given earlier of the cash sales, posting will be made on the debit side of the Cash Account, as it has been debited in the journal and the credit side of Sales Account, as it had been in the journal.
3. Whether the posting is made on the debit side or the credit side, first of all the date of the transaction (as given in the journal) will be entered in the date column. The method of recording the date in the ledger account is the same as in the journal.
4. While posting on the debit side of an account, in the particulars column we shall write the name of the account which had been credited in the journal and add the word 'To' before the name. Similarly while posting on the credit side of an account, we shall write the name of the account which has been debited in the journal and add the word 'By' before the name. In case of the above example, we shall write 'To Sales A/c' in particulars column on the debit side of Cash Account; and 'By Cash A/c' in particulars column on the credit side of the Sales Account.
5. The journal entries contain 'narration'. But it is not required in the ledger accounts. Similarly, there is no need to draw a line between the two entries in an account as is done in the journal. Note that posting in the

ledger account is considered complete only when both the debit and the credit aspects of all journal entries have been posted.

6. In the folio column, we shall mention the page number of the journal where the concerned journal entry appears. At the same time, the page number of the ledger accounts will be entered in the 'L.F.' column in the journal so as to complete the cross reference.
7. The amount involved in the journal entry shall be entered in amount columns of both the accounts.

Now let us take a transaction, journalize it, and then show how the posting is done in the ledger.

Illustration 1

Purchased machinery for cash, Rs. 50,000 on April 4, Year X. This transaction will appear in the journal and the ledger as under:

Journal

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
Year X April 4	Machinery A/c Dr. To Cash A/c (Being machinery purchased)		Rs. 50,000	Rs. 50,000

Ledger

Machinery Account

Dr. Cr.

Date	Particulars	F	Amount	Date	Particulars	F	Amount
			Rs.				Rs.
Year X April 4	To Cash A/c		50,000				

Cash Account

Dr. Cr.

Date	Particulars	F	Amount	Date	Particulars	F	Amount
			Rs.				Rs.
				Year X April 4	By Machinery A/c		50,000

Now we take a few more transactions and illustrate further the ledger posting aspect of the transactions from the journal entries.

Illustration 2

Journalize the following transactions and post them into the ledger.

Year X

		Rs.
April 2	Cash Sales	15,000
April 2	Paid Salaries	6,000
April 6	Sold goods to Pankaj	10,000
April 10	Cash Purchases	5,000
April 13	Paid for stationery	100
April 18	Goods taken by proprietor for personal use	1,000
April 23	Bought goods from Manoj	13,000
April 25	Received from Pankaj on account	4,000
April 27	Sold goods for cash	4,000
April 30	Received interest on investments	1,400

Solution:

Journal

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
Year X April 2	Cash account Dr. To Sales Account (Being cash sales)		Rs.15,000	Rs.15,000
" 2	Salaries Account Dr. To Cash Account (Being salaries paid)		6,000	6,000
" 6	Pankaj's Account Dr. To Sales A/c (Being goods sold to Pankaj on credit)		10,000	10,000
" 10	Purchases Account Dr. To Cash Account (Being Cash purchase)		5,000	5,000
" 13	Stationery Account Dr. To Cash account (Being stationery purchased)		100	100
" 18	Drawings Account Dr. To Purchase Account (Being goods taken for personal use)		1,000	1,000
" 23	Purchases Account Dr. To Manoj's Account (Being the amount received)		13,000	13,000
" 25	Cash Account Dr. To Pankaj's Account (Being the amount received)		4,000	4,000
" 27	Cash Account Dr. To Sales Account (Being cash sales)		4,000	4,000
" 30	Cash Account Dr. To Interest Account (Being interest received on investments)		1,400	1,400

LEDGER

Cash Account

Dr. Cr.

