TOPIC 2

ACCOUNTING PROCESS-JOURNAL ENTRIES

DOUBLE ENTRY SYSTEM

- Developed by 'Luca Pacioli' of Italy in 15^{th} Century.
- According to this system every transaction has two aspects & both the aspects should be recorded in the books of accounts.
- For every debit there is a equal & corresponding credit and vice-versa.

Ex. Purchase of computer for cash 50000.
Answer:

Computer A/c	Dr.	50000	
To Cash A/c			50000

ADAVANTAGES OF DOUBLE ENTRY SYSTEM

(i) By the use of this system the accuracy of the accounting work can be established, through the device of the trial balance.

(ii) The profit earned or loss suffered during a period can be ascertained together with details.

(iii) The financial position of the firm or the institution concerned can be ascertained at the end of each period, through preparation of the balance sheet.

(iv) The system permits accounts to be kept in as much details as necessary and, therefore affords significant information for the purposes of control etc.

(v) Result of one year may be compared with those of previous years and reasons for the change may be ascertained.

ACCOUNTS

- Account is the summary of transaction and events of similar nature, recorded sequentially under a particular head is called account.
- Accounts are usually prepared in T-form.

Ledger Account

Date	Particulars	Ref.	Amount	Date	Particulars	Ref.	Amount

DEBIT AND CREDIT

Debit	Credit
Left side of an accounts	Right side of an accounts

s

Particulars	Debit	Credit
Assets	Increase	Decrease
Liabilities	Decrease	Increase
Capital	Decrease	Increase
Income	Decrease	Increase
Expenses	Increase	Decrease

TRANSACTIONS

A transaction is an activity of the business which changes its financial position. For recording transaction, it is very important that they are supported by a substantial document like purchasing invoices, bills, pay-slips, cash-memos, passbook etc.
To analyse the dual aspect of each transaction, two approaches can be followed:

Approaches to analyse Double Entry System

Accounting Equation Approaches   Traditional Approaches

Accounting Equation Approach

The relationship of assets with that of liabilities and owners' equity in the equation form is known as 'Accounting Equation'.

Assets = Liabilities + Capital
or
Assets – Liabilities = Capital

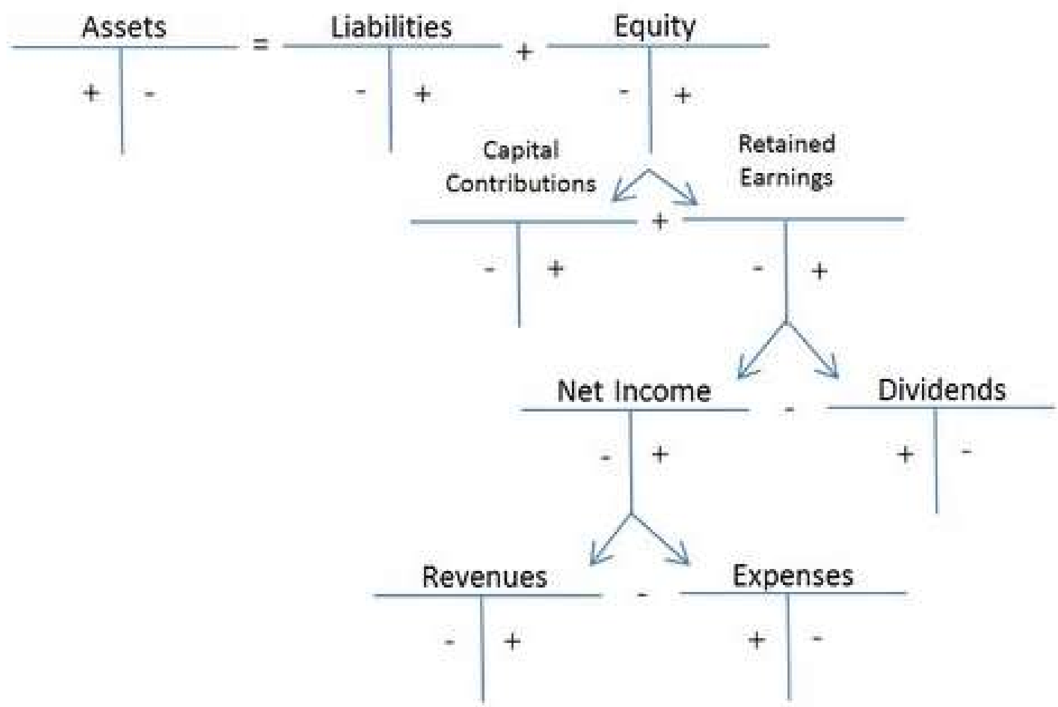
To understand the equation better, let us expand it:-

Assets = Liabilities + Stockholders' Equity

Assets = Liabilities + (contributed capital + beginning retained earnings + revenue - expense - dividends)

Here,
Contributed capital = the original capital introduced by the owner.

Beginning retained earnings = previous earnings not distributed to the shareholders.
Revenue = generated from the ongoing activities of the business
Expenses = cost incurred for the operations of the company.
Dividends = earnings distributed to the shareholders of the company



Class Example.

1. Which of the following represents the accounting equation - Assets = Liabilities + Owner's equity:
   (a) Income Statement
   (b) Statement of Cash flows
   (c) Balance Sheet.

2.

	Transactions	Total Assets Rs	= Liabilities Rs	+ Owner's Capital Rs
(1)	Started business with cash Rs 10,00,000	10,00,000		10,00,000
(2)	Borrowed Rs 5,00,000			
(3)	Withdrew cash from business Rs 2,00,000	+ 5,00,000	+ 5,00,000	
(4)	Loan repaid to the extent of Rs 1,00,000			
		- 2,00,000		- 2,00,000

	- 1,00,000	- 1,00,000		
Balance	**12,00,000**	**= 4,00,000**	**+ 8,00,000**	

Traditional Approaches

Transactions in the journal are recorded on the basis of the rules of debit and credit only. For the purpose of recording, these transactions are classified in three groups:

- Personal transactions.
- Transactions related to assets and properties.
- Transactions related to expenses, losses, income and gains.

Classification of Accounts

Personal accounts			**Impersonal Accounts**	
(Relate to persons, trade receivables or trade payables)			**(All accounts other than the personal accounts)**	
Natural personal Accounts	Artificial personal Accounts	Representative personal Accounts	Real Accounts	Nominal Accounts
Related to Individuals or Natural person.(Alia, Ranbir)	Related to entities recognised by Law. (Government,companies, clubs, societies)	Which represent certain Person or a Group. (capital a/c, drawing a/c).	Which represent Assets of the firm both Tangible and Intangible. (car,FA,cash)	Accounts related to Incomes, Gains, Expenses, Losses

Golden Rules of Accounting

Types of Account	**Account to be Debited**	**Account to be Credited**
Personal Account	Receiver	Giver
Real Account	What comes in	What goes out
Nominal Account	Expense and losses	Income and gains

Class Example:

3.The debts written off as bad, if recovered subsequently are

(a) Credited to Bad Debts Recovered Account

(b) Credited to Trade receivables Account.

(c) Debited to Profit and Loss Account.

4.From the following information, state the nature of account and state which account will be debited and which will be credited.**(ICAI)**

1. Started business with a capital of Rs 50,00,000.
2. Wages and salaries paid Rs 50,000
3. Rent received Rs 2,00,000
4. Purchased goods on credit Rs 9,00,000
5. Sold goods for Rs 8,16,000 and received payment in cheque.

SOLUTION

Transaction	**ACCOUNTS INVOLVED**	**NATURE**	**DEBIT OR CREDIT**	**Journal Entry**
Started business with capital of Rs 50,00,000	Bank account Capital account	Personal Personal	Debit (Receiver) Credit (giver)	Bank A/c Dr. To Capital A/c
Wages and salaries paid	Wages/salaries Bank	Nominal Personal	Debit (expense) Credit (giver)	Wages/ Salaries Dr. To Bank A/c
Rent received	Bank Rent	Personal Nominal	Debit (Receiver) Credit (income)	Bank A/c Dr. To Rent A/c
Purchases made on credit	Purchases Creditor	Nominal Personal	Debit (expense) Credit (giver)	Purchases A/c Dr. To Creditor A/c
Goods sold and payment received in cheque	Bank Sales	Personal Nominal	Debit (Receiver) Credit (gains)	Bank A/c Dr. To Sales A/c

Modern Classification of Accounts

Now, let us see the modern and more acceptable classification of accounts:-

Types of account	**Normal balance of account**	**A Increase to the account**	**A decrease to the accounts**
Asset account	Debit	Debit	Credit
Liabilities account	Credit	Credit	Debit
Capital account	Credit	Credit	Debit
Revenue account	Credit	Credit	Debit
Expenditure account	Debit	Debit	Credit
Drawing account	Debit	Debit	Credit

Class Example:5.

Accounts involved	**Nature**	**Debit/Credit**	**Reason**
Bank	Asset	Debit	Increase
Capital	Liability	Credit	Increase
Wages /salaries	Expense	Debit	Increase
Bank	Asset	Credit	Decrease
Bank	Asset	Debit	Increase
Rent	Revenue	Credit	Increase
Purchase	Expanse	Debit	Increase
Creditor	Liability	Credit	Increase
Bank	Asset	Debit	Increase
Sales	Revenue	Credit	Increase

JOURNAL

It is the First book of accounts in which transaction are originally recorded. It is also known as books of Original Entry or Subsidiary book. All the transactions are recorded in a Chronological order.

