

FINAL ACCOUNTS

The transactions of a business enterprise for the accounting period are first recorded in the books of original entry, then posted there from into the ledger and lastly tested as to their arithmetical accuracy with the help of trial balance. After the preparation of the trial balance, every businessman is interested in knowing about two more facts. They are: (i) Whether he has earned a profit or suffered a loss during the period covered by the trial balance, and (ii) Where does he stand now? In other words, what is his financial position?

For the above said purposes, the businessman prepares financial accounts for his business i.e. he prepares the Trading and Profit and Loss Account and Balance Sheet at the end of the accounting period. Thus it involves preparation of income statement and financial statement and are popularly known as final accounts. The preparation of financial statements depends upon whether the business concern is a trading concern or manufacturing concern. If the business concern is a trading concern, it has to prepare the following accounts along with the Balance Sheet: (i) Trading Account; and (ii) Profit and Loss Account.

But, if the business concern is a manufacturing concern, it has to prepare the following accounts along with the Balance Sheet: (i) Manufacturing Account; (ii) Trading Account; and (iii) Profit and Loss Account.

Trading Account is prepared to know the Gross Profit or Gross Loss. Profit and Loss Account discloses net profit or net loss of the business. Balance sheet shows the financial position of the business as on a given date. For preparing final accounts, certain accounts representing incomes or expenses are closed either by transferring to Trading Account or Profit and Loss Account. Any account, which cannot find a place in any of these two accounts goes to the Balance Sheet.

TRADING ACCOUNT

After the preparation of trial balance, the next step is to prepare Trading Account. Trading Account is one of the income statements, which shows the result of buying and selling of goods and/or services during an accounting period. The main objective of preparing the Trading Account is to ascertain gross profit or gross loss during the accounting period. Gross Profit is said to have made when the sale proceeds exceed the cost of goods sold. Conversely, when

sale proceeds are less than the cost of goods sold, gross loss is incurred. For the purpose of calculating cost of goods sold, we have taken into consideration opening stock, purchases, direct expenses on purchasing or manufacturing the goods and closing stock. The balance of this account i.e. gross profit or gross loss is transferred to the Profit and Loss Account. The specimen of a Trading Account is given below:

Dr.		Name of the Firm Trading Account for the year ended on 31st December	Cr.
		Rs	Rs
To Opening Stock	-	By Sales less Returns	-
To Purchases less Returns	-	By Closing Stock	-
To Wages	-		
To Carriage	-		
To Freight	-		
To Dock Charges	-		
To Excise Duty	-		
To Octroi	-		
To Import Duty	-		
To Fuel, Power etc.	-		
To Stores consumed	-		
To Royalty (Production basis)	-		
To Manufacturing expenses	-		
To Profit and Loss A/c (Gross Profit transferred)	-		
	_____		_____

Opening stock is always debited to Trading Account.

MANUFACTURING ACCOUNT

The concern which are engaged in the conversion of raw materials into finished goods, are interested to knowing the cost of production of the goods produced. The cost of the goods produced cannot be obtained from the Trading Account. So, it is desirable to prepare a Manufacturing Account prior to be preparation of the Trading account with the objective of ascertaining the cost of goods produced during the accounting period.

The proforma of Manufacturing Account is given as under:

MANUFACTURING ACCOUNT
FOR THE YEAR ENDING.....

	Rs.		Rs.
Dr. To Work-in process (Opening) To Raw Materials consumed: Opening Stock <i>Add</i> Purchases of Raw Materials <i>Less</i> Closing Stock of Raw Materials To Direct or Productive Wages To Factory Overheads: Power & Fuel Repairs of Plant Depreciation on Plant		Cr. By Work-in-process (Closing) By Sale of Scrap By Cost of Production of finished goods during the period transferred to the Trading Account	

The Trading Account in case manufacturing account is prepared will appear as follows:

TRADING ACCOUNT
FOR THE YEAR ENDING.....

	Rs.		Rs.
Dr. To Opening Stock of Finished Goods To Cost of Production of finished goods transferred from Manufacturing Account To Purchases of Finished Goods <i>less</i> Returns To Carriage Charges on goods purchased To Gross Profit transferred to Profit and Loss A/c		Cr. By Sales <i>less</i> Returns By Closing Stock of Finished goods By Gross Loss transferred to Profit and Loss A/c	

PROFIT AND LOSS ACCOUNT

Trading Account results in the gross profit/ gross loss made by a businessman on purchasing and selling of goods. It does not take into consideration the other operating expenses incurred by him during the course of running the business. Besides this, a businessman may have other sources of income. In order to ascertain the true profit or loss, which the business has made during a particular period, it is necessary that all such expenses and incomes should be considered. Profit and Loss Account considers all such expenses and incomes and gives the net profit made or net loss suffered by a business during a particular period. All the indirect revenue expenses and losses are shown on the debit side of the Profit and Loss Account, where as all indirect revenue incomes are shown on the credit side of the Profit and Loss Account.

Profit and Loss Account measures net income by matching revenues and expenses according to the accounting principles. Net income is the difference between total revenues and total expenses. In this connection, we must remember that all the expenses, for the period are to be debited to this account - whether paid or not. If it is paid in advance or outstanding, proper adjustments are to be made. Likewise all revenues, whether received or not are to be credited. Revenue if received in advance or accrued but not received, proper adjustment is required.

