



GOVERNMENT ARTS AND SCIENCE COLLEGE
(Affiliated to Manonmaniam Sundaranar University, Tirunelveli.)
KANAYAKUMARI- 629401.

STUDY MATERIAL FOR B.COM

FINANCIAL ACCOUNTING -I

SEMESTER – I



Academic Year 2022-2023

Prepared by

COMMERCE DEPARTMENT

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FINANCIAL ACCOUNTING -I
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Objectives

1. To acquire conceptual knowledge of financial accounting.
2. To impart skills for recording various kinds of business transactions

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Unit I

Accounting – Definition – Branches of Accounting – Functions of Accounting –Advantages – Limitations –Book keeping – Difference between Book keeping and Accounting –Users of Accounting information – Accounting Principles – Concepts and Conventions –Accounts and classification – Double entry system of Accounting – Journal – Ledger –Subsidiary Books – Trial balance – Final Accounts

Unit II

Bank Reconciliation Statement –Rectification of Errors – Suspense Account.

Unit III

Bills of Exchange- Essentials – Accounting Treatment – Renewal of the Bill – Noting Charges – Retiring the Bill – Insolvency – Accommodation Bill - Average Due Date – Account

Current.

Unit IV

Depreciation – Meaning – Causes – Types – Straight Line Method – Written Down Value Method – Annuity Method – Insurance Claims – Loss of Stock – Loss of Profit.

Unit V

Single Entry system – Meaning – Salient Features – Defects – Statement of Affairs Method – Conversion Method – Difference between Single entry and Double entry System – Self Balancing Ledger – Sectional Balancing System.

Text & Reference Books

1. S.P.Jain & K.L.Narang, Advanced Accountancy, Kalyani Publishers, New Delhi.
2. R.L.Gupta and M.Radhaswamy, Advanced Accountancy, Sultan Chand & Sons, New Delhi.
3. M.C.Shukla and T.S.Grewal, Advanced Accountancy, Sultan Chand & Co., New Delhi.
4. Dr.M.A.Arulanandam & K.S.Raman, Advanced Accountancy, Himalaya Publishing House, Mumbai.
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6. R.S.N.Pillai, Bagavathi & S.Uma, Fundamentals of Advanced Accounting, S.Chand & Company Ltd., New Delhi.

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UNIT-1

1. Financial Accounting - நிதிக் கணக்கில்
2. Debit - பற்று
3. Credit - வரவு
4. Profit - லாபம்
5. Loss - நஷ்டம்
6. Book keeping - கணக்கு பராமரிப்பு
7. Personal account - ஆள்சார் கணக்கு
8. Real account - சசாத்து கணக்கு
9. Nominal account - சபயரளவு கணக்கு
10. Single entry system - ஒற்றை பதிவு முறை
11. Double entry system - இரட்டை பதிவு முறை
12. Journal - குைிப்பபடு
13. Ledger - பபபரடு
14. Trial balance - இருப்புநிலை குறிப்பு
15. Subsidiary book - துறணபயடு

Definition of Accounting

1. According to A. W. Johnson; “Accounting may be defined as the collection, compilation and systematic recording of business transactions in terms of money, the preparation of financial reports, the analysis and interpretation of these reports and the use of these reports for the information and guidance of management”.
2. According to the American Accounting Association [AAA]: “Accounting refers to the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information”.

Branches of Accounting

The following are the main branches of accounting:

(a) Financial accounting:

Financial Accounting is that branch of accounting which involves identifying, measuring, recording, classifying, summarizing the business transactions, i.e. it involves the steps from Identifying, Recording of transactions to Summarization, and communicating the financial data.

(b) Cost accounting:

Cost Accounting is that branch of accounting which is concerned with the process of ascertaining and controlling the cost of products or services.

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(c) Management accounting:

Management accounting refers to that branch of accounting which is concerned with presenting the accounting information in such a way that helps the management in planning and controlling the operations of a business and in decision making.

Functions of Accounting

Historical Functions:

Historical function in accounting means keeping the accurate past transactional record of the business. To conduct this function you need to follow the below steps:

- Recording and managing journal of all monetary transactions
- Classifying the records in different ledgers
- Summaries for hassle-free reviews
- Final accounts preparation to know the financial position of the business
- Communicating financial information to the prospective sectors such as shareholder, researchers, government, suppliers etc.

Managerial Functions:

In a business, it is the responsibility of the finance managers to take decisions. So to make smooth decisions and to ensure accurate results they analyze the records of previous reports. Here are the six accounting managerial functions:

- Forming Plans
- Controlling financial policies
- Preparation of budget to obtain an approximate value of future expenditure.
- Controlling the cost by comparing cost and work efficiency
- Evaluating the performance of employees
- Analyzing errors and mistakes in the past record to make accurate reports

Advantages of Accounting

1. Provide information about financial performance

- Accounting provides factual information about financial performance during a given period of time
- Like, profit earned or loss incurred over a period and financial position at a particular point of time.

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2. Provide assistance to management

- Accounting helps management in business planning, decision making and in exercising control.
- For this, it provides financial information in the form of reports.