JOURNAL

Date (Rs) (1)	Particulars Rs (2)	L.F. (3)	Dr. Amount Rs (4)	Cr. Amount Rs. (5)

ADVANTAGES OF JOURNAL

- Complete recording of all transaction in chronological order.
- Narrations written below each journal entry help to understand the transaction.
- Journal forms the basis for posting the entries in the ledger.

PRACTICAL QUESTION

Question 1 (ICAI MODULE)

Analyse transactions of M/s Sahil & Co. for the month of March, 2017 on the basis of double entry system by adopting the following approaches:

(A) Accounting Equation Approach.

(B) Traditional Approach.

Transactions for the month of March, 2017 were as follows (figures are in '000):

1. Sahil introduced capital through bank of Rs 4,000.
2. Cash withdrawn from the City Bank Rs 200.
3. Loan of Rs 500 taken from Mr. Y.
4. Salaries paid for the month of March, 2017, Rs 300 and Rs 100 is still payable for the month of March, 2017.
5. Furniture purchased Rs 500.

Question 2 (ICAI MODULE)

Journalise the following transactions. Also state the nature of each account involved in the Journal entry.

Following figures are given in ('00)

1. December 1, 2016, Ajit started business with capital Rs 4,00,000
2. December 3, he withdrew cash for business from the Bank Rs 2,000.
3. December 5, he purchased goods making payment through bankvRs 15,000.
4. December 8, he sold goods Rs 16,000 and received payment through bank.
5. December 10, he purchased furniture and paid by cheque Rs 2,500.
6. December 12, he sold goods to Arvind Rs 2,400.
7. December 14, he purchased goods from Amrit Rs 10,000.

8. December 15, he returned goods to Amrit Rs 500.
9. December 16, he received from Arvind Rs 2,300 in full settlement.
10. December 18, he withdrew goods for personal use Rs 1,000.
11. December 20, he withdrew cash from business for personal use Rs 2,000.
12. December 24, he paid telephone charges Rs 110.
13. December 26, amount paid to Amrit in full settlement Rs 9,450.
14. December 31, paid for stationery Rs 200, rent Rs 5,000 and salaries to staff2,000.
15. December 31, goods distributed by way of free samples Rs 2,000.

Question 3 (ICAI MODULE)

Show the classification of the following Accounts under traditional and accounting equation approach:

(a) Building; (b) Purchases; (c) Sales; (d) Bank Fixed Deposit; (e) Rent; (f) Rent Outstanding; (g) Cash; (h) Adjusted Purchases; (i) Closing Inventory; (j) Investments; (k) Trade receivables; (l) Sales Tax Payable, (m) Discount Allowed;
(n) Bad Debts; (o) Capital; (p) Drawings; (q) Interest Receivable account; (r) Rent received in advance account; (s) Prepaid salary account; (t) Bad debts recovered account; (u) Depreciation account, (v) Personal income-tax account.

Question 4 (ICAI MODULE)

Transactions of Ramesh for April are given below. Journalise them.

2017	**Rs**
April 1 Ramesh started business with	10,00,000
" 3 Bought goods for cash	50,000
" 5 Drew cash from bank	10,000
" 13 Sold to Krishna- goods on credit	1,50,000
" 20 Bought from Shyam goods on credit	2,25,000
" 24 Received from Krishna	1,45,000
" Allowed him discount	5,000
" 28 Paid Shyam cash	2,15,000
" Discount allowed	10,000
" 30 Cash sales for the month	8,00,000
Paid Rent	50,000
Paid Salary	1,00,000

Question 5 (ICAI MODULE)

Show the classification of the following Accounts under traditional and accounting equation approach:

a. Rent outstanding
b. Closing Inventory
c. Sales
d. Bank Fixed Deposit
e. Cash
f. Bad Debts
g. Capital
h. Sales Tax Payable
i. Trade receivables
j. Depreciation
k. Drawings

Question 4 (ICAI MODULE)

Pass Journal Entries for the following transactions in the books of Gamma Bros.

(i) Employees had taken inventory worth Rs 1,00,000 (Cost price Rs 75,000) on the eve of Deepawali and the same was deducted from their salaries in the subsequent month.

(ii) Wages paid for erection of Machinery Rs 18,000.

(iii) Income tax liability of proprietor Rs 1,17000 was paid out of petty cash.

(iv) Purchase of goods from Naveen of the list price of Rs 2,00,000. He allowed 10% trade discount, Rs 5,000 cash discount was also allowed for quick payment.

Question 5 (ICAI MODULE)

Calculate the missing amount for the following.

	Assets	Liabilities	Capital
(a)	15,00,000	2,50,000	?
(b)	?	1,50,000	75,000
(c)	14,50,000	?	13,75,000
(d)	57,00,000	- 2,80,000	?

Question 6 (ICAI MODULE)

Show the effect of increase = (+), decrease = (-) and no change=(0) on the assets of the following transactions:

a. Purchased office furniture, payment to be made next month.
b. Collected cash for repair services
c. Goods sold on credit.
d. Withdrawal of cash by the owner for personal use.
e. Hired an employee as sales manager of the north wing.
f. Returned goods worth Rs 50,000.
g. One of our debtors agreed to pay his dues to Mr. C who is a creditor of the company with the same amount being due to him.
h. Entered into an agreement with Mehta & Co. to purchase all raw materials from their company from next year.

Also give reasons for your answers.

Question 7 (ICAI MODULE)

Following is the information provided by Mr. Gopi pertaining to year ended 31st March 2017. Find the unknowns, showing computation to support your answer:

Particulars	**Rs**	**Particulars**	**Rs**
Machinery	1200000	Trade Receivables	B
Accounts payable	100000	Loans	C
Inventory	60000	Closing capital	D
Total liabilities including capital	1415000	Opening capital	1000000
Cash		Loss incurred during the year	35000
Bank	A	Capital introduce during the year	100000
	80000		

Additional Information: During the year sales of Rs 15,55,000 was made of which Rs 15,00,000 have been received.

(Answer hint: A-20,000, B-55,000, C-2,50,000, D-10,65,000)

TOPIC 3
LEDGERS

LEDGERS

The book which contains all set of accounts (viz. personal, real and nominal accounts), is known as Ledger. It is known as principal books of account in which account-wise balance of each account is determined.

SPECIMEN OF LEDGER ACCOUNTS

Dr. **Account** Cr.

Date	**Particulars**	**J.F.**	**Amount (Rs)**	**Date**	**Particulars**	**J.F.**	**Amount (Rs)**

POSTING

The process of transferring the debit and credit items from journal to classified accounts in the ledger is known as posting.

RULES REGARDING POSTING OF ENTRIES IN THE LEDGERS

- Open the respective ledgers accounts for recording entries recorded in journal.
- Use words 'To' and 'By' on Debit and Credit side respectively.
- The concerned account debited in the journal should also be debited in the ledger but reference should be of the respective credit account.

BALANCING AN ACCOUNT

- The difference between the totals of debits and credit sides is found out as the balance.
- In the ledger Book, the balances of Assets, Liabilities and Capital are carried forward to the next period. Revenue and Expense accounts are closed by transferring their totals to Trading and Profit and Loss A/c.

Debit Balance Write as on right side 'By Balance c/d'

Credit Balance Write as on lift side 'To Balance c/d'

PRACTICAL QUESTION

QUESTION 1. (ICAI MODULE)

Prepare the Stationery Account of a firm for the year ended 31.12.2015 duly balanced of, from the following details:

2015		**Rs.**
Jan. 1	Inventory of stationery	480
April 5	Purchase of stationery by cheque Purchase of stationery	800
Nov. 15	on credit from Five Star Stationery Mart Inventory of stationery	1,280
Dec. 31		240

QUESTION 2. (ICAI MODULE)

Prepare the ledger accounts on the basis of following transactions in the books of a trader.

Debit Balances on January 1, 2015:

Cash in Hand Rs 8,000, Cash at Bank Rs 25,000, inventory of Goods Rs 20,000, Building Rs 10,000. Trade receivables:

Vijay Rs 2,000 and Madhu Rs 2,000.

Credit Balances on January 1, 2015:

Trade payables: Anand Rs 5,000, Capital Rs 55,000

Following were further transactions in the month of January, 2015:

Jan. 1 Purchased goods worth RS 5,000 (payable at later date) for cash less 20% trade discount and 5% cash discount.

Jan. 4 Received Rs 1,980 from Vijay and allowed him Rs 20 as discount.

Jan. 8 Purchased plant from Mukesh for Rs 5,000 and paid Rs 100 as cartage for bringing the plant to the factory and another Rs 200 as installation charges.

Jan. 12 Sold goods to Rahim on credit Rs 600.

Jan. 15 Rahim became insolvent and could pay only 50 paise in a rupee.

Jan. 18 Sold goods to Ram for cash Rs 1,000.

QUESTION 3. (ICAI MODULE)

The following data is given by Mr. S, the owner, with a request to compile only the two personal accounts of Mr. H and Mr. R, in his ledger, for the month of April, 2015.