Date	Particulars	F	Amount	Date	Particulars	F	Amount
			Rs.				Rs.
Year X April 2 ” 25 ” 27 ” 30	 To Sales A/c To Pankaj’s A/c To Sales A/c To Interest A/c		 15,000 4,000 4,000 1,400	Year X April 2 “ 10 “ 13	 By Salaries A/c By Purchases A/c By Stationery A/c		 6,000 5,000 100

Sales Account

				Year X April 2 " 6 “ 27	 By Cash A/c By Pankaj’s A/c By Cash A/c		 15,000 10,000 4,000

Salaries Account

Year X April 6	 To Cash A/c		 Rs. 6,000				

Pankaj’s Account

Year X April 6	 To Sales A/c		 10,000	Year X Apr. 25	 By Cash A/c		 Rs. 4,000

Purchases Account

Year X Apr. 10 ” 3	 To Cash A/c To Manoj‘s A/c		 Rs. 5,000 13,000	Year X Apr. 18	 By Drawings A/c		 Rs. 1,000

Stationery Account

Year X Apr. 13	 To Cash A/c		 Rs. 100				

Drawings Account

Year X Apr. 18	 To Purchases A/c		 Rs. 1,000				

Manoj’s Account

				Year X Apr. 13	 By Purchases A/c		 13,000

Interest Account

				Year X Apr. 30	To Cash A/c		1,4000

4. Posting a Compound Journal Entry

Normally we post a journal entry into two accounts, on the debit side of one account and the credit side of the other account. This is because most journal entries have only two accounts. But it is not so in case of a compound journal the debit side of two or more accounts and the credit side of the one account, or on the debit side of one account and credit side of two or more accounts. This will depend upon the number of accounts that have been debited and credited in the journal entry. Take, for example, a journal entry for the following transactions:

On May 31, Year Y Mohini, a customer, paid cash Rs. 950 in settlement of her account of Rs. 1,000.

The journal entry for this transaction will be:

Year Y May 31	Cash A/c Dr. Discount Allowed A/c Dr. To Mohan (Being amount received in full settlement)		Rs. 950 50	Rs. 1,000

In this journal entry two accounts have been debited and one account has been credited. It will be posted on the debit side of both Cash Account and Discount Allowed Account, and the credit side of Mohan's Account. In the Particulars column of the debit side of Cash Account and Discount Allowed Account we shall write 'To Mohan'. On the credit side of Mohan's Account, in Particulars column we shall write 'By Cash A/c', and then in the next line 'By Discount Allowed A/c' and show the respective amounts column. See the posting of this compound journal entry as follows:

Cash Account

Dr. **Cr.**

Date	Particulars	F	Amount	Date	Particulars	F	Amount
			Rs.				**Rs.**
Year Y May 31	To Mohan		Rs. 950				

Discount Allowed Account

Dr. **Cr.**

Date	Particulars	F	Amount	Date	Particulars	F	Amount
			Rs.				**Rs.**
Year Y May 31	To Mohan		Rs. 50				

Mohan's Account

Dr. **Cr.**

Date	Particulars	F	Amount	Date	Particulars	F	Amount
			Rs.	Year Y			Rs.
				May 31 May 31	By Cash A/c By Discount Allowed A/c		950 50

Alternatively, in Mohan's Account we can simply write 'By Sundries' in Particulars column and show full amount in the Amount column.

The above example should help you to also correctly post a compound journal entry where one account has been debited and two or more accounts have been credited, or where many accounts have been debited and many accounts have been credited.

Questions for Discussion A

1. What is a Ledger?

   ....

   ....

   ....

   ....

2. What is posting?

   ....

   ....

   ....

   ....

3. State whether each of the following statements is True or False.
   a) Posting is done in the journal.
   b) Posting will be made on the debit side of an account that had been debited in the journal.
   c) The word 'To' is used with the name of an account while making posting on the credit side of an account.
   d) No narration is written while posting into ledger accounts.
   e) Every journal entry will be posted only into those accounts that have been debited in the journal.
   f) Compound journal entry is posted to more than two accounts.

4. Balancing Ledger Accounts

In the above illustration you have seen that many transactions are likely to involve a particular account, and there are a number of entries on both sides of an account. At the end of a day, a week or a month, it would be necessary to know the net effect of various transactions entered in an account. For example, it would be important and useful to know as to what is still due from a customer. We can get this information by working out the difference between the total of debit entries and the total of credit entries in a customer's account. This process is termed as 'balancing of an account'. For example, look at Pankaj's Account in Illustration 2. You find that there are two transactions, one on each side. Pankaj has been debited with Rs. 10,000 for credit sales to him, and credited by Rs. 4,000. The amount credited is Rs. 6,000. This amount of Rs. 6,000 is the 'balance' in his credit side total, as in this case, it is called a debit balance. It is shown, in particulars column, on the credit side by writing 'By Balance c/d' and totals on balance is shown on the debit side, on the next date, by writing 'To balance b/d' in particulars column. The term c/d is an abbreviation for carried down and b/d is for brought down. Such balancing of accounts is done periodically, say, daily (as in the case of cash account), weekly, monthly or at any other convenient time, as and when needed.