A proforma of the Profit and Loss Account showing probable items therein is as follows:

Profit and Loss Account for the year ended 31st December		Cr.
Dr.	Rs	Rs
To Gross Loss b/d		By Gross Profit b/d
To Management Expenses :		By Interest Received
Office Salaries		By Discount Received
Rent of office building		By Commission
Office Lighting		By <u>Income from Investment</u>
Office, Rent, Rates and Taxes		By <u>Apprenticeship Premium</u>
Printing and Stationery		By <u>Rent from Tenants</u>
Telephone Charges		By <u>Reserve for Discount on Creditors</u>
Postage		By Interest on Renewal of Bills
Legal Expenses		By Miscellaneous Income
Audit Fees		By Net Loss, transferred to Capital Account
Insurance		
<u>General Expenses etc.</u>		
To Selling Expenses :		
Salesmen Salaries		
Travelling Expenses		
Advertising		
<u>Bad Debts</u>		
Selling Commission		
Brokerage		
Free Samples		
To Distribution Expenses		
Carriage Out		
Warehouse Rent		
Warehouse Insurance		
Delivery Van Expenses		
<u>Packing Expenses</u>		
To Depreciation :		
Depreciation of Assets		
Maintenance Expenses		
To Finance Expenses :		
Discount Allowed		
Interest on Loan		
Interest on Capital		
Discount on Bills		
Loss by Fire		
To Net Profit, transferred to Capital Account		

BALANCE SHEET

A Balance Sheet is a statement of financial position of a business concern at a given date. It is called a Balance Sheet because it is a sheet of balances of those ledger accounts, which have not been closed till the preparation of Trading and Profit and Loss Account. After the preparation of Trading and Profit and Loss Account the balances left in the trial balance represent either personal or real accounts. In other words, they either represent assets or liabilities existing on a

particular date. Excess of assets over liabilities represent the capital and is indicative of the financial soundness of a company.

A Balance Sheet is also described as a Statement showing the Sources and Application of Capital. It is a statement and not an account and prepared from real and personal accounts. The left hand side of the Balance Sheet may be viewed as description of the sources from which the business has obtained the capital with which it currently operates and the right hand side as a description of the form in which that capital is invested on a specified date.

Characteristics

The characteristics of a Balance Sheet are summarized as under:

- (a) A Balance Sheet is only a statement and not an account. It has no debit side or credit side. The headings of the two sides are Assets and Liabilities.
- (b) A Balance Sheet is prepared at a particular point of time and not for a particular period. The information contained in the Balance Sheet is true only at that particular point of time at which it is prepared.
- (c) A Balance Sheet is a summary of balances of those ledger accounts, which have not been closed by transfer to Trading and Profit and Loss Account.
- (d) A Balance Sheet shows the nature and value of assets and the nature and the amount of liabilities at a given date.

Balance Sheet of as at

Liabilities	Rs	Assets	Rs
<i>Current Liabilities</i>		<i>Current Assets:</i>	
Bank Overdraft	xxx	Cash-in-hand	xxx
Bills Payable	xxx	Cash at bank	xxx
Outstanding Expenses	xxx	Bills Receivable	xxx
Sundry Creditors	xxx	Sundry Debtors	xxx
Income received-in-advance	xxx	Prepaid Expenses	xxx
		Accrued income	xxx
<i>Long-term Liabilities:</i>		Closing Stock	xxx
Loan	xxx	<i>Investments:</i>	
<i>Capital:</i>		<i>Fixed Assets:</i>	
Opening balance	xxx	Furniture and Fixture	xxx
Add: Net Profit	xxx	Plant and Machinery	xxx
(Less: Net Loss)	xxx	Building	xxx
	xxx	Land	xxx
Less: Drawing	xxx	Goodwill	xxx
	xxx		xxx

Adjustment entries:

1. **Closing stock:** On the credit side of the trading account and on the asset side of the balance sheet.
2. **Outstanding expenses:** Add to the respective expense account on the Dr side of the trading or P&L account and show as a liability in the balance sheet.
3. **Prepaid expenses:** Deduct from the respective expense account on the Dr side of the trading or P&L account and show as an asset in the balance sheet.
4. **Accrued income:** Add to the respective income account on the Cr side of the trading or P&L account and show as an asset in the balance sheet.
5. **Income received in advance:** Deduct from the respective income account on the Cr side of the trading or P&L account and show as a liability in the balance sheet.
6. **Depreciation:** On the debit side of P&L account and deduct from the respective asset on the asset side of balance sheet.
7. **Bad debts:**

If it is inside trial balance then it is to be shown on the Dr side of P&L account and no other treatment is given.

However if it is outside trial balance, then it is shown on the Dr side of P&L account and also deducted from debtors on the asset side of balance sheet.
8. **Provision for bad debts:** On the debit side of P&L account and deducted from debtors on the asset side of balance sheet.
9. **Interest on capital:** On the debit side of P&L account and added to capital on the liability side of balance sheet.
10. **Interest on drawings:** On the credit side of P&L account and deducted from capital on the liability side of balance sheet.
11. **Goods for domestic use:** Deduct from purchases on the debit side of trading account and deduct from capital on the liability side of balance sheet.