1 Mr. S owes Mr. R Rs 15,000; Mr. H owes Mr. S Rs 20,000.

4 Mr. R sold goods worth Rs 60,000 @ 10% trade discount to Mr. S.

5 Mr. S sold to Mr. H goods prices at Rs 30,000.

17 Record a purchase of Rs 25,000 net from R, which were sold to H at a profit of Rs 15,000.

18 Mr. S rejected 10% of Mr. R's goods of 4th April.

19 Mr. S issued a cash memo for Rs 10,000 to Mr. H who came personally for this consignment of goods, urgently needed by him.

22 Mr. H cleared half his total dues to Mr. S, enjoying a $\frac{1}{2}$% cash discount (of the payment received,Rs 20,000 was by cheque).

26 R's total dues (less Rs10,000 held back) were cleared by cheque, enjoying a cash discount of Rs 1,000 on the payment mode.

29 Close H's Account to record the fact that all but Rs 5,000 was cleared by him, by a cheque, because he was declared bankrupt.

30 Balance R's Account.

TOPIC 4
TRIAL BALANCE

INTRODUCTION

- Preparation of trial balance is the third phase in the accounting process.

JOURNAL

↓

LEDGERS

↓

TRIAL BALANCE

MEANING OF TRIAL BALANCE

A statement which shows separately the debit and credit balances is known as the trial balance.

OBJECTIVES OF PREPARING THE TRIAL BALANCE

- To check arithmetical accuracy of transactions recorded in book of accounts.
- Helps in preparation of Profit and Loss account and Balance Sheet.
- Acts as a summary of various ledgers accounts.

FORMAT OF TRIAL BALANCE

Trial Balance
as at......................

Sr. No.	**Ledger Accounts**	**L.F.**	**Dr. Amount** (Total or Balance) Rs	**Cr. Amount** (Total or Balance) Rs

LIMITATIONS OF TRIAL BALANCE

Agreement of trial balance dose not mean that accounts are free all types of errors
These may be of the following types:

- Transaction has not been entered at all in the journal.

- A wrong amount has been written in both columns of the journal.
- A wrong account has been mentioned in the journal.
- An entry has not at all been posted in the ledger.
- Entry is posted twice in the ledger.

METHODS OF PREPARATION OF TRIAL BALANCE

Total Method	Balance Method	Total & Balance
• Total of debit & credit Side each ledger account transferred to the Trial Balance. • This method inconvenient. • Also called as Gross Trial Balance.	• Differential balance of each ledger account is transferred to trial balance. • Simple & scientific . • Also called as Net Trial Balance.	• Combination of two method.

QUESTION 1. (ICAI MODULE)

Given below is a ledger extract relating to the business of X and Co. as on March, 31, 2016. You are required to prepare the Trial Balance by the Total Amount Method.

Dr. **Cash Account** Cr.

Particulars	Rs	Particulars	Rs
To Capital A/c	10,000	By Furniture A/c	3,000
To Ram's A/c	25,000	By Salaries A/c	2,500
To Cash Sales	500	By Shyam's A/c	21,000
		By Cash Purchases	1,000
		By Capital A/c	500
		By Balance c/d	7,500
	35,500		35,500

Dr. **Furniture Account** Cr.

Particulars	Rs	Particulars	Rs.
To Cash A/c	3000	By balance c/d	3000
	3000		3000

Dr. **Salaries Account** Cr.

Particulars	Rs	Particulars	Rs.
To Cash A/c	2500	By balance c/d	2500
	2500		2500

Dr. **Shyam's Account** Cr.

Particulars	Rs	Particulars	Rs.
To Cash A/c	21000	By balance c/d (credit Purchase)	25000
To purchase returns A/c	500		
To balanced c/d	3500		-
	25000		25000

Dr. **Purchases Account** Cr.

Particulars	Rs	Particulars	Rs.
To Cash A/c (cash purchase)	1000	By balance c/d	26000
To sundries as per purchase book (credit purchase)	25000		-
	26000		26000

Dr. **Purchases Returns Account** Cr.

Particulars	Rs	Particulars	Rs.
To balance c/d	500	By sundries as per purchase return book	500
	500		500

Dr. **Ram's Account** Cr.

Particulars	Rs	Particulars	Rs.
To sale A/c (credit sale)	30000	By sale return A/c	100
		By cash A/c	25000
		By Balanced c/d	4900
	30000		30000

Sales Account

Particulars	Rs	Particulars	Rs.
To balanced c/d	30500	By Cash A/c (cash sales)	500
		By sundries as per sale book (credit sales)	30000
	30500		30500

Sales Returns Account

Particulars	Rs	Particulars	Rs.
To sundries as per sale return book	100	By balance c/d	100
	100		100

Dr. **Capital Account** Cr.

Particulars	Rs	Particulars	Rs.
To cash A/c	500	By cash A/c	10000
To Balance c/d	9500		
	10000		10000

ADJUSTED TRIAL BALANCE (THROUGH SUSPENSE ACCOUNT)

- If two sides of Trial Balance does not agree its implies that there are certain one side errors in recording transaction in books of accounts.
- In such case the difference in Trial Balance is part in a separate account called Suspense Account until the errors are located.
- Suspense Account treated as a temporary Account created to avoid delay preparation of statement.

QUESTION 2. (ICAI MODULE)

Taking the same information as given in QUESTION 1, prepare the Trial Balance by Balance Method.

RULES OF PREPARING THE TRIAL BALANCE

Debit **Credit**

Balance of	**Balance of**
▪ Assets A/c	▪ Liabilities A/c
▪ Losses	▪ Capital A/c
▪ Cash & Bank A/c	▪ Income
▪ Expenses A/c	▪ Profits
▪ Drawings	

QUESTION 3 (ICAI MODULE)

From the following ledger balances, prepare a trial balance of Anuradha Traders as on 31st March, 2016:

Account Head	**Rs**
Capital	1,00,000
Sales	1,66,000
Purchases	1,50,000
Sales return	1,000
Discount allowed	2,000
Expenses	10,000
Trade receivables	75,000
Trade payables	25,000
Investments	15,000
Cash at bank and in hand	37,000
Interest received on investments	1,500
Insurance paid	2,500

QUESTION 4. (ICAI MODULE)

One of your clients, Mr. Singhania has asked you to finalise his accounts for the year ended 31st March, 2016. Tilldate, he himself has recorded the transactions in books of accounts. As a basis for audit, Mr. Singhania furnishedyou with the following statement.

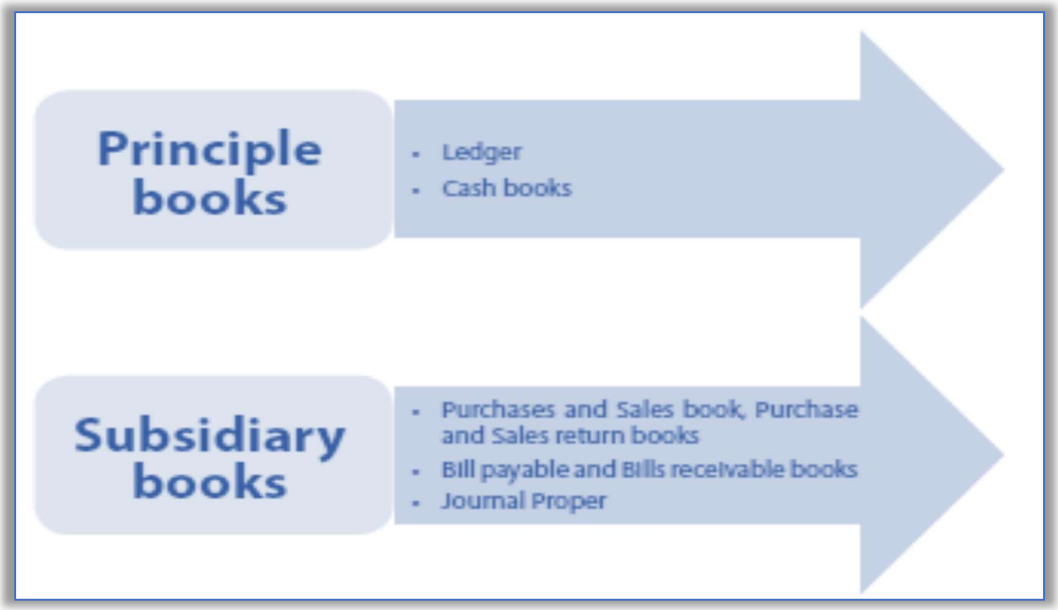
	Dr. Balance (Rs)	**Cr. Balance (Rs)**
Singhania's Capital		1,556
Singhania's Drawings	564	

Leasehold premises	750	
Sales		2,750
Due from customers		530
Purchases	1,259	
Purchases return	264	
Loan from bank		256
Trade payables	528	
Trade expenses	700	
Cash at bank	226	
Bills payable	100	
Salaries and wages	600	
Inventories (1.4.2015)		264
Rent and rates	463	
Sales return		98
	5,454	5,454

The closing inventory on 31st March, 2016 was valued at Rs574. Mr. Singhania claims that he has recorded everytransaction correctly as the trial balance is tallied. Check the accuracy of the above trial balance.

Topic 5
SUBSIDIARY BOOKS

Unit Overview



Meaning

- Subsidiary books are books of original entry.
- In the normal course of business, a majority of transactions are either relate to sales, purchases or cash. So record transactions of the same or similar nature in one place, i.e. the subsidiary book.
- And record these transactions in chronological order.