Let us see the balancing of Pankaj's Account.

Pankaj's Account

Dr. **Cr.**

Date	Particulars	F	Amount	Date	Particulars	F	Amount
			Rs.				Rs.
Year X				Year X			
Apr. 6	To Sales A/c		10,000	Apr. 25	By Cash A/c		4,000
				Apr. 30	By Balance c/d		6,000
			10,000				10,000
May 1	To Balance b/d		6,000				

In another situation, the total of the credit side may be more than the total of the debit side. In that case it will be called credit balance. It will be shown on the debit side by writing 'To Balance c/d' in particulars column and the totals of the two sides made equal. After totalling the two sides on the next date, write 'By Balance b/d' in the particulars column.

Let us now explain the procedure of balancing an account stepwise.

1. Total both the amount columns (debit and credit) and ascertain the difference in the two totals (use a separate rough sheet for this purpose). If there is no difference between the totals of the two sides, it means there is nil balance on this account. This means, the account is closed. However, if there is some difference in the two totals, such a difference is called the 'balance'. If the debit side total is more than the credit side total (as in Pankaj's Account), the difference is called debit balance. If, on the other hand, the total of the items on the credit side is greater than the total of the debit side, the difference is called credit balance.
2. Put the difference between the two sides on the side showing a smaller total.
3. Enter the date on which balancing is being done, in the date column. Note that balancing is not a transaction, as this does not involve any transfer between two accounts.
4. If the balance is entered on the debit side, then write in particulars column 'To Balance c/d'. In case, the balance is entered on the credit side, write

in particulars column 'By Balance c/d' (c/d stands for carried down).

5. Now total both the amount columns. There might be more entries on one side, as compared to the other. Even then, the totals must be written on the same horizontal line. Draw one line across both the amount columns, on the same horizontal line. Put the totals on both the sides, which will now be identical and then draw a line immediately beneath the totals (see Pankaj's Account on the previous page)
6. The closing balance (which was carried down) has now to be brought down on the side that was showing the bigger total. In other words, at the beginning of the next period, the debit balance is shown on the debit side and credit balance on the credit side of the account. It is called opening balance. The balance brought down is usually given the date following the balance date. After entering the date in the date column, if the balance brought down is on the debit side, write 'To Balance b/d' in particulars column. Similarly, if the balance brought down is on the credit side, write 'By Balance b/d' (b/d stands for brought down), particulars column. Suppose an account was balanced on June 30, and the closing balance was entered on the credit side as 'By Balance c/d'. On July 1, this balance would be entered on the debit side as 'To Balance b/d' below the total.

You have now understood the method of balancing an account. Usually a page is allotted to an account and all transactions affecting that account are posted there. Sometimes, when transactions are numerous, more number of pages can be set apart for such an account. When the balance is proposed to be brought down on the same page, then the abbreviations, c/d and b/d are used.

However, when there is not much space on the same page, and the balance has to be carried forward either to the next page, or some other page, and the balance has to be carried forward either to the next page, or some other page, the abbreviations 'c/f' (carried forward) and 'b/f' (brought forward) are used in place of 'c/d' and 'b/d'. The page numbers are entered in the Folio columns to show as to where the balance has been carried forward and from where it has been brought forward.

Sometimes, there may be no difference between the totals of the two sides. In such cases, there will be no closing balance and no opening balance. However, to signify that the balancing has been done, totals are entered on both the sides and the account is closed.

Now let us take up comprehensive illustration and reinforce what you have learnt so far regarding journalizing, posting into the ledger and balancing the accounts.