12. Goods as free samples: Deduct from purchases on the debit side of trading account and also show it as an expense on the debit side of P&L account.

13. Accidental loss of goods:

- **Not insured:** Show it on the credit side of trading account and as a loss on the debit side of P&L account.
- **Fully insured:** Show it on the credit side of trading account and as an insurance claim on the asset side of balance sheet.
- **Partly insured:** Show it on the credit side of trading account and the part, which is not insured is shown as a loss on the debit side of P&L account while as the part which is insured is shown as an insurance claim on the asset side of balance sheet.

ILLUSTRATION 7.16

The following Trial Balance was extracted from the books of V. Bal as on 31st December 2004:

Debit balances:	Rs.		Rs.
Plant and Machinery	20,000	Motor Car	12,000
Manufacturing Wages	34,500	Purchases	1,02,000
Salaries	15,850	Sales Returns	3,100
Furniture	10,000	Bad Debts	1,400
Freight on Purchases	1,860	Interest and Bank charges	400
Freight on Sales	2,140	Cash at Bank	4,200
Building	24,000	Cash in Hand	1,120
Manufacturing Expenses	9,500	Credit Balances:	
Insurance and Tax	4,250	Capital	80,000
Goodwill	25,000	Sundry Creditors	44,560
General Expenses	8,200	Bank Loan	15,000
Factory Fuel and power	1,280	Purchase Returns	1,740
Sundry Debtors	78,200	Sales	2,50,850
Factory Lighting	950	Provision for Bad Debts	2,000
Opening Stock	34,200		

Prepare Trading and Profit and Loss Account for the year ended 31st December 2004 and the Balance Sheet as on that date taking into consideration the following information:

- Stock in hand on 31st December 2004 was valued at Rs. 30,500.
- Depreciate Plant and Machinery by 10%.
Furniture by 5%
Motor Car by Rs. 1,000.
- Bring Provision for Bad Debts to 5% on Sundry Debtors.
- A commission of 1% on the gross profit is to be provided for Works Manager.
- A commission of 2% on net profit (after charging the Works Manager's commission) is to be credited to the General Manager. (CA Entrance)

SOLUTION

Trading and Profit and Loss Account of Mr. V. Bal
for the year ending 31st December, 2004

Dr.	Rs.	Rs.	Cr.	Rs.	Rs.
To Opening Stock		34,200	By Sales	2,50,850	
To Purchases	1,02,000		Less: Returns	3,100	2,47,750
Less: Returns	1,740	1,00,260	By Closing Stock		30,500
To Freight on Purchases		1,860			
To Manufacturing Wages		34,500			
To Factory Fuel and Power		1,280			
To Factory Lighting		950			
To Manufacturing Expenses		9,500			
To Cross profit c/d		95,700			
		2,78,250			2,78,250
To Salary		15,850	By Gross Profit b/d		95,700
To Freight on Sales		2,140			
To Insurance and Tax		4,250			
To General Expenses		8,200			
To bad Debts	1,400				
Add: Provision (5% on 78,200)	3,910	5,310			
Less: Old Provision	2,000	3,310			
To Interest and Bank Charges		400			
To Depreciation:					
Plant and Machinery	2,000				
Furniture	500				
Motor Car	1,000	3,500			
To Works Manager's (95,700 × 1%) Commission		957			
To General Manager's Commission 2% on Rs. 57,093 (i.e. Rs. 95,700 – 38,607)		1,142			
To Net Profit Transferred to Capital Account		55,951			
		95,700			95,700

Balance Sheet of Mr. V. Bal
as on 31st December, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry Creditors		44,560	Cash in hand		1,120
Bank Loan		15,000	Cash at Bank		4,200
Outstanding Commission:			Sundry Debtors	78,200	
Works Manager		957	Less: Provision for Bad Debts	3,910	74,290
General Manager		1,142	Closing Stock		30,500
Capital	80,000		Furniture	10,000	
Add: Net Profit	55,951	1,35,951	Less: Depreciation	500	9,500
			Motor Car	12,000	
			Less: Depreciation	1,000	11,000
			Plant and Machinery	20,000	
			Less: Depreciation	2,000	18,000
			Buildings		24,000
			Goodwill		25,000
		1,97,610			1,97,610

ILLUSTRATION 7.17

From the following Trial Balance of Mr. Seth, prepare Trading and Profit and Loss Account for the year ended 31st December 2004 and a Balance Sheet as on that date, after giving effect to the undermentioned adjustments:

	Rs.		Rs.
Debit Balances:		Bad Debts	400
Drawings	3,250	Patents and Patterns	500
Stock (opening)	17,445	Cash	62
Returns Inwards	554	Discount	330
Deposit with Gupta	1,375	Wages	754
Carriage Outward	725	Carriage Inward	1,240
Loan to Ashok @ 5% given on 1st Jan. 2004	1,000	<i>Credit balances:</i>	
Rent	820	Capital	15,000
Purchases	12,970	Returns Outwards	840
Debtors	4,000	Interest on Loan to Ashok	25
Goodwill	1,730	Rent Outstanding	130
Advertisement	954	Creditors	3,000
		Provision for Doubtful Debts	1,200
		Sales	27,914

Adjustments:

1. The Manager of Seth is entitled to commission of 10% of the net profit calculated after charging such commission.
2. Increase Bad Debts by Rs. 600.
3. Make Provision for Doubtful Debts at 10% and Provision for Discount on Debtors at 5%.
4. Stock valued at Rs. 1,500 destroyed by fire on 25th Dec. 2004 but the Insurance Company admitted a claim for Rs. 950 only and paid it in January 2005.
5. Rs. 200 out of the Advertisement are to be carried forward to the next year.
6. The value of closing stock is Rs. 18,792.