Advantages of Subsidiary Books

- Division of work
- Saving of time
- Availability of information
- Facilities of checking
- Specialization and Efficiency

Cash Book	It is a book which records the receipts and payment of cash transaction.
Purchase Book	It is a book which records all the credit purchases of goods of the company.
Purchase Return Book	It is a book which records all the return of credit purchases of goods of the company.

Sale Book	It is a book which records all the credit sales of goods of the company.
Sale Return Book	It is a book which records all the return of credit sales of goods of the company.
Bills Receivable Book	It is a book which records all the bills receivable.
Bills Payable Book	It is a book which records all the bills payable.
Journal	All the transactions which are not recorded in the other books are recorded here.

Difference between Subsidiary books & Principal books.

Principal Books	Subsidiary Books
In the Principal Book will contain only the consolidated entry to facilitate the preparation of final accounts.	In the Subsidiary Book all the details of particular transaction are recorded
• Ledgers	• Purchase Book • Sale Book • Purchase Return Book • Sales Return Book • Bills Receivable Book • Bills payable Book • Cash Book • Journal

QUESTION 1. (ICAI MODULE)

The Rough Book of M/s. Narain & Co. contains the following:

Feb. 2016

1. Purchased from Brown & Co. on credit:
   5 gross pencils @ Rs 100 per gross,
   1 gross registers @ Rs 240 per doz.
   Less: Trade Discount @ 10%
2. Purchased for cash from the Stationery Mart;
   10 gross exercise books @ Rs 300 per doz.
3. Purchased computer for office use from M/s. office Goods Co. on credit for Rs 30,000.
4. Purchased on credit from The Paper Co.
   5 reams of white paper @ Rs 100 per ream.
   10 reams of ruled paper @ Rs 150 per ream.
   Less: Trade Discount @ 10%
5. Purchased one dozen gel pens @ Rs 15 each from M/s. Verma Bros. on credit.
   Make out the **Purchase Book** of M/s. Narain & Co.

SOLUTION

Purchases Book

Date 2016	**Particulars**	**Rs**	**L.F.**	**Amount Rs.**
Feb 1.	M/s Brown & Co.			
	5 gross pencils @ Rs 100 per gross,	500		
	1 gross registers @ Rs 240 per doz.	2880		
		3380		
	Less: Trade Discount @ 10%	(338)		3042
Feb 4	The Paper Co.			
	5 reams of white paper @ Rs 100 per ream.	500		
	10 reams of ruled paper @ Rs 150 per ream.	1500		
		2000		
Feb 5	Less: Trade Discount @ 10%	(200)		1800
	M/s. Verma Bros.			
	1 doz gel pens @Rs 15	180		180
		Total		
				5022

Note: Purchases of cash and purchase of computer cannot be entered in the Purchase Book.

QUESTION 2. (ICAI MODULE)

Enter the following transactions in **Purchase Book and post them into ledger**.

2017

April 4 Purchased from Ajay Enterprises, Delhi
100 Doz. Rexona Hawai Chappal
@ Rs 120 per doz.
200 Doz. Palki Leather Chappal
@ Rs300 per Doz.
Less: Trade discount @ 10%

Freight charged Rs 150.

April 15 Purchased from Balaji Traders, Delhi
50 doz. Max Shoes
@ Rs 400 per doz.
100 pair Sports Shoes.
@ Rs 140 per paid.
Less: Trade discount @ 10%.
Freight charged Rs 200.

April 28 Purchased from Tripti Industries, Bahadurgarh
40 pair leather shoes
@ Rs 400 per pair
100 doz. Rosy Hawai Chappal
@ Rs 180 per doz.
Less: Trade discount @ 10%.
Freight charged Rs 100.

SOLUTION

Purchase Book

Date 2017	Particulars	Gross Amount	Trade Discount	Net Price	Fright	Total Amount
April 4	Ajay Enterprise 100 doz chappal @Rs 120 per doz –Rs 12000, 200 doz palki leather chappal @ Rs 300 per doz Rs 60000 Less: trade discount @ 10%	**72000**	**7200**	**64800**	**150**	**64950**
April 15	Balaji Traders, Delhi 50 doz max shoes @Rs 400 per doz – Rs 20000 100 pair sport shoes @Rs 140 per pair - 14000 Less: Trade discount @10%	**34000**	**3400**	**30600**	**200**	**30800**
April 28	Tripati Industries, Bahadurgarh 40 pair Leather shoes @ Rs 400 per pair -16000,					

100 doz Rosy Hawai Chappai:@ Rs 180 per doz- Rs 18000

Less: Trade discount @ 10%

34000	**3400**	**30600**	**100**	**30700**
140000	**14000**	**126000**	**450**	**126450**

Ledgers

Purchases A/c

Dr.					Cr
2017		**Rs**	**2017**		**Rs**
April 30	To amount as per purchase book	126000			

Freight A/c

Dr.					Cr.
2017		**Rs**	**2017**		**Rs**
April 30	To amount as per purchase book	450			

Ajay Enterprises

Dr.					Cr.
2017		**Rs**	**2017**		**Rs**
			April 30	By Purchase A/c	64800
				By Fright A/c	150

Balaji Traders

Dr.					Cr.
2017		**Rs**	**2017**		**Rs**
			April 15	By Purchase A/c	30600
				By Fright A/c	200

Tripti Industries

Dr.					Cr.
2017		**Rs**	**2017**		**Rs**
			April 28	By Purchase A/c	30600

	By Fright A/c 100

QUESTION 3. (ICAI MODULE)

The following are some of the transaction of M/s Kishore & Sons of the year 2017 as per their Waste Book.

Make out their **Sales Book.**

Sold to M/s. Gupta & Verma on credit:

30 shirts @ Rs 800 per shirt.

20 trousers @ Rs1,000 per trouser.

Less : Trade Discount @ 10%

Sold furniture to M/s. Sehgal & Co. on credit Rs 8,000.

Sold 50 shirts of M/s. Jain & Sons @ Rs 800 per shirt.

Sold 13 shirts to Cheap Stores @ Rs 750 each for cash.

Sold on credit to M/s. Mathur & Jain.

100 shirts @ Rs 750 per shirt

10 overcoats @ Rs 5,000 per overcoat.

Less: Trade Discount @ 10%

SOLUTION

Sales Book

Date	Particular	Details Rs	L.F.	Amount Rs
2017	M/s. Gupta & Verma			
	30 shirts @ Rs 800	24000		
	20 trousers @ Rs1,000	20000		
		44000		
	Less : Trade Discount @ 10%	(4400)		
	Sales as per invoice no. dated……			39600
	M/s. Jain & Sons			
	50 shirts @ Rs800			40000
	M/s. Mathur & Jain.			
	Sales as per invoice no. dated……			
	100 shirts @ Rs 750	75000		
	10 overcoats @ Rs 5,000 Less:	50000		

	125000	
Less: 10%	(12500)	112500
Sales as per invoice no. dated……	Total	192100

Note: Cash sale and sale of furniture are not entered in Sales Book.

QUESTION 4. (ICAI MODULE)

Post the following into the ledger

Returns Outward Book

Date 2017	**Particulars**	**L.F.**	**Details Rs**	**Amount Rs**
Nov 20	Rajindra Prakash & Sons			
	One 36" Usha Ceiling Fan		200.00	
	Less : Trade Discount @ 10%		(20.00)	180.00
Nov 30	Modern Electric Company			100.00
	Total			280.00

SOLUTION

Ledger

Dr. **Rajindra Parkash & Sons** Cr.

Date 2017	**Particulars**	**Folio**	**Amount**	**Date**	**Particulars**	**Folio**	**Amount**
Nov 20	To Returns Outward A/c		180.00				

Dr. **Modern Electric Co.** Cr.

Date 2017	**Particulars**	**Folio**	**Amount**	**Date**	**Particulars**	**Folio**	**Amount**
Nov 30	To Returns Outward A/c		100.00				

Dr. **Returns Outward Account** Cr.

Date 2017	Particulars	Folio	Amount	Date	Particulars	Folio	Amount
				Nov 30	By sundries as per returns outward A/c		280.00

QUESTION 5. (ICAI MODULE)

From the following transactions, prepare the Purchases Returns Book of Alpha & Co., a saree dealer and post them to ledger :

Date	Debit Note No.	Particulars
04.01.2016	101	Returned to Goyal Mills, Surat - 5 polyester sarees @ Rs 1,000.
09.01.2016		Garg Mills, Kota - accepted the return of goods (which were purchased for cash) from us - 5 Kota sarees @ Rs 400.
16.01.2016	102	Returned to Mittal Mills, Bangalore - 5 silk sarees @ Rs 2,600.
30.01.2016		Returned one computer (being defective) @ Rs 35,000 to B & Co.

SOLUTION

Purchase Returns Book

Date 2016	Debit Note No.	Name of Supplier	L.F.	Amount
Jan. 4	101	Goyal Mills, Surat		5,000
Jan. 16	102	Mittal Mills, Bangalore		13,000
Jan. 31		Purchases Returns Account (Cr.)		18,000

Topic 6 CASH BOOK

CASH BOOK

Cash transactions are straightaway recorded in the Cash Book and on the basis of such a record, ledger accounts are prepared. Therefore, the Cash Book is a subsidiary book. But the Cash Book itself serves as the cash account and the bank account; the balances are entered in the trial balance directly. The Cash Book, therefore, is part of the ledger also. Hence, it has also to be treated as the principal book. The Cash Book is thus both a subsidiary book and a principal book.