Illustration 3

Journalize the following transactions, post them into a ledger and balance the accounts:

Year X		**Rs.**
March 1	Asha commenced business with cash	1,20,000
” 2	Purchased furniture for cash	24,000

" 2	Purchasd goods from Vijaya	36,000
" 3	Sold goods	4,800
" 4	Paid rent	3,000
" 6	Sold goods to Aruna	9,000
" 7	Aruna returned goods	450
" 10	Bought goods from Dinesh	24,000
" 11	Returned goods to Dinesh	600
" 14	Paid for advertising	1,500
" 15	Paid for stationery	300
" 17	Drew for personal use	2,400
" 20	Cash Sales	9,600
" 21	Received from Aruna	2,550
" 23	Paid to Vijaya	12,000
" 24	Sold goods to Sanjay	15,000
" 28	Cash sales	6,000
" 31	Paid salaries	6,000
" 31	Paid municipal taxes	1,200
" 31	Paid printing charges	1,500

Solution:

Journal

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
Year X May 1	Cash account Dr. To Capital Account (Being Capital brought in)		Rs. 1,20,000	Rs. 1,20,000
" 2	Furniture Account Dr. To Cash Account (Being furniture purchased)		24,000	24,000
" 2	Purchase Account Dr. To Vijaya's Account (Being credit purchases)		36,000	36,000
" 3	Cash account Dr. To Sales Account (Being Cash Sales)		4,800	4,800
" 4	Rent Account Dr. To Cash Account (Being rent paid)		3,000	3,000
" 6	Aruna's Account Dr. To Sales Account (Being credit sales)		9,000	9,000
" 7	Returns Inwards Account Dr. To Aruna's Account (Being goods returned by Aruna)		450	450
" 10	Purchases Account Dr. To Dinesh's Account (Being credit purchases)		24,000	24,000
" 11	Dinesh's Account Dr. To Returns Outwards Account (Being goods returned to Dinesh)		600	600

" 14	Advertising Account Dr. To Cash Account (Being the amount paid for advertising)			1,500	1,500
" 15	Stationary Account Dr. To Cash Account (Being the payment for stationery)			300	300
" 17	Drawings Account Dr. To Cash Account (Being cash withdrawn for personal use)			2,400	2,400
" 20	Cash Account To Sales Account (Being cash sales)			9,600	9,600
" 21	Cash Account Dr. To Aruna's Account (Being the amount received from Aruna)			2,550	2,550
" 23	Vijaya's Account Dr. To Cash Account (Being the amount paid to Vijaya)			12,000	12,000
" 24	Sanjay's Account Dr. To Sales Account (Being credit sales)			15,000	15,000
" 28	Cash Account Dr. To Sales Account (Being salaries paid)			6,000	6,000
May 31	Salaries Account Dr. To Cash Account (Being salaries paid)			6,000	6,000
May 31	Municipal Taxes Account Dr. To Cash Account (Being municipal taxes paid)			1,200	1,200
May 31	Printing Charges Account Dr. To Cash Account (Being printing charges paid)			1,500	1,500

LEDGER
Cash Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			**Rs.**
Year --			**Year --**		
Mar. 1	To Capital A/c	1,20,000	Mar. 2	By Furniture A/c	24,000
Mar. 3	To Sales A/c	4,800	Mar. 4	By Rent A/c	3,000
Mar. 20	To Sales A/c	9,600	Mar. 14	By Advertising A/c	1,500
Mar. 21	To Aruna	2,550	Mar. 15	By Stationery A/c	300
Mar. 28	To Sales A/c	6,000	Mar. 17	By Drawings A/c	2,400
			Mar. 23	By Vijaya	12,000
			Mar. 31	By Municipal Tax A/c	1,200
			Mar. 31	By Printing Charges A/c	1,500
			Mar. 31	By Balance c/d	91,050
		1,42,950			1,42,950
April 1	To Balance b/d	91,050			

Sales Account

Dr.					Cr.
Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
Mar. 31	To Balance c/d	44,400	Mar. 3	By Cash A/c	4,800
			Mar. 6	By Aruna	9,000
			Mar. 20	By Cash A/c	9,600
		44,400	Mar. 24	By Sanjay	15,000
				By Cash A/c	6,000
					44,400
			April 1	By Balance b/d	44,400

Aruna's Account

Dr.					Cr.
Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
Mar. 6	To Sales A/c	9,000	Mar. 7	By Returns Inward A/c	450
					2,550
			Mar. 27	By Cash A/c	6,000
			Mar. 27	By Balance c/d	
		9,000			9,000
April 1	To Balance b/c	6,000			