(B.Com., Guru Nanak, MS)

SOLUTION

**Trading and Profit and Loss Account of Mr. Seth
For the year ended 31st December 2004**

Dr.				Cr.	
	Rs.	Rs.		Rs.	Rs.
To Opening Stock		17,445	By Sales	27,914	
To Purchases	12,970		Less: Returns	554	27,360
Less: Returns	840	12,130	By Stock-in-Trade		18,792
To Wages		754	By Stock Destroyed by fire		1,500
To Carriage Inward		1,240			
To Gross Profit c/d		16,083			
		<u>47,652</u>			<u>47,652</u>
To Rent		820	By Gross Profit b/d		16,083
To Advertisement Expenses	954		By Interest on Loan	25	
Less: Prepaid	200 ¹	754	Add: Accrued Interest	25	50
To Bad Debts	400				
Add: Additional Bad Debts	600				
Add: New Provision for Doubtful Debts	340				
	<u>1,340</u>				
Less: Old Provision for Doubtful Debts	1,200	140			
To Discount		330			
To Loss on Stock by fire		550			
To Carriage Outward		725			
To Provision for Discount on Debtors		153			
To Commission to Manager		1,151			
($\frac{10}{110} \times \text{Rs. } 12,661$)					
To Net Profit transferred to Capital Account		11,510			
		<u>16,133</u>			<u>16,133</u>

**Balance Sheet of Mr. Seth
as at 31st December 2004**

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Outstanding Rent		130	Cash		62
Commission Payable to Manager		1,151	Deposit with Gupta		1,375
Creditors		3,000	Loan to Ashok	1,000	
Capital	15,000		Add: Interest Accrued	25	1,025
Add: Net Profit	11,510		Insurance Company		950
	<u>26,510</u>		Debtors	4,000	
Less: Drawings	3,250	23,260	Less: Further Bad Debts	600	
				<u>3,400</u>	
			Less: Provision for Doubtful Debtors	340	
				<u>3,060</u>	
			Less: Provision for Discount on Debtors	153	2,907

Stock	18,792
Prepaid Advertisement	200
Patents and Patterns	500
Goodwill	1,730
	<u>27,541</u>

ILLUSTRATION 7.20

From the following Trial Balance of Mr. Ram, prepare Trading and Profit and Loss Account for the year ended 31st December 2004 and Balance Sheet as at that date taking into consideration the following adjustments:

- Closing stock Rs. 9,500.
- One quarter of insurance premium falls in next year.
- Provide 10% depreciation on furniture.
- Loan to X carries 8% interest per year.
- Loan from Y carries 6% interest per year.
- Goods worth Rs. 500 have been taken by the proprietor for private use.
- Provide 5% for bad and doubtful debts.
- Salaries include salary to the Proprietor @ Rs. 200 per month.

Debit Balances	Rs.	Credit Balances	Rs.
Stock on 1.1.2004	6,000	Capital	40,000
Salaries	6,000	Return Outwards	500
Drawings	6,000	Loan from Y	5,000
Carriage inwards	1,000	Rent Outstanding	100
Carriage outwards	500	Creditors	13,000
Return Inwards	800	Outstanding Expenses	1,900
Loan to X	3,000	Bad Debts Provision	1,000
Rent	1,200	Discount	300
Goodwill	5,000	Sales	73,700
Wages	100	Rent by subletting	500
Insurance Premium	600		
Bank	8,500		
Purchases	60,000		
Debtors	30,000		
Advertisements	3,000		
Bad Debts	500		
Discount	600		
Cash	200		
Furniture	3,000		

**Trading and Profit and Loss Account of Mr. Ram
for the year ending 31st December, 2004**

Dr.	Rs	Rs	Cr.	Rs	Rs
To Opening Stock		6,000	By Sales	73,700	
To Purchases	60,000		Less: Returns	800	72,900
Less: Returns	500		By Closing Stock		9,500
	59,500				
Less: Drawings	500	59,000			
To Wages		100			
To Carriage Inwards		1,000			
To Gross Profit c/d		16,300			
		82,400			82,400
To Salaries	6,000		By Gross Profit b/d		16,300
Less: Paid to Proprietor	2,400	3,600	By Discount		300
To Salaries to Proprietor		2,400	By Rent by Subletting		500
To Carriage Outwards		500	By Interest accrued		240
To Rent		1,200			
To Bad Debts	500				
Add: Provision for Bad Debts	1,500				
	2,000				
Less: Old Provision	1,000	1,000			
To Advertisement		3,000			
To Discount		600			
To Insurance Premium	600				
Less: Unexpired	150	450			
To Outstanding Interest		300			
To Depreciation on Furniture		300			
To Net profit transferred to capital		3,990			
		17,340			17,340