- It records transaction concerning Cash Receipts & Payment.
- Cash book has two side

  Debit side – Record Cash & Cheque received.

  Credit side – Record cash & Cheque payments.

KINDS OF CASH BOOK

Simple Cash Book	Record only Cash transaction
Two column Cash Book	Record transaction (Cash) along with discount allowed & discount received.
Three column Cash Book	Record Cash,Bank,& Discount transaction.

SIMPLE CASH BOOK

Such a cash book appears like an ordinary account, with one amount column on each side. The left-hand side records receipts of cash and the right-hand side the payments.

Balancing of the Cash Book: The cash book is balanced like other accounts. The total of receipts column is always greater than total of payments column. The difference is written on the credit side as 'By balance c/d'.

The totals are then entered in the two columns opposite one another and then on the debit side the balance is written as "To Balance b/d", to show cash balance in hand in the beginning of next period.

Dr., **Cr.**

Date	Particulars	L.F	Amount	Date	Particulars	L.F	Amount

Class Example 1.

Enter the following transactions in a Simple Cash Book:

2016		Rs
Jan 1	Cash in hand	1200
" 5	Received from Ram	300
" 7	Paid Rent	30
" 8	Sold goods for each	300
" 10	Paid to Shyam	700
" 27	Purchased furniture	200
" 31	Paid Salaries	100
" 31	Rent due, not yet paid for january	30

SOLUTION

Dr. **Cash Book** **Cr.**

Date 2016	Receipt	L.F.	Amount Rs	Date 2016	Payment	L.F.	Amount Rs
Jan 11	To Balance b/d		1200	Jan 7	By Rent A/c		30
Jan 5	To Ram A/c		300	Jan 10	By Shyam A/c		700
Jan 8	To Sales A/c		300	Jan 27	By Furniture A/c		200
				Jan 31	By Salaries A/c		
				Jan 31	By Balance c/d		100
							770
			1800				1800

2016

Feb 1	To Balance b/d	770

Note: One can see the following:

(i) In the simple cash book only the cash receipts and cash payments are recorded.

(ii) The total of debit side is always greater than the total of credit side since the payment cannot exceed the available cash.

(iii) The simple cash book is like an ordinary account.

Double Column Cash Book

If along with columns for amounts to record cash receipts and cash payments another column is added on each side to record the cash discount allowed or the discount received, or a column on the debit side showing bank receipts and another column on the credit side showing payments through bank. It is a double-column cash book.

Cash discount is an allowance which often accompanies cash payments.

In the cash column on the debit side, actual cash received is entered; the amount of the discount allowed, if any, to the customer concerned is entered in the discount column. Similarly, actual cash paid is entered in the cash column on the payments side and discount received in the discount column. Also the bank column on the debit side records all receipts through bank and the same column on the credit side shows payment through bank.

Balancing: It should be noted that the discount columns are not balanced. They are merely totaled. The total of the discount column on the receipts side shows total discount allowed to customers and is debited to the Discount Account. The total of the column on the payments side shows total discount received and is credited to the Discount Account. The Cash columns are balanced, as already shown. The bank columns are also balanced and the balancing figure is called bank balance. Thus a double column cash book should have two columns on each side comprising of either cash and discount transaction or cash and bank transactions.

Dr									Cr.
Date	**Particulars**	**L.F**	**Discount**	**Amount**	**Date**	**Particulars**	**L.F**	**Discount**	**Amount**

Class Example 2.

Ganesh commenced business on 1st April, 2017 with Rs 2,000 as capital. He had the following cash transactions in the month of April 2017:

		Rs			Rs
April 1	Purchased furniture and paid cash	250	April 7	Paid for petty expenses	15
"2	Purchased goods	500		Cash purchases	150
"4	Sold goods for cash	950	13	Paid for labour	1000
"5	Paid cash to Ram Mohan	560	" "	Paid Ali & Sons	400
"6	He allowed discount	10		They allowed discount	8
"6	Received cash from Krishna & Co.	600	" "		
	Allowed discount	20			

Make out the two-column Cash Book (Cash and discount column) for the month of April, 2017.

SOLUTION

Dr. Date 2017	**Receipts**	**L.F**	**Discount Rs**	**Amount Rs**	**Date 2017**	**Payment**	**L.F.**	**Discount Rs**	**Cr. Amount Rs**

April 1	To Capital A/c		2000	April 1	By Furniture A/c		250
"4	To Sales A/c		950	"2	By Purchases A/c		500
"6	To Krishna A/c	20	600	"'5	By Ram Mohan	10	560
				"7	By Petty Expenses A/c		15
				"8	By Purchases A/c		150
				"13	By wages A/c		1000
				"13	By Ali & Sons	8	400
				"30	By Balance c/d		675
		20	3550			18	3550
May 1	To Balance b/d		675				

To summaries:

(i) the discount columns in the cash book are totalled;

(ii) they are not balanced; and

(iii) Their totals are entered in the discount received/paid account in the ledger.

Note: The person who pays, is credited by both the cash paid by him and the discount allowed to him. Similarly, the person to whom payment is made, is debited with both the amount paid and the discount allowed by him.

THREE COLUMN CASH BOOK

A firm normally keeps the bulk of its funds at a bank; money can be deposited and withdrawn at will if it is current account. Probably payments into and out of the bank are more numerous than strict cash transactions. There is only a little difference between cash in hand and money at bank. Therefore, it is very convenient if, on each side in the cash book, another column is added to record cash deposited at bank (on the receipt side of the cash book) and payments out of the bank (on the payment side of the cash book).

Balancing: The discount columns are totalled but not balanced. The cash columns are balanced exactly in the same manner as indicated for the simple cash book. The process is similar for balancing the bank columns also. It is possible, however, that the bank may allow the firm to withdraw more than the amount deposited i.e., to have an overdraft. In such a case, the total of the bank column on the credit side is bigger than the one on the debit side. The difference is written on the debit side as "To Balance c/d." Then the totals are written on the two sides opposite one another, the balance is then entered on the credit side as "By Balance b/d."

However, the usual case is that payments into the bank will exceed the withdrawals or payments out of the bank. Then the bank columns are balanced just like the cash columns.

Dr. **Cr.**

Date	**Particulars**	**L.F**	**Discount**	**Cash**	**Bank**	**Date**	**Particulars**	**L.F**	**Discount**	**Cash**	**Bank**

- CONTRA ENTRY – Which involves both Cash& Bank transactions.
  Class Example: 3- Cash withdrawn form bank 10,000.
  Class Example :4- Cash deposited in Bank 25,000.

Answer:

3.	Cash A/c	Dr.	10,000	
	To Bank A/c			10000
4.	Bank A/c	Dr.	25,000	
	To Cash A/c			25,000

Class Example 5.

Enter the following transactions in Cash Book with Discount and Bank Columns. Cheques are first treated as cash receipt.

2016		Rs
Jan.1	Chandrika commences business with Cash	20,000
"3	He paid into Current A/c	19,000
"4	He received cheque from Kirti & Co. on account	600
"7	He pays in bank Kirty& Co.'s cheque	600
"10	He pays Rattan & Co. by cheque and is allowed discount Rs 20	330
	Tripathi & Co. pays into his Bank A/c	
"12	He receives cheque from Warshi and allows him discount Rs 35	475
"15		450
	He receives cash Rs 75 and cheque Rs 100 for cash sale	
"20	He pays into Bank, including cheques received on 15th and 20th	
"25		1,000
	He pays by cheque for cash purchase	
	He pays sundry expenses in cash	
"27		275
"30		50

SOLUTION

Dr. **Cash Book** **Cr.**

Date	Receipts	L. F.	Discount Rs	Cash Rs	Bank Rs	Date	Payment	L. F.	Discount Rs	Cash Rs	Bank Rs
2016						2016					
Jan 1	To capital A/c			20000		Jan 3	By bank A/c	C		19000	
3	To cash	C			19000	7	By bank A/c	C		600	
4	To Kriti & Co.			600		10	By Ratan & Co.				330
7	To cash	C			600		By Bank A/c		20		
12	To Tripathi & Co.				475	25	By purchase A/c	C		1000	
15	To warship		35	450		27				275	
							By S Exp. A/c				
20	To Sales A/c			175					20		
25	To Cash	C			1000	30				50	

				31	By c/d	Balance		
	35	27225	21075				300	20745
To balance B.d		300	20745				21225	21075

PETTY CASH BOOK

- A book used to record petty cash expenses of the business is called Petty Cash Book.
- Maintained by **petty cashier**.
- A definite sum of money to the petty cashier in the beginning of a period and to reimburse him for payments made at the end of the period& again the fixed amount in the beginning of the new period. Such a system is known as the **Imprest system of petty cash**.