Return Inward Account

Dr.					Cr.
Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
Mar. 7	To Aruna	450	Mar. 31	By Balance c/d	450
Apr. 1	To Balance b/d	450			

Dinesh's Account

Dr.					Cr.
Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
Mar. 11	To Returns Outward A/c	600	Mar. 10	By Purchases A/c	24,000
	To Balance b/d	23,400			24,000
Mar. 31		24,000	Apr. 1	By Balance b/d	24,000

Returns Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
Mar. 31	To Balance c/d	600	Mar. 11	By Dinesh's	600
			Apr. 1	By Balance b/d	600

Advertising Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
Mar. 14	To Cash A/c	1,500	Mar. 31	By Balance c/d	1,500
Apr. 1	To Balance b/d	1,500			

Capital Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
Mar. 31	To Balance c/d	1,200,000	Mar. 1	By Cash A/c	1,20,000
			Apr. 1	By Balance b/d	1,20,000

Furniture Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
Mar. 2	To Cash A/c	24,000	Mar. 31	By Balance c/d	24,000
Apr. 1	To Balance b/d	24,000			

Purchases Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
Mar. 2	To Vijaya's	36,000	Mar. 31	By Balance c/d	60,000
Mar. 10	To Dinesh's	24,000			60,000
		60,000			
Apr. 1	To Balance b/d	60,000			

Vijaya's Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			**Rs.**
Year --			**Year --**		
Mar. 23	To Cash A/c	12,000	Mar. 2	By Purchases A/c	36,000
Mar. 31	To Balance c/d	24,000			
		36,000			36,000
			Apr. 1	By Balance b/d	24,000

Rent Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			**Rs.**
Year --			**Year --**		
Mar. 4	To Cash A/c	3,000	Mar. 31	By Balance c/d	3,000
Apr. 1	To Balance b/d	3,000			

Stationery Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			**Rs.**
Year --			**Year --**		
Mar. 15	To Cash A/c	300	Mar. 31	By Balance c/d	300
Apr. 1	To Balance b/d	300			

Drawings Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			**Rs.**
Year --			**Year --**		
Mar. 17	To Cash A/c	2,400	Mar. 31	By Balance c/d	2,400
Apr. 1	To Balance b/d	2,400			

Sanjay's Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			**Rs.**
Year --			**Year --**		
Mar. 24	To Sales A/c	15,000	Mar. 31	By Balance c/d	15,000
Apr. 1	To Balance b/d	15,000			

Salaries Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
2002			**2002**		
Mar. 31	To Cash A/c	6,000	Mar. 31	By Balance c/d	6,000
Apr. 1	To Balance b/d	6,000			

Municipal Taxes Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
Mar. 31	To Cash A/c	1,200	Mar. 31	By Balance c/d	1,200
Apr. 1	To Balance b/d	1,200			

Printing Charges Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
Mar. 31	To Cash A/c	1,500	Mar. 31	By Balance c/d	1,500
Apr. 1	To Balance b/d	1,500			

Note: Nominal Accounts are balanced for the purpose of preparing the Trial Balance.

6. Significance of Balance

You have learnt that the 'balance in an account signifies the net effect of all transactions related to it during a given period'. It may be a debit balance or a credit balance or a nil balance depending upon whether the debit or the credit total is higher. Let us now understand the significance of a balance in respect of the various types of accounts in the ledger.

Personal Accounts

Personal accounts are more frequently balanced as compared to any other class of accounts. Balance in a personal account indicates whether the party concerned owes to the business or the other way round. When it shows a debit balance, it means that the party owes that amount to the business. In other words, she is a debtor to the business. Similarly, when it shows a credit balance, it would mean that the business owes that amount to her i.e. she is a creditor of the business. If, however, the account shows a nil balance, it means that nothing is due to her or due from her.

Real Accounts

Real accounts are normally balanced at the end of the accounting period primarily for the purpose of preparing the final accounts. The cash account, however, is balanced everyday because the actual cash is to be verified and confirmed with the closing balance shown by Cash Account. All real accounts show a debit balance as there are assets accounts.

Nominal Accounts

Nominal accounts are not usually balanced, but closed by transfer to Profit and Loss Accounts, at the time of preparing the final accounts (at the end of the accounting period). However, to start with, for the purpose of understanding the procedure involved, nominal accounts have also been balanced. Even otherwise, the difference between the debit side and credit side totals has to be worked out for preparing the trial balance. The accounts which relate to expenses or losses will show a debit balance; whereas those relating to incomes and gains will have a credit balance. This is because all expenses and losses are debited and all incomes and gains are credited.