**Balance Sheet
as on 31st December, 2004**

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Creditors		13,000	Cash		200
Y's Loan		5,000	Bank		8,500
Liability for other Expenses		1,900	Debtors	30,000	
Rent Outstanding		100	Less: Provision for Doubtful Debts	1,500	28,500
Interest Outstanding		300	Loan to X		3,000
Capital	40,000		Closing Stock		9,500
Add: Salary Credited	2,400		Unexpired Insurance Premium		150
Add: Net Profit	3,990		Interest accrued		240
	46,390		Furniture	3,000	
Less: Drawings	6,000		Less: Depreciation	300	2,700
Salary	2,400	37,490	Goodwill		5,000
Goods taken	500	57,790			57,790

Problem 12 On 31st March 20X2 the following Trial Balance has been extracted from the books of a merchant.

	Rs		Rs
<i>Dr. Balances:</i>		<i>Dr. Balances (Contd.)</i>	
Drawings A/c	3,000	Bills Receivable	6,882
Sundry Debtors	19,100	Carriage Inward	3,929
Interest on Loan	200	Establishment	8,097
Cash in hand	3,050	Rates, Taxes & Ins.	3,891
Stock (1.4.20X1)	5,839	<i>Cr. Balances:</i>	
Motor Vehicles	9,000	Capital A/c	30,000
Cash at bank	4,555	Sundry Creditors	8,401
Land and Buildings	12,000	5% Loan on	
Bad Debts	625	Mortgage (1.4.20X1)	8,500
Purchases	67,458	Bad Debts Provision	710
Sales Returns	7,821	Sales	1,11,243
Carriage Outward	1,404	Purchases Returns	1,346
Advertisement	2,264	Discounts	440
General Expenses	4,489	Bills Payable	2,714
		Rent Received	250

Prepare Trading and Profit and Loss Account for the year ending on 31st March 20X2 and a Balance Sheet as on that date after considering the following matters:

- Depreciate Land and Building at 5% p.a. and Motor Vehicles at 15% p.a.
- Goods costing Rs 600 were sent to a customer on sale or return for Rs 700 on 30th March 20X2 and has been recorded in the books as actual sales.
- Salaries amounting to Rs 700 and Rates amounting to Rs 400 are due.
- A fire broke out on 1 April 20X2 destroying goods worth Rs 200.
- The Provision for Doubtful Debts is to be brought up to 5% on Sundry debtors.
- Stock in hand on 31st March 20X2 was valued at Rs 6,250.
- Goods costing Rs 500 were taken away by the proprietor for his personal use, no entry has been made in the books of accounts.
- Prepaid insurance amounted to Rs 175.
- Provide for manager's commission at 5% on net profit after charging such Commission.

Solution

Trading and Profit and Loss Account
for the year ending 31st March 20X2

Dr.	Particulars	Rs	Particulars	Rs
	To Opening Stock	67,458	By Sales	1,11,243
	To Purchases	500	Less: Sale Price of Goods on approval	700
	Less: Drawings	1,346	Less: Returns	7,821
	Less: Returns	3,929	By Stock in hand	6,250
	To Carriage Inwards		Add: Cost of Goods Sent on approval	600
	To Gross Profit t/f to P&L Account	34,192		6,850
		1,09,572		1,09,572
	To Interest on Loan	200	By Gross Profit b/d	34,192
	Add: Outstanding	225	By Discount	440
	To Bad Debts	625	By Rent Received	250
	Add: New Provision	920		
	Less: Old Provision	710		
	To Carriage Outwards	1,404		
	To Establishment (Rs 8,097 + 700)	8,797		
	To Rates, Taxes & Ins.	3,891		
	Add: Rates due	400		
	Less: Insurance Prepaid	175		
	To Advertising	2,264		
	To General Expenses	4,489		
	To Depreciation:			
	Land & Building @ 5%	600		
	Motor Vehicles @ 15%	1,350		
	To Manager's Commission	505		
	To Net Profit transferred to Capital A/c	10,097		
		34,882		34,882

Balance Sheet as at 31st March 20X2

Liabilities	Rs	Assets	Rs
Bills Payable	2,714	Cash in hand	3,050
Sundry Creditors	8,401	Cash at bank	4,555
Outstanding Expenses:		Bills Receivable	6,882
Salaries	700	Sundry Debtors	19,100
Manager's Commission	505	Less: Goods sent on app.	700
Rates	400	Less: Provision	920
Loans on Mortgage	8,500	Stock (Rs 6,250 + Rs 600)	17,480
Add: Interest	225	Land and Buildings	6,850
Capital:	8,725	Less: Depreciation	600
Opening Balance	30,000	Motor Vehicles	11,400
Less: Drawings	3,500	Less: Depreciation	9,000
(Rs 3,000 + Rs 500)		Prepaid Insurance	7,650
Add: Profit	10,097		175
	36,597		
	58,042		58,042

Note An event occurring after the date of Balance Sheet (i.e., fire as on 1.4.20X2) does not affect the Balance Sheet.