Receipt Rs	**Date 2016**	**V.No**	**Particulars**	**Total Rs**	**Conveyance Rs**	**Cartage Rs**	**Stationery**	**Postage & Telegra**	**Wages Rs**	**Sundries Rs**

ENTRIES FOR SALE THROUGH CREDIT/DEBIT CARDS

- Now-a-days sales through Credit/Debit Cards are issued by almost every Bank in India either directly orwith collaboration of some other agencies.
- Debit Card is issued by bank to a customer who has an account with the bank, maintaining a minimum balance. Debit card is16 digit number and also the name of the cardholder.
- Credit Card is issued by bank to a prospective customer, after verifying his credibility, which is generally measured by his income sources.Bank charges annual subscription fees from the credit card holder.
- The bank issuing the Card, charges commission for each such transaction, which varies between 1% to 4% and is immediately debited to seller's bank account.

ACCOUNTING FOR CREDIT/DEBIT CARD SALE

From the seller's point of view. Commission charged by thebank will be treated as selling expenses.

The following journal entries will be made in the seller's books ofaccounts.

1. Bank A/c Dr.
   To Sales Account
   (Sales made through Credit/Debit Card)
2. Commission Account Dr.
   To Bank Account
   (Commission charged by bank)

Class example 6

Prepare a Petty Cash Book on the imprest System from the following:

2016		**Rs**
Jan. 1	Received Rs 100 for petty cash	
" 2	Paid bus fare	50
" 2	Paid cartage	2.50
" 3	Paid for Postage & Telegrams	5.00
" 4	Paid wages for casual labourers	6.00
" 4	Paid for stationery	4.00
" 5	Paid tonga charges	2.00
" 5	Paid for the repairs to chairs	15.00
" 5	Bus fare	1.00
" 5	Cartage	4.00
" 6	Postage and Telegrams	7.00
" 6	Tonga charges	3.00
" 6	Cartage	3.00
" 6	Stationery	2.00
" 6	Refreshments to customers	5.00

SOLUTION

Receipt Rs	**Date 2016**	**V. No**	**Particulars**	**Total Rs**	**Conveyance Rs**	**Cartage Rs**	**Stationery**	**Postage & Telegram Rs**	**Wages Rs**	**Sundries Rs**
100	Jan 1		To cash							
	2	1	By Conveyance	.50	0.50	2.50				
		2	By cartage	2.50				5.00		
	3	3	By postage and Telegram	5.00						

		4	By wages	6.00					6.00	
	4	5	By stationery	4.00			4.00			
		6	By conveyence	2.00	2.00					
	5	7	By repairs to furniture	15.00						15.00
		8	By conveyance	1.00	1.00					
		9	By cartage	4.00		4.00				
	6	10	By postage & telegram	7.00				7.00		
	"	11	By conveyance	3.00	3.00					
	"	12	By cartage	3.00		3.00				
	"	13	By stationery	2.00			2.00			
	"	14	By general expenses	5.00						5.00
			By balance c/d	60.00	6.50	9.50	6.00	12.00	6.00	20.00
				40.00						
100			To balance c/d							
40			To cash	100.00						
60	8									

PRACTICAL QUESTIONS

QUESTION 1. (ICAI MODULE)

Enter the following transaction in Cash Bank with Discount and Bank columns. Cheques are first treated as cash receipts -

2016		**Rs**
March 1	Cash in Hand	15,000
	Overdraft in Bank	500
2	Cash Sales	3,000
3	Paid to Sushil Bros. by cheque	3,400

	Discount received	100
5	Sales through credit card	2,800
6	Received cheque from Srijan	6,200
7	Endorsed Srijan's cheque in favour of Adit	
9	Deposit into Bank	6,800
10	Received cheque from Aviral and deposited the same into Bank by allowing discount of Rs 50	3,600
12	Adit informed that Srijan's cheque is dishonoured. Now cash is received from Srijan and amount is paid to Adit through own cheque	
	Sales through Debit Card	
15	Withdrawn from Bank	3,200
24	Paid to Sanchit by cheque	1,800
28	Bank charged 1% commission on sales through Debit/Credit Cards	3,000
30		

QUESTION 2. (ICAI MODULE)

Shri Ramaswamy maintains a Columnar Petty Cash Book on the Imprest System. The imprest amount is Rs 500. From the following information, show how his Petty Cash Book would appear for the week ended12th September, 2015:

7-9-2015	Balance in hand	134.90
	Received Cash reimbursement to make up the imprest	365.10
	Stationery	49.80
8-9-2015	Miscellaneous Expenses	20.90
9-9-2015	Repairs	156.70
10-9-2015	Travelling	68.50
11-9-2015	Stationery	71.40

12-9-2015	Miscellaneous Expenses	6.30
	Repairs	48.30

QUESTION 3. (RTP MAY 2018)

Prepare a Triple Column Cash Book from the following transactions and bring down the balance for the start of next month:

Nov. 2017		**Rs**
1	Cash in hand	3,000
1	Cash at bank	12,000
2	Paid into bank	1,000
5	Bought furniture and issued cheque	1,500
8	Purchased goods for cash	500
12	Received cash from Mohan	980
	Discount allowed to him	20
14	Cash sales	5,000
16	Paid to Amar by cheque	1,450
	Discount received	50
19	Paid into Bank	500
23	Withdrawn from Bank for Private expenses	600
24	Received cheque from Parul	1,430
	Allowed him discount	20
26	Deposited Parul's cheque into Bank	
28	Withdrew cash from Bank for Office use	2,000
30	Paid rent by cheque	800

CHAPTER 7 - INVENTORIES

DEFINITION

1. Inventory can be defined as assets held
   - for sale in the ordinary course of business, **(FG)** or
   - in the process of production for such sale, **(WIP)** or
   - Which is in the form of materials/supplies to be consumed in the production of goods or rendering of services. **(RM)**
2. Inventory classified under '**current assets'** generally.
3. Inventory is measured (value Karana) at every '**Balance Sheet'**.
4. Inventories refer to the closing stock of goods a company has at the end of a specific period (usually a financial year).
5. **Accounting standard – 2** covers all the provisions relating to inventory.

Balance Sheet as on

31.3.2021

Liabilities	Amount	Assets	Amount
capital		**Closing stock**	
		cash	
		Assets	

Trading and profit & loss account

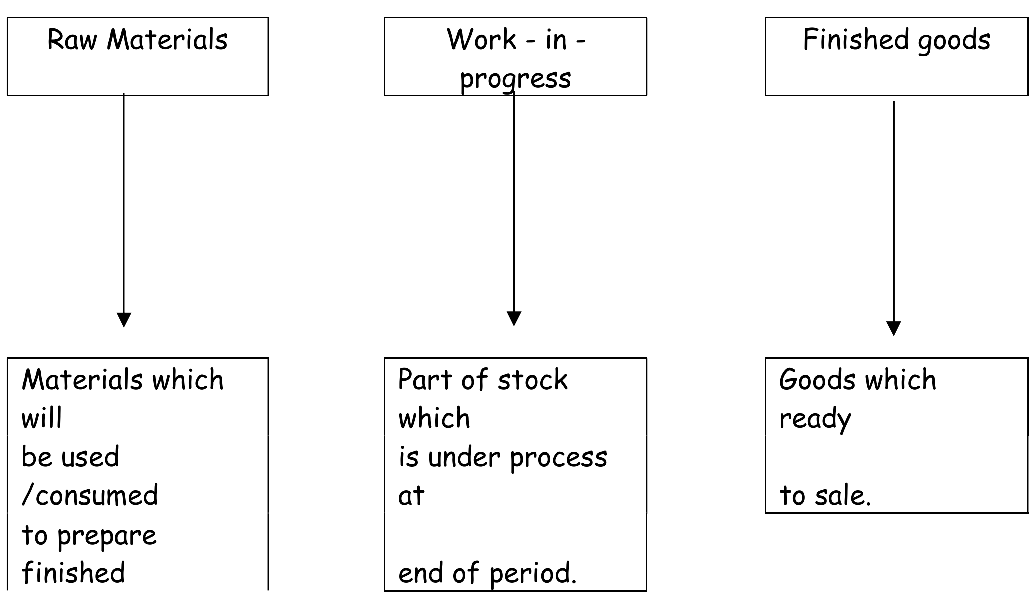
For the year ended 31.3.21

Particulars	amount	Particulars	amount
To opening stock		By sales	
To purchase		**By closing stock**	
To direct expense			
To gross profit			

PURPOSE OF VALUATION OF INVENTORY

- Determination of income.
- Ascertainment of financial position
- Liquidity analysis
- Statutory Compliances

INVENTORY

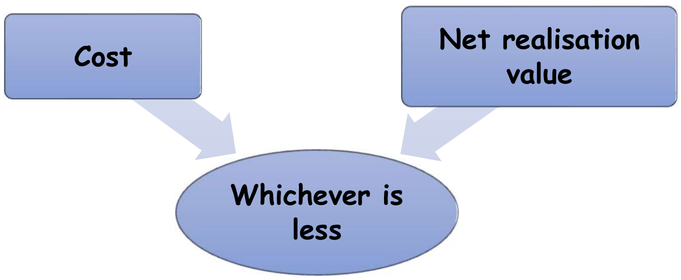


goods.

BASIS OF INVENTORY VALUATION

Inventories should be generally **valued at the lower of cost or net realizable value**.

(*Based on prudence & conservatism)*



COST

Cost includes

- All cost of purchase, *(Nonrefundable taxes, freight)*
- Costs of conversion, *(raw material ko FG main convert Karne ka cost)*
- Other costs incurred in bringing the inventories to their present location & condition.

  (Transportation cost, transit insurance)

Cost of purchase consist of purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining costs of purchase.

Costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of _xed and variable overheads.

Other Costs may include administrative overheads incurred to bring the inventory into present location and condition or any cost specifically incurred on inventory of a specified customer. Interest and other borrowing costs are generally not included in the cost of inventory. However, in some circumstances where production process is longer and it is required to carry inventory for a long period e.g. wine, rice and timber it may be appropriate to consider interest and other borrowing cost also part of cost of inventory.

Cost excludes

- Abnormal losses
- Storage costs
- Administrative overheads that do not contribute
- selling and distribution costs

NET REALIZABLE VALUE

In case of finished goods the estimated price of a finished good after deducting the costs to make the sale.

In the case of raw materials, it will be the replacement cost of the raw materials, i.e. their market price. &

WIP it will be the selling price minus the cost of conversion.

INVENTORY RECORD SYSTEMS

Recording of stock can be done by two different methods

1. **PERIODIC INVENTORY SYSTEM;**

Periodic inventory system is a method of ascertaining inventory by taking an **actual physical count (or measure or weight)** of all the inventory items on hand at a **particular date** on which inventory is valued. It is because of actual physical count that the system is also called physical inventory system. The cost of goods sold is determined as shown below:

Opening inventory (known) + Purchases (known) - closing inventory (physically counted) = Cost of goods sold.

Limitations

(i) Physical inventory taking is required more than once a year for preparation of quarterly or half yearly financial statements thereby making this system more expensive.

(ii) Physical count of goods requires closure of normal operations of business.

(iii) As cost of goods sold is taken as residual figure, it is not possible to identify loss of goods due to pilferage, damage or even fraud.

(iv) Inventory control is not possible under this system.

(v) Books of accounts does not reflect inventory in hand and its value therefore, it is difficult to plan operations e.g. how much or when to order/manufacture.

2. ***PERPETUAL INVENTORY SYSTEM;***

Perpetual inventory system is a system of **recording inventory balances after each receipt and issue.** In order to ensure accuracy of perpetual inventory records, physical inventory should be checked and compared with recorded balances. Under this system, cost of goods issued is directly determined and inventory of goods is taken as residual figure with the help of inventory ledger in which flow of goods is recorded on continuous basis. The basic feature of this system is the maintenance of inventory ledger to have records of goods on continuous basis. Under perpetual inventory system, closing inventory is determined as follows:

Opening inventory (known) + Purchases during the period (known) – Cost of Goods Sold (known) = Closing Inventory (balancing figure)

S. No.	Periodic Inventory System	Perpetual Inventory System
1.	This system is based on physical verification.	It is based on book records.
2.	This system provides information about inventory and cost of goods sold at a particular date.	It provides continuous information about inventory and cost of sales.
3.	This system determines inventory and takes cost of goods sold as residual figure.	It directly determines cost of goods sold and computes inventory as balancing figure.
4.	Cost of goods sold includes loss of goods as goods not in inventory are assumed to be sold.	Closing inventory includes loss of goods as all unsold goods are assumed to be in Inventory.
	Under this method, inventory control is not possible.	Inventory control can be exercised under this system.
5.	This system is simple and less expensive.	It is costlier method.
6.	Periodic system requires closure of business for counting of inventory.	Inventory can be determined without affecting the operations of the business.

7.

HOW TO CALCULTE INVENTORY?

Opening stock @ cost	---------
+ Purchase @ cost	---------
+Direct expenses @ cost	---------
Total cost	--------
Cost of Sale (COGS)	--------

GROSS PROFIT = Sale – COGS

Class ex.1

Cost of opening stock 50000 @cost as on 1 June

Goods purchase in June month 880000 @cost

In June month 62000 cost of goods sold @750000

Calculate Closing stock & gross profit?

Solution

Opening stock @ cost	*50000*
+ Purchase @ cost	*880000*
+Direct expenses @ cost	*nil*
Total cost	*930000*
-Cost of Sale	*(620000)*
Value Closing stock	*310000*

Gross profit = Sale – COGS = 750000- 620000= 130000

Class ex. 2

Opening stock @ cost 75000

Purchase cost 520000

Sold 70% of purchase goods @ 20% above cost

Calculate closing stock & gross profit.

Solution

Opening stock @ cost	*75000*	
+ Purchase @ cost	*520000*	
+Direct expenses @ cost	*nil*	
Total cost	*595000*	
-Cost of Sale	*(364000)*	
Value Closing stock	*231000*	

Gross profit = sale – COGS = 436800 – 364000=72800

COST + PROFIT =SALE

100 + 20 = 120

364000 = 436800

Class ex.3

Opening stock -100 units @ 50 per unit.

Purchase – 800 units @58 per unit.

Sold 750units (out of which 100 entire opening stock@75 per units.)

Calculate the closing stock & gross profit

Solution

*Opening stock 100*50*	*5000*	
*+ Purchase 800*58*	*46400*	
		51400
-COGS	*42700*	
*(100*50+650*58)*		
Closing stock		*8700*

*Sale value =750*75=56250*

Gross profit = sale – COGS = 56250 - 42700=13550.

METHODS FOR VALUATION OF STOCK

1) **Historical Cost Method**

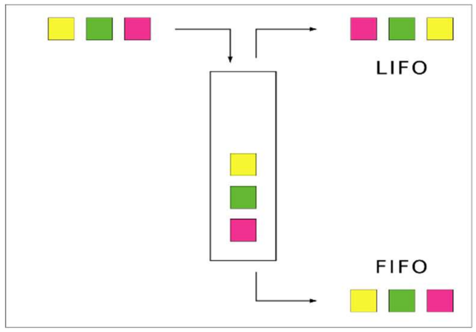
Historical cost means the cost actually paid to acquire material

A) FIFO (First in first out) Method

Goods received first are issued first and the stock includes latest purchase material. Inventory cost under FIFO method will be the cost of latest purchase.

B) LIFO (Last in first out) Method

Latest units are issued first and the stock includes earlier purchased goods. Inventory cost under LIFO method will be the cost of earliest purchases.



Class ex.4

Calculate the closing stock by FIFO AND LIFO

Opening stock = nil

Purchase

1. 1000 books @500 per books.
2. 1500 books @475 per books.
3. 500 books @ 495 per books.
4. 800 books @ 520 per books.

Admission =2500 students.

Solution

1. **FIFO**

= Total units - Units issue

= (1000+1500+500+800)-2500

= 1300 units

1300 units

500*495=247500 800*520=416000

Closing stock = 247500+416000=663500

2. **LIFO**

= Total units - Units issue

= (1000+1500+500+800)-2500

= 1300 units

1300 units

1000*500=500000 300*475=142500

Closing stock = 500000+142500=642500.

Class ex.5

Opening stock 500 @30 per units

Purchase 300@33 per units.

Sale 400.

Purchase 200@35 per units.

Sale 300 units.

Purchase 400 @32 per units.

Calculate closing stock by weighted average method.

Solution

A) 1^{st} issue

Closing stock = Total units of 1^{st} sale – sale

= (500+300)-400= 400

Average price per units= (500*30+300*33)/800=31.12 per units

Value of closing stock =400*31.13=12452/-.

B) 2nd sale

Closing stock =400+200-300=300

Average price per units= (400*31.13) + (200*35)/600=32.42 per units.

Value of closing stock=300*32.42=9726/-

C) Weighted average method

= [(300*32.42+400*32)/700=32.18 per units]

C) Simple Average Price Method

All the different prices of the purchases are added together and divided by the number of prices.

D) Weighted Average Price Method

Under weighted average price method, cost of goods available for sale during the period is aggregated and then divided by number of units available for sale during the period to calculate weighted average price per unit

Weighted average price per unit =

$$\frac{\text{Total cost of goods available for sale during the period}}{\text{Total number of units available for sale during the period}}$$

Closing inventory = No. of units in inventory × Weighted average price per unit

Cost of goods sold = No. of units sold × Weighted average price per unit.

Ex. So if we buy 100 goods at Rs 5/- and 200 goods at Rs 6/-, the weighted average rice will be (100×5) + (200×6) / 300 = 5.667/

Class ex.5

Opening stock 500 @30 per units

Purchase 300@33 per units.

Sale 400.

Purchase 200@35 per units.

Sale 300 units.

Purchase 400 @32 per units.

Calculate closing stock by weighted average method.

Solution

A) 1st issue

Closing stock = Total units of 1st sale – sale

= (500+300)-400= 400

Average price per units= (500*30+300*33)/800=31.12 per units

Value of closing stock =400*31.13=12452/-.

B) 2nd sale

Closing stock =400+200-300=300

Average price per units= (400*31.13) + (200*35)/600=32.42 per units.

Value of closing stock=300*32.42=9726/-

C) Weighted average method

= [(300*32.42+400*32)/700=32.18 per units]

E) Specific Identification Method

Pricing under this method is based on actual physical flow of goods. It attributes specific costs to identified goods and requires keeping different lots purchased separately to identify the lot out of which units in inventories are left.

2) Non-Historical Cost Method

Here purchasing price is not relevant.

A) Adjusted Selling Price Method/ retail inventory method

Stock of Closing Stock = Selling price of Closing stock – Gross profit ratio (Profit amount).

B) Standard Cost Method

Goods are valued at pre-decided standard cost.