7. Trial Balance

You have learnt that every debit has its corresponding credit and this equality between debits and credits is the essence of the double entry principle. You have also seen that when a journal entry is passed, every debit has a corresponding credit and this is verified by totalling every page of the journal. However, when the journal entries are posted to various accounts in the ledger, the debits and credits get scattered and recorded in different accounts. Thus the individual debits and credits forego their identity and get merged. At this stage it is necessary to ensure that posting into the ledger has been correctly done and to check whether the equality between debits and credits has been maintained throughout. For this purpose, a statement showing the balances of various accounts is prepared. This statement is known as `Trial Balance'.

The Trial Balance is usually prepared just before the preparation of final accounts in order to check the arithmetical accuracy of posting into the ledger. However, to demonstrate the mechanics of its preparation and to impress upon you the ability of the Trial balance in providing a test of the arithmetical accuracy, an attempt is made here to prepare the Trial Balance.

Since, under the double entry system, every debit has an equal and corresponding credit, the total of debits given to different accounts must equal the total of credits given to different accounts. Continuing the same logic, since the balance on an account represents the net effect of various debits and credits posted to that account, the total of debit balances on different accounts must be equal to the total of credit balances on different accounts. Thus the two totals (i.e., the total of debit balances and the total of credit balances) should tally, thus upholding the debit - credit equality. If, however, the two totals do not tally, it would simply mean that there are certain errors in posting.

A Trial Balance has been prepared for the ledger accounts of Illustration 3 and presented here. You will notice that all the accounts which appear in the ledger have been listed here and their balance entered in the appropriate columns. You will also observe that the debit and credit amount columns show equal totals, signifying that the Trial Balance has tallied.

Trial Balance as on March 31, Year----

Name of the Account	L.F.	Dr. Balances	Cr. Balances
		Rs.	Rs.
Cash Account		91,050	
Capital Account			1,20,000
Furniture Account		24,000	
Purchases Account		60,000	
Vijaya's Account			24,000
Sales Accounts			44,000
Rent Account		3,000	
Aruna's Account		6,000	
Return Inward Account		450	
Dinesh's Account			23,400
Returns Outward Account			600
Advertising Account		1,500	
Stationery Account		300	
Drawings Account		2,400	
Sanjay's Account		15,000	
Salaries Account		6,000	
Municipal Taxes Account		1,200	
Printing Charges Account		1,500	
Total		**2,12,400**	**2,12,400**

Questions for Discussion B

1. Why do you balance an account?

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2. Explain the procedure balancing a ledger account.

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3. Name the types of the accounts that are balanced.

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4. What is a Trial Balance?

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5. Why do we prepare a Trial Balance?

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8. Posting an Opening Entry

You learnt about the opening entry which is passed in the journal for all assets and liabilities brought from the previous year. The posting of the opening entry is very different from the posting of other journal entries. We open the concerned accounts in the new ledger for all items that appear in the opening entry. Then, in the accounts which have been debited in the opening entry we shall write 'To Balance b/f ' in the Particulars column on the debit side of those accounts and show the respective amount in the Amount column. Similarly, in the accounts that have credited in the opening entry, we shall write 'By Balance b/f ' in the particulars column on the credit side of those accounts and show the respective amount in the Amount Column. Thus, the posting is complete. As a matter of fact, the accounts which have been debited or credited in the opening entry merely represent the costing balances of various personal and real accounts from the previous year. These are now entered in the ledger accounts of the current year as opening balances through the opening entry. Illustration 4 should help you to understand the posting of the opening entry.