Introduction to final accounts:

https://www.youtube.com/watch?v=-fg5bo3_zMA

For trading account:

<https://www.youtube.com/watch?v=S903iuef5DQ>

For P&L account and balance sheet:

<https://www.youtube.com/watch?v=FhxmXjyhD4>

For fundamental problems:

<https://www.youtube.com/watch?v=vWcZ5nVDIZQ>

Adjustments:

Part 1: <https://www.youtube.com/watch?v=5S1Buq1WzSk>

Part 2: <https://www.youtube.com/watch?v=UhUkvEKBuI0>

Part 3: <https://www.youtube.com/watch?v=I7M-KqMYAQc>

Part 4: <https://www.youtube.com/watch?v=9mTcFDwRIiU>

Part 5: <https://www.youtube.com/watch?v=ZbnwId1YuV0>

For comprehensive problems:

<https://www.youtube.com/watch?v=BJXEtGt2xHY>

https://www.youtube.com/watch?v=Xqlhtt_iUp0

ERRORS AND ITS RECTIFICATION

Every concern is interested in ascertaining its true profit/loss and financial position at the close of the trading year. The effort of the accountant is to prepare the final accounts in such a fashion, which exhibits true picture of the business. The basic information for the preparation of final accounts is supplied by the trial balance. Thus, the accuracy of the trial balance determines to a great extent

the accuracy or otherwise of the information provided by final accounts. However, the trial balance is prepared to ensure the arithmetical accuracy of the records of a business and also to ensure that for every debit entry a credit of an equal amount has been recorded. Thus, a trial balance in which the total of the debits does not equal the total of credits can be taken as an evidence for the existence of some errors in the records. On the other hand, a trial balance in which the total of the debits equal the total of credits is not a conclusive proof of accuracy of the records. Certain errors may not affect the agreement of a trial balance as the erroneous entries may not violate the dual aspect concept. It means that even if the trial balance agrees, steps should be taken to ensure that the records are free from errors. It, therefore, becomes utmost important to locate such errors and rectify them so that the correct financial position of the concern may be ascertained. So whenever errors in accounting records come to notice, they should be rectified without waiting till the end of the accounting year when trial balance is to be prepared. The objectives of rectification of errors are as follows:

- a) Presenting correct accounting records;
- b) Ascertaining correct profit or loss for the accounting period;
- c) Exhibiting a true financial position of the concern on particular date.

CLASSIFICATION OF ERRORS

The errors can be classified as follows:

- Clerical Errors
- Errors of Principle

Clerical errors

Clerical errors are those errors, which are committed by the clerical staff during the course of recording the business transactions in the books of accounts. These errors are:

- a) Errors of omission
- b) Errors of commission
- c) Compensating errors

a) Errors of Omission

When a transaction is either wholly or partially not recorded in the books of

accounts, it is an error of omission. When a transaction is omitted completely, it is called complete error of omission and when a transaction is partly omitted, it is called a partial error of omission. A complete error of omission does not affect the agreement of trial balance whereas partial error of omission may or may not affect the agreement of trial balance. For example, Rs. 100 paid to Ram is neither recorded in the cash book nor in the account of Ram, this error will not affect the agreement of trial balance. Only the total of the trial balance would be short by Rs. 100. But if posting is not done in one of the accounts, this will affect the agreement of trial balance.

b) Errors of Commission

Errors of commission take place when some transactions are incorrectly recorded in the books of accounts. Such errors include errors on account of wrong balancing of an account, wrong posting, wrong totaling, wrong carry forwards, etc. For example, if a sum of Rs. 255 received from Hari is credited to his account as Rs. 525, this is an error of commission. Similarly, if a sum of Rs. 500 paid to Suresh is credited to Sohans account such an error is an error of commission. Some of the errors of commission affect the agreement of trial balance whereas others do not. Errors affecting the agreement of trial balance can be easily revealed by preparing a trial balance.