3. Facilitates comparative study

- By keeping systematic records and preparation of reports at regular intervals, accounting helps in making a comparison.

4. Helps in settlement of tax liability

- Systematic accounting records help in settlement of various tax liabilities. Such as – Income Tax, GST, etc.

6. Helpful in decision making

- Accounting provides useful information to the management for taking decisions.

Limitations of Accounting

Following are the limitations of accounting:

- **Accounting is not precise:** Accounting is not completely free from personal bias or judgment.
- **Accounting is done on historic values of assets:** Accounting records assets at their historical cost less depreciation. It does not reflect their current market value.
- **Ignore the effect of price level changes:** Accounting statements are prepared at historical cost. So changes in the value of money are ignored.
- **Ignore the qualitative information:** Accounting records only monetary transactions. It ignores the qualitative aspects.
- **Affected by window dressing:** Window dressing means manipulation in accounting to present a more favorable position of the business than the actual position.

Bookkeeping

Bookkeeping is the systematic recording and organizing of financial transactions in a company. Bookkeeping is the recording, on a day-to-day basis, of the financial transactions and information pertaining to a business. It ensures that records of the individual financial transactions are correct, up-to-date and comprehensive. Accuracy is therefore vital to the process.

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Difference between Bookkeeping and Accounting

Parameters	Bookkeeping	Accounting
Scope	Bookkeeping involves identifying, measuring, recording & classifying financial transactions in the ledger accounts.	In addition to bookkeeping, Accounting also includes summarizing, interpreting and communicating the financial data to the users of financial statements.
Objective	The main aim is to maintain systematic records of financial transactions.	The main aim is to ascertain the profitability and financial position of the business.
Stage	It is a primary stage of accounting	It is a second stage and begins where book-keeping ends.
Nature of job	This job is in routine and repetitive in nature.	This job is analytical in nature.
Level of skills	Bookkeeping does not require special skills. It is performed by Junior Staff.	It requires specialized skill to analyze, so it is performed by senior staff.

Users of Accounting Information

Users may be categorized into internal users and external users.

(A) Internal Users

- **Owners:** Owners contribute capital in the business and thus they are exposed to maximum risk. So, they are always interested in the safety of their capital.
- **Management:** Accounting information is used by management for taking various decisions.
- **Employees:** Employees are interested in the financial statements to assess the ability of the business to pay higher wages and bonuses.

(B) External Users

- **Banks and financial institutions:** Banks and Financial Institutions provide loans to business. So, they are interested in financial information to ensure the safety and recovery of the loan.

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- **Investors:** Investors are interested to know the earning capacity of business and safety of the investment.
- **Creditors:** Creditors provide the goods on credit. So they need accounting information to ascertain the financial soundness of the firm.
- **Government:** The government needs accounting information to assess the tax liability of the business entity.
- **Researchers:** Researchers use accounting information in their research work.
- **Consumers:** They require accounting information for establishing good accounting control, which will reduce the cost of production.

Accounting Principles

The following are a few accounting principles:

- 1. Going Concern Assumption:** It is presumed that the business is a going concern, i.e. it will continue to exist for a foreseeable period. That presumption is important because if the business were to liquidate in the near future, by the actual amount that may be realized or payable as the case may be, it would have to restate its assets and liabilities to represent the organization's true financial status.
- 2. Matching Principle:** This definition demands that the income be compared with its corresponding expenditure for a given period to display the true benefit for that time.
- 3. Accrual Accounting Basis:** This concept demands that both revenue and expenditure be recorded in the actual time incurred, and not when cash or cash equivalent has been received/spent. Irrespective of the subsequent cash flow, earning the income and incurring the expenditure is significant.
- 4. Accounting Period:** This concept means that a company's accounting process will be completed within a certain period that is typically a financial year or a calendar year. Thus, every transaction that relates to a particular period of accounting must form part of the financial statements prepared for that time.

Accounting concepts and conventions

Accounting Concepts

1. Business Entity Concept – business is a separate entity.
2. Money Measurement Concept – money common denominator of measurement.
3. Going Concern Concept – perpetual succession.
4. Accounting Period Concept – pre-determined periodicity generally a year.

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5. Cost Concept – an asset's cost is the basis of all subsequent accounting.
6. Realization Concept – revenue should be recognized “when it is earned”.
7. Matching Concept – associating the cause and effect relationship of revenues and expenses.
8. Accrual Concept – similar to matching, period should be decided on the basis of accrual.
9. Dual Aspect Concept – this aspects must be examined the giving and the receiving.

Accounting Conventions

1. Consistency – method once adopted should be followed.
2. Disclosure – all relevant facts concerning financial position must be communicated to users.
3. Materiality – concerned with significant information.
4. Objectivity – unbiased and subject to verification by external expert.
5. Stable Monetary Unit – the Indian Rupee.
6. Conservatism or Prudence – when in doubt, choose the solution that is least likely to overstate net assets and net income for the current period.

Types of Accounts

Accounts are classified into following categories:

- A. Personal Account
- B. Real Account
- C. Nominal Account

A. Personal Account:

As the name suggests, Personal Accounts are the ones that are related with individuals, companies, firms, group of associations etc. These persons could include natural persons, artificial persons or representative persons.