Illustration 4

Post the following opening entry into a ledger:

Year			**Rs.**	**Rs.**
Jan.1	Cash A/c	Dr.	5,000	
	Stock A/c	Dr.	20,000	
	Furniture A/c	Dr.	2,000	
	Shah & Co.	Dr.	2,000	
	Prem Chand	Dr.	1,500	
	To Ramesh Lal			3,000
	To Rakesh			1,000
	To Capital A/c			26,500
	(Being an opening entry for assets and liabilities b/f from last year)			

Solution:

Cash Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
Jan. 1	To Balance b/f	5,000			

Stock Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
Jan. 1	Balance b/f	20,000			

Furniture Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
Jan. 1	Balance b/f	2,000			

Shah's Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
Jan. 1	Balance b/f	2,000			

Prem Chand's Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
Jan. 1	Balance b/f	1,500			

Ramesh Lal's Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
			Jan. 1	Balance b/f	3,000

Rakesh Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
			Jan. 1	Balance b/f	1,000

Capital Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
Year --			**Year --**		
			Jan. 1	Balance b/f	26,500

1. A ledger is a book which contains all the accounts affected by various transactions.
2. A Journal by itself does not help us to know the net effect of the various transactions affecting a particular account. Hence, all journal entries are posted into ledger accounts.
3. Posting is made on the debit side of the accounts which have been debited in the journal, and the credit side of the accounts which have been credited in the journal.
4. As various transactions are posted to different accounts during a particular period of time, it is necessary to ascertain the net effect of all the postings made. This is done by balancing an account.
5. After various accounts are balanced, it would be useful to verify the arithmetical accuracy of the double entry by preparing the Trial Balance.

Balance: The difference between the total of debits and total of credits appearing in an account. It signifies the net effect of the transactions posted to that account.

Ledger: A book which contains all accounts affected by various transactions in business.

Posting: A process of entering transactions into ledger accounts.

Trial Balance: A statement of balances of various ledger accounts, prepared to test the arithmetical accuracy of the double entry.

Answers to Questions for Discussion

A. 3	a) False	b) True	c) False
	d) True	e) False	f) True

Exercises

1. Journalize the following transactions and post them into the Ledger:

Year--		Rs.
Jan. 1	Mohini commenced business with cash	48,000
" 2	Deposited into bank	36,000
" 3	Purchased goods for cash	2,000
" 4	Bought furniture for office use	5,600
" 10	Drew from Bank for office use	4,000
" 13	Goods sold to Rahul	2,400
" 15	Bought goods from Anil	1,600
" 18	Paid trade expenses	400
" 19	Received cash from Rahul	2,400
" 25	Paid wages	200
" 28	Paid Anil in full settlement	1,590
" 30	Paid rent	400
" 31	Interest on capital	400

2. Enter the following transactions in the journal of Hema and post them into the Ledger.

Year--		Rs.
Feb. 1	Commenced business with cash	60,000
" 2	Bought goods from Madhan	30,000
" 2	Purchased fittings for cash	4,800
" 2	Sold goods to Chetan	9,600
" 3	Paid Madhan on account	18,000
" 4	Sold goods to Pradeep	12,000
" 5	Received cheque from Chetan in full settlement of his account	9,550
" 6	Paid wages	480
" 8	Bought goods for cash	3,600
" 9	Sold goods to Ravi	20,400
" 10	Purchased goods from Promod	15,600
" 11	Paid Madhan in final settlement	12,000
" 12	Paid carriage on goods sold	240
" 13	Paid wages	480
" 14	Bought goods from Mahesh	18,000
" 16	Sold goods to Shyam	21,600
" 17	Shyam paid on Account	24,000
" 18	Purchased goods from Hareesh	9,000
" 19	Sold goods for cash	9,600
" 20	Paid wages	480
" 21	Sent cheque to Hareesh	9,000

" 22	Sold goods to Sunil	15,600
" 23	Bought goods for Amar	28,800
" 24	Bought goods for cash	8,400
" 25	Sent cheque on account to Amar	28,000
" 26	Received from Sunil on Account	15,600
" 27	Paid wages	500
" 28	Paid rent	1,100

3. Enter the following transactions in journal, and post them into the ledger.

Year--		**Rs.**
Mar. 1	Rohini commenced her business with the following assets, Plant and Machinery	1,00,00
	Stock	36,000
	Furniture	26,000
	Cash	
	Her transactions for the month were	2,500
" 2	Sold goods to Sanjay	16,000
" 3	Bought goods from Murari	26,000
" 4	Sanjay paid cash	10,000
" 6	Returned damaged goods to Murari	720
" 10	Paid Murari on account	11,280
" 15	Bought goods from Govind	21,600
" 18	Sold goods to Krishna	30,000
" 20	Received cash from Krishna	24,000
" 20	Krishna returned damaged goods	16,00
" 26	Paid to Govind	14,400
" 31	Paid salaries	3,000
" 31	Paid rent	1,000

4. Balance the ledger accounts in the Exercises 1 to 3 given above, prepare the Trial Balance and verify the arithmetical accuracy.