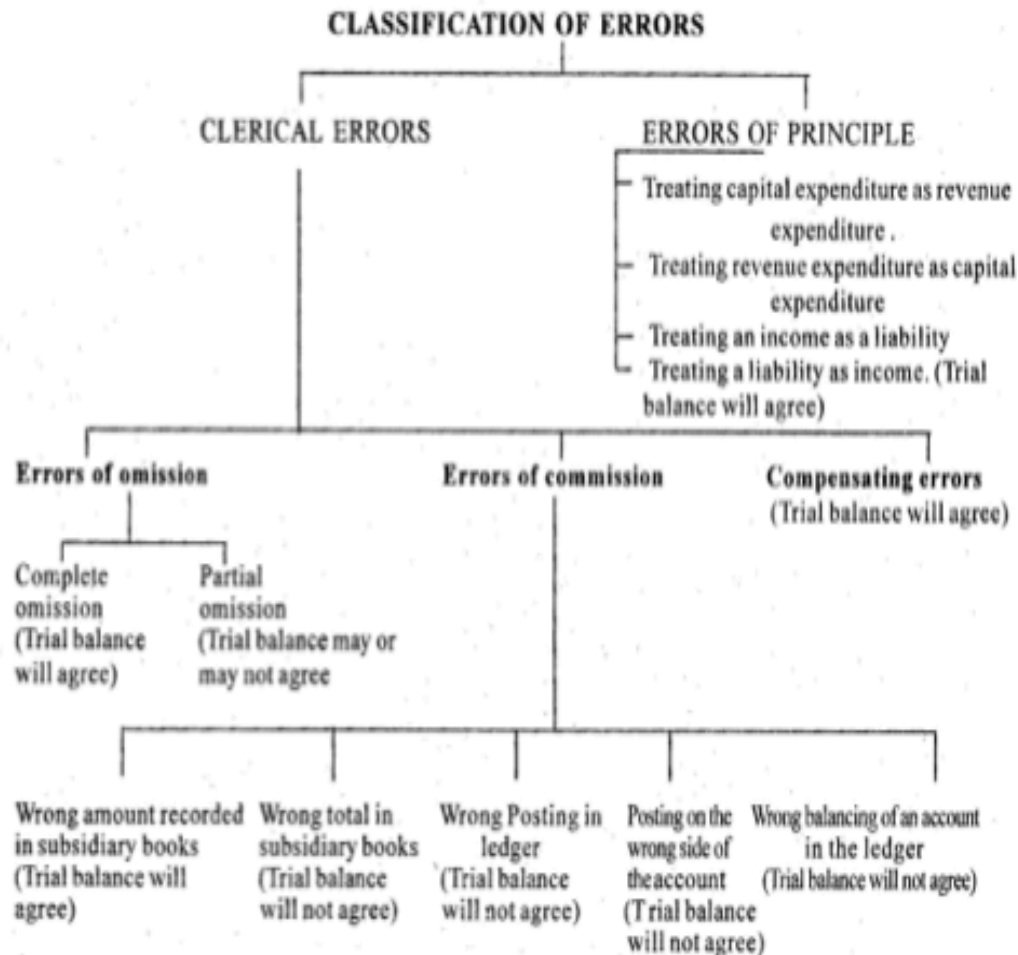
c) Compensating Errors

These errors, also called self-balancing or equalizing errors, are a group of errors, the total effect of which is not reflected in the trial balance. These errors are of a neutralizing nature. One error is compensated by the other error or by errors of an opposite nature. For example, Amitabhs account is credited with Rs. 500 instead of Rs. 600; Abhijits account credited with Rs. 160 instead of Rs. 100 and Jayas account credited with Rs. 150 instead of Rs. 110. Here the first error of under-credit of Rs. 100 is covered by second and third errors of over- credit of Rs. 60 and Rs. 40 respectively.

Errors of Principle

When a transaction is recorded against the fundamental principles of accounting, it is an error of principle. These errors arise because of the failure to differentiate capital and revenue items i.e. a capital expenditure is taken as a revenue expenditure or vice-versa. Similarly, a capital receipt may have been taken as a

revenue receipt or vice-versa. For example, a sum of Rs. 50 paid on the repairs of furniture should be debited to repairs account, but if it is debited to the furniture account, it will be termed as an error of principle. Repair of furniture is revenue expenditure. If it is debited to furniture account, it has been taken as a capital expenditure. Such errors do not affect the agreement of the trial balance because they are correctly recorded so far as the debit or credit side of the wrong class of account is concerned. It would be appreciated that such an error arises through lack of knowledge of principles of accountancy.



LOCATION OF ERRORS

The location of errors of omissions, compensations and principles are slightly difficult because of the fact that such errors do not affect the agreement of trial

balance. However, the locations of some errors of commission are comparatively easier because they affect the agreement of the trial balance. Thus, the errors can be classified into two categories from the point of view of locating them:

Errors, which do not affect the agreement of Trial Balance: As stated, errors of omission, errors of compensating nature and errors of principle do not affect the agreement of the trial balance. Their location is, therefore, a difficult task. These are usually found out when the statements of accounts are sent to the customers or received by the business or during the course of audit and sometimes by chance. For example, if a credit sale of Rs. 2000 to Suresh has not been recorded in the books of accounts, the error will not affect the agreement of the trial balance and therefore, at the time of finalizing the accounts it may not be traced out. However, this will be found out when a statement of account is received from Suresh showing the money payable by him or when a statement of account is sent to Suresh showing the money due from him.

Errors which affect the agreement of Trial balance

The errors, which cause a mismatch in the trial balance totals are frequently referred to as errors disclosed by a trial balance. However, the mismatch does not automatically point out the actual errors. It is only the diligence and ingenuity of the person preparing the accounts, which would help in the location of errors. The procedure to be followed for location of such errors can be put as follows:

- i) The totals of the trial balance itself should be thoroughly rechecked in order to find out exact or correct difference.
- ii) Make sure that the balances of cash and banks are included.
- iii) The difference of the two sides of the trial balance should be found and be divided by two and then find out whether a figure equal to the same (i.e. half the difference) appears in the trial balance. This procedure would enable to locate the amount placed on the wrong side.
- iv) If the error remains undetected, divide the exact difference by 9. If it is divisible by 9, this will mean that there may be transposition error or slide error. A transposition error is committed when the digit of an amount is misplaced. For example, machinery account has a balance of Rs. 5689, but it has been written as Rs. 5869 in the trial balance. The resulting error is Rs.

180, which is divisible by 9. A slide error is committed when the decimal point is placed incorrectly. For example, Rs. 3670 is copied as Rs. 36.70. The resulting error is Rs. 3633.30, which is also divisible by 9.