INVENTORIES TAKING

Stock taking is reverse calculation of stock many times the value of stock is available few days after the closing date. Thus stock as on year ending date is calculated by reverse calculation called a stock taking.

MULTIPLE CHOICE QUESTIONS

1. The amount of purchase if
   Cost of goods sold is Rs 80,700
   Opening Inventory Rs 5,800
   Closing Inventory Rs 6,000
   (a) Rs 80,500 (b) Rs 74,900 (c) Rs 80,900.

2. Average Inventory = Rs 12,000. Closing Inventory is Rs 3,000 more than opening Inventory. The value of closing Inventory = _______.
   (a) Rs 12,000 (b) Rs 24,000 (c) Rs 13,500.

3. While finalizing the current year's profit, the company realized that there was an error in the valuation of closing Inventory of the previous year. In the previous year, closing Inventory was valued more by Rs 50,000. As a result
   (a) Previous year's profit is overstated and current year's profit is also overstated
   (b) Previous year's profit is overstated and current year's profit is understated
   (c) Previous year's profit is understated and current year's profit is also understated

4. Consider the following for Q Co. for the year 2015-16:
   Cost of goods available for sale Rs 1,00,000
   Total sales Rs 80,000
   Opening inventory of goods Rs 20,000
   Gross profit margin on sales 25%
   Closing inventory of goods for the year 2015-16 as
   (a) Rs 80,000 (b) Rs 60,000 (c) Rs 40,000

5. Average Inventory = Rs 12,000. Closing Inventory is Rs 3,000 more than opening Inventory. The value of closing Inventory = _______.
   (a) Rs 12,000 (b) Rs 24,000 (c) Rs 13,500

6. If the profit is 25% of the cost price then it is
   (a) 25% of the sales price
   (b) 33% of the sales price
   (c) 20% of the sales price

7. Goods purchased Rs 1,00,000. Sales Rs 90,000. Margin 20% on cost. Closing Inventory = ?
(a) Rs 20,000 (b) Rs 10,000 (c) Rs 25,000

8. A company is following weighted average cost method for valuing its inventory. The details of its purchase and issue of raw-materials during the week are as follows:
1.12.2015 opening Inventory 50 units value Rs 2,200.
2.12.2015 purchased 100 units @ Rs 47.
4.12.2015 issued 50 units.
5.12.2015 purchased 200 units @ Rs 48.
The value of inventory at the end of the week and the unit weighted average costs is
(a) Rs 14,200 – Rs 47.33 (b) Rs 14,300 – Rs 47.67 (c) Rs` 14,000 – Rs 46.66

9. The cost of sales is equal to
(a) Opening stock plus purchases
(b) Purchases minus Closing stock
(c) Opening stock plus purchases minus closing stock

10. Inventory is disclosed in financial statements under:
(a) Fixed Assets
(b) Current Assets
(c) Current Liabilities

11. Accounting Standards do not permit following method of inventory valuation
(a) FIFO
(b) Average cost
(c) LIFO

12. Which inventory costing formula calculates value of closing inventory considering that inventory most recently purchased has not been sold?
(a) FIFO
(b) LIFO
(c) Weighted average cost

13. Valuing inventory at cost or net releasable value is based on which principle
(a) Consistency (b) Conservatism (c) Going concern

14. Under inflationary trend, which of the methods will show highest value of inventory?
(a) FIFO
(b) Weighted average
(c) LIFO

15. Which of the following methods does not consider historical cost of inventory?
(a) Weighted average
(b) FIFO
(c)Retail price method

THEORETICAL QUESTIONS

1. Write short notes on:
   (i) Adjusted Selling Price method of determining cost of stock.
   (ii) Principal methods of ascertainment of cost of inventory.

2. Distinguish between:
   (i) LIFO and FIFO basis of costing of stock.
   (ii) FIFO and weighted average price method of stock costing.

3. Define inventory. Explain the importance of proper valuation of inventory in the preparation of statements of the business entity.

PRACTICE QUESTIONS

ILLUSTRATION 1 (ICAI MODULE)

A manufacturer has the following record of purchases of a condenser, which he uses while manufacturing radio sets:

Date	Quantity (units)	Price per unit
Dec. 4	900	50
Dec. 10	400	55
Dec. 11	300	55
Dec. 19	200	60
Dec. 28	800	47
	2600	

1,600 units were issued during the month of December till 18th December. By using FIFO method.

ILLUSTRATION 2 (ICAI MODULE)

A manufacturer has the following record of purchases of a condenser, which he uses while manufacturing radio sets:

Date	Quantity (units)	Price per unit

Dec. 4	900	50
Dec. 10	400	55
Dec. 11	300	55
Dec. 19	200	60
Dec. 28	800	47
	2600	

Record of Issues

Date	Quantity (Units)
Dec. 5	500
Dec. 20	600
Dec. 29	500
Total	1,600

let us calculate the value of closing inventory using LIFO Method

ILLUSTRATION 3

In the same example of a manufacturer of radio sets given earlier, let us calculate the value of closing inventory using Average Price Method

ILLUSTRATION 4 (ICAI MODULE)

A manufacturer has the following record of purchases of a condenser, which he uses while manufacturing radio sets:

Date	Quantity (units)	Price per unit
Dec. 4	900	50
Dec. 10	400	55
Dec. 11	300	55
Dec. 19	200	60

Dec. 28	800	47
	2600	

Record of Issues

Date	Quantity (Units)
Dec. 5	500
Dec. 20	600
Dec. 29	500
Total	1,600

calculate the value of closing inventory using weighted average price method.

ILLUSTRATION 5 (ICAI MODULE)

M/s X, Y and Z are in retail business, following information are obtained from their records for the year ended 31st March, 2016:

Goods received from suppliers	
(subject to trade discount and taxes)	15,75,500
Trade discount 3% and sales tax 11%	
Packaging and transportation charges	87,500
Sales during the year	22,45,500
Sales price of closing inventories	2,35,000

Find out the historical cost of inventories using adjusted selling price method. (ICAI SM)

ILLUSTRATION 6

From the following information, calculate the historical cost of inventories using adjusted selling price method:

	Rs
Sales during the year	2,00,000
Cost of purchases	2,00,000
Opening inventory	Nil
Closing inventory at selling price	50,000

ILLUSTRATION 7

From the following particulars ascertain the value of Inventories as on 31st March, 2017:

	Rs
Inventory as on 1.4.2016	1,42,500
Purchases	7,62,500

Manufacturing Expenses	1,50,000
Selling Expenses	60,500
Administrative Expenses	30,000
Financial Charges	21,500
Sales	12,45,000

At the time of valuing inventory as on 31st March, 2016, a sum of Rs 17,500 was written off on a particular item, which was originally purchased for Rs 50,000 and was sold during the year for Rs 45,000. Barring the transaction relating to this item, the gross profit earned during the year was 20 percent on sales.

ILLUSTRATION 8

A trader prepared his accounts on 31st March, each year. Due to some unavoidable reasons, no inventory taking could be possible till 15th April, 2017 on which date the total cost of goods in his godown came to Rs 5,00,000. The following facts were established between 31st March and 15th April, 2017.

(i) Sales Rs 4,10,000 (including cash sales Rs 1,00,000)

(ii) Purchases Rs 50,340 (including cash purchases Rs 19,900)

(iii) Sales Return Rs 10,000.

Goods are sold by the trader at a profit of 20% on sales.
You are required to ascertain the value of inventory as on 31st March, 2017.

ILLUSTRATION 9

Inventory taking for the year ended 31st March, 2016 was completed by 10th April 2016, the valuation of which showed a inventory figure of Rs 16,75,000 at cost as on the completion date. After the end of the accounting year and till the date of completion of inventory taking, sales for the next year were made for Rs 68,750, profit margin being 33.33 percent on cost. Purchases for the next year included in the inventory amounted to Rs 90,000 at cost less trade discount 10 percent. During this period, goods were added to inventory at the mark up price of Rs 3,000 in respect of sales returns. After inventory taking it was found that there were certain very old slow moving items costing Rs 11,250, which should be taken at Rs 5,250 to ensure disposal to an interested customer. Due to heavy flood, certain goods costing Rs 15,500 were received from the supplier beyond the delivery date of customer. As a result, the customer refused to take delivery and net realizable value of the goods was estimated to be Rs 12,500 on 31st March. Compute the value of inventory for inclusion in the final accounts for the year ended 30th March, 2016.

ILLUSTRATION 10

The following are the details of a spare part of Sriram mills:

1-1-2016	Opening Inventory	Nil
1-1-2016	Purchases	100 units @ Rs 30 per unit
15-1-2016	Issued for consumption	50 units
1-2-2016	Purchases	200 units @ Rs 40 per unit

15-2-2016	Issued for consumption	100 units
20-2-2016	Issued for consumption	100 units

Find out the value of Inventory as on 31-3-2016 if the company follows First in first out basis.

ILLUSTRATION 11

The following are the details of a spare part of Sriram Mills:

1-1-2016	Opening Inventory	Nil
1-1-2016	Purchases	100 units @ Rs 30 per unit
15-1-2016	Issued for consumption	50 units
1-2-2016	Purchases	200 units @ Rs 40 per unit
15-2-2016	Issued for consumption	100 units
20-2-2016	Issued for consumption	100 units

Find out the value of Inventory as on 31-3-2016 if the company follows Weighted Average basis.