A Simple Example of Balance Sheets

Let us write the following details of cash of Shantha's business of making shoes at the end of the first month. Make two columns. In the first column write where the money came from and in the second column write the form the money is in now.

Where the money came from	Amount (Rs.)	**What form the money is in now**	Amount (Rs.)
Shantha's investment	65,500	Machinery	1,20,000

Bank term loan	1,27,500	Electrification	25,000
Bank working capital loan	42,000	Shed deposit	4,000
		Cash in hand	86,000
Total	2,35,000		2,35,000

We must remember that the money that came in must equal the money used plus cash balance in hand. In other words, the total amount of the two must balance.

We can repeat the exercise at the end of month 2.
The figures should appear as below:

Where the money came from	Amount (Rs.)	**What form the money is in now**	Amount (Rs.)
Shantha's investment	65,500	Machinery	1,20,000
Bank term loan	1,27,500	Electrification	25,000
Bank working capital loan	42,000	Shed deposit	4,000
		Furniture	25,000
		Training Workers	5,000
		Raw Material	22,400
		Cash in hand	31,200
Total	2,35,000		2,32,600

You must be thinking about the difference of Rs. 2,400. This is the money spent on rent and overheads, which are expenses, and so the money is not available now in any form. Discuss and bring out from the entrepreneur that until Shantha is able to sell her product, any expense, which cannot be recovered, is a loss. The balance sheet would therefore look like this:

Where the money came from	Amount (Rs.)	**What form the money is in now**	Amount (Rs.)
Shantha's investment	65,500	Machinery	1,20,000
Bank term loan	1,27,500	Electrification	25,000
Bank Working capital loan	42,000	Shed deposit	4,000
		Furniture	25,000
		Training Workers	5,000
		Raw Material	22,400
		Cash in hand	31,200
		Loss	2,400
Total	2,35,000		2,35,000

Let us repeat the exercise at the end of month 3. This will help to explain that having made shoes and sold them for Rs. 48,000 the dealer owes Shantha Rs. 48,000, which is the money available as dues receivable. This amount should, therefore, appear in the right column. This results in the total of the right hand columns to be more than that of the left hand columns. This difference is the profit that Shantha has earned, and therefore, is a source of money. This figure of Rs. 7,200 accordingly appears in the left hand column as profit. The fact that cash balance is zero does not indicate that there is no profit. The balance sheet should now look this.

Where the money came from	Amount (Rs.)	**What form the money is in now**	Amount (Rs.)
Shantha's investment	65,500	Machinery	1,20,000
Bank term loan	1,27,500	Electrification	25,000
		Shed deposit	4,000
		Furniture	25,000
		Training Workers	5,000
		Raw Material	22,400
		Cash in hand	0
Profit	7,200		
Total	2,42,000		2,42,000

If the accounts have been kept correctly, the balance sheet always balances, and the profit or loss can be seen from this record in a convenient manner. This also informs the entrepreneur about the amounts owed to her and by her at any point of time.

A balance sheet is a powerful tool for any business to find out what its money position is, at any point of time. The entrepreneur will be able to keep track of money she owes to others, money owed to you by others, the amount of stock she is keeping etc. From this she can also work out if she can ensure that the money owed to her does not become too large, thus blocking her cash. She can also try and see if she can reduce her stocks, as much as possible, for the same purpose. By reducing the amount of cash she needs to run the business, she can either save on the interest she pays, or with the surplus money she can do more business and earn more profits.

Questions for Discussion C

1) What is a balance sheet?

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2) List the advantages of preparing a balance sheet.

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3) What two aspects need to be covered in a balance sheet?

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4) Prepare a balance sheet for next 2 months.

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Acknowledgements

Department of Women and Child Development
Ministry of Human Resource Development Publications

1. Network of Self Help Groups: A Guide Book written by Tara Sinha, Friends of Women's World Banking, India
2. Resource Book for Group Building
3. Swa Shakti: Guide Book for Field Workers
4. Training of Self Help Groups: A Guide Book written by Girija Srinivasan
5. Organizing Self Help Groups – A Resource Book

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