- v) See that there is no mistake in balancing of the various accounts.
- vi) The schedules of debtors and creditors should be scrutinised so as to find out that all the debtors and creditors have been included in these schedules; their totals are correct.
- vii) If the difference is of a substantial amount, compare the figures of trial balance of the current year with the trial balance of the preceding year and see whether there is any abnormal difference between the balances of important accounts of the two trial balances.
- viii) The total of subsidiary books should be checked and it should be seen whether posting has been done from these books correctly to respective accounts in the ledger or not.
- ix) It should be checked that opening balances have been correctly brought forward in the current years books.
- x) If the difference is still not traced, check thoroughly the books of original entry and their posting into the ledger and finally the balancing of various accounts.
- xi) If the error still remains undetected, repeat the above steps with the help of other members of the staff, who are not involved in maintaining the books of accounts.

RECTIFICATION OF ERRORS

From the point of view of rectification of errors, these can be divided into two groups:

- a) Errors affecting one account only.
- b) Errors affecting two or more accounts.

Errors affecting One Account

The following errors affect only one account:

- (a) Errors of posting
- (b) Carry forward
- (c) Balancing
- (d) Omission from trial balance

(e) Casting

Such errors should first of all be located and rectified. These are rectified either with the help of journal entry or by giving an explanatory notes in the account concerned and not by simply crossing the wrong amount and inserting the right one.

Errors affecting two or more accounts

The following errors affect two or more accounts:

- (a) Errors of omission
- (b) Posting to wrong account
- (c) Principles

As these errors affect two or more accounts, rectification of such errors is done with the help of a journal entry.

STAGES OF RECTIFICATION OF ERRORS

All types of errors can be rectified at two stages:

- i) Before the Preparation of Final Accounts.
- ii) After the Preparation of Final Accounts.

Rectification of errors before the preparation of final accounts

If the error is located before the preparation of final accounts, it is either rectified by recording or posting the necessary amount in the respective account or by recording the necessary journal entry to rectify that error. If the error is one sided, it can be rectified by recording or posting the necessary amount in that account. If it is two sided, the necessary journal entry is recorded.

a) Rectification of One-sided errors

These are the errors, which affect one account and will affect the agreement of trial balance. Debiting or crediting the affected account in the ledger rectifies such errors. For example:

- i) Purchase Book has been undercast by Rs. 2,000.

The error is only in purchases account. If Rs. 2000 is now posted in the debit side of purchase account as To undercasting of Purchase Book , the error will be rectified.

- ii) Amount of Rs. 1000 paid to Hari not debited to his personal account.

This error is affecting the personal account of Hari and its debit side is less by Rs. 1000 because of omission to post the amount paid. We shall now write on the

debit side of Hari Account as To Cash (omitted to be posted) Rs. 1000 to rectify this error.

iii) Goods sold to Khan wrongly debited in Sales account:

This error is affecting the sales account only as the amount, which should have been posted on the credit side has been wrongly placed on the debit side of the same account. By putting double the amount of transaction on the credit side of sales account by writing By sales to Khan wrongly debited previously, this error shall be rectified.

b) Rectification of two sided errors

As these errors affect two or more accounts, rectification of such errors can often be done with the help of a journal entry. These type of errors do not affect the agreement of trial balance. For example, if furniture purchased has been recorded through purchase book, two accounts viz. purchases account and furniture account are affected. Thus, rectification will be made by taking these two accounts. When such errors are to be rectified, the following procedure should be followed:

1. What has been done? The journal entry, which has been recorded:

INCORRECT ENTRY

Purchase Account - Dr.

To Suppliers Account

2. What should have been done? The correct entry, which was to be recorded:

CORRECT ENTRY

Furniture Account - Dr.

To Suppliers Accounts

3. What should now be done? The rectifying entry, which is now to be recorded:

RECTIFIED JOURNAL ENTRY

Furniture Account Dr.

To Purchases Account rectification of an error

ILLUSTRATION: An amount of Rs. 4000 paid to R. Ramesha has been credited to the account of S. Ramesha. It is obvious that the credit, placed wrongly to the account of S.Ramesha, should be transferred to the account of R.Ramesha. The correcting entry is:

		Rs.	Rs.
S. Ramesha's Account	Dr.	4,000	
	To R.Ramesha's Account		4,000

Rectification of errors after the preparation of final accounts

The rectification of errors after the preparation of final accounts depends upon the nature of error. If an error is a one sided error, it can be corrected by passing a rectifying entry with the help of the Suspense Account and if the error is two sided, it is rectified by passing a rectifying entry in both the affected accounts and such errors are not rectified through Suspense Account.

Suspense account

In case, the accountant is not in a position to locate the difference in the totals of the trial balance and he is in a hurry to close the books of accounts, he may transfer the difference to an account known as Suspense Account. After transferring the difference, the trial balance is totaled and balanced. On locating the errors in the beginning or during the course of next year, suitable accounting entries are passed and the Suspense Account is closed. However, the Suspense Account should be opened only when the accountant has failed to locate the errors in spite of his best efforts. It should not be by way of a normal practice, because the very existence of the Suspense Account creates doubt about the authenticity of the books of accounts.