Type of Personal Accounts

a. Natural Persons

These accounts relate to natural persons such as Veer's A/c, Ayan's A/c, Karen's A/c etc.

b. Artificial Accounts

These accounts relate to companies and institutions such as Kapoor Pvt Ltd A/c, Booker's Club A/c etc. Thus, companies and institutions are the entities that exist in the eyes of law.

c. Representative Accounts

Accounts that are a representative of some person are called as representative accounts. These include Outstanding Interest A/c, Outstanding Wages A/c, Prepaid Expense A/c etc.

Golden Rule Related To The Personal Account

Debit the Receiver, Credit the Giver

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B. Real Account

Real Accounts are the ones that are related with properties, assets or possessions. These properties can be both physically existing as well as non physical in nature. Thus, Real Accounts can be of two types: Tangible Real Accounts and Intangible Real accounts.

a. Tangible Real Accounts

Tangible Real Accounts are accounts which have physical existence. In other words, such assets can be seen, felt or touched. For example Machinery A/c, Vehicle A/c, Building A/c etc.

b. Intangible Real Accounts

These are the assets or possessions that do not have physical existence but can be measured in terms of money. This means that such assets have some value attached to them. For example, trademarks, patents, goodwill, copyrights etc.

Golden Rule Related To The Personal Account

Debit What Comes In, Credit What Goes Out

C. Nominal Account

Nominal Accounts relate to income, expenses, losses or gains. These include Wages A/c, Salary A/c, Rent A/c etc.

Golden Rule Related To The Personal Account

Debit All Expenses and Losses, Credit All Incomes and Gains

Double-entry system

- The double entry system is based on the Dual Aspect Principle.
- Every transaction has two aspects, 'a Debit' and 'a credit' of an equal amount.
- This system of accounting recognizes and records both aspects of the transaction.

Advantages of the Double-entry System of Accounting

Following are the main advantages of the double-entry system of accounting:

Scientific system

- As compared to the other systems, this system of recording transactions is more scientific and useful to achieve the objective of accounting.

A complete record of the transaction

- Since both the aspects of transactions are considered there is a complete recording of each and every transaction.
- Using these records we are able to compute profit or loss easily.

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Checks arithmetical accuracy of accounts

- Under this system, by preparing a Trial Balance we are able to check the arithmetical accuracy of the records.

Determination of profit/loss and depiction of financial position

- Under this system by preparing 'Profit & Loss A/c' we get to know about the profit earned or loss incurred.
- By preparing the 'Balance Sheet' the financial position of the business can be ascertained, i.e. position of assets and liabilities is depicted.

Helpful in decision making

- Administration and management are able to take decisions on the basis of factual information under the double-entry system of accounting.

Ledger

The ledger is the principal account book which is a comprehensive set of all accounts impacted by the business transactions. All transactions accounted for in the journal are transferred to i.e.: posted to each respective ledger account. Thus the ledger is a comprehensive record of all business transactions recorded account wise. The ledger contains all real, personal and nominal accounts.

Trial balance

Trial balance is a list of all real, personal and nominal account balances compiled from the individual ledger accounts. Trial balance is compiled in columnar format, with columns on the left reflecting accounts with debit balances and columns on the right reflecting accounts with credit balance.

Journal

A journal or book of original entry is the place where journal entries are recorded before they are posted to the ledger accounts. A journal is a record of all the transactions a company has recorded.

Subsidiary Book There are numerous transactions which occur so many times in a day. It is inadequate and inconvenient to record the transaction in the book of original entry i.e. journal. Every transaction recorded in journal becomes thick, bulky, tedious and consumes more time, labour and money. So the transactions which are of repetitive nature are recorded in a separate book through special journal. Such separate book of original entry, maintained for recording the similar and repetitive types of transactions is known as subsidiary books. Also known as sub-journal or sub-division of journal, this book includes purchase book, sales book, purchase return book, sales return book and cash book.

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UNIT-2

1. Bank reconciliation statement	- வங்கி சரிகட்டும் பட்டியல்
2. Cash book	- ராக்க ஏடு
3. Pass book	- ரசல்லலடு
4. Overdraft	- லேல்வலப்பற்று
5. Cheque	- காலசாலல
6. Bank balance	- வங்கி இருப்பு
7. Rectification of errors	- பிலைத்திருத்தம்
8. Suspense account	- அனாதேத்து கணக்கு

Bank Reconciliation Statement

Meaning

Bank Reconciliation Statement is a record book of the transactions of a bank account. This statement helps the account holders to check and keep track of their funds and update the transaction record that they have made. Bank Reconciliation statement is also known as bank passbook. The balance mentioned in the bank passbook of the statement must tally with the balance mentioned in the cash book. In the statement, all the deposit will be shown in the credit column and withdrawals will be shown in the debit column. However, if the withdrawal exceeds deposit it will show a debit balance (overdraft).

Importance of Bank Reconciliation Statement

Generally while making a comparison between the company's cash book and bank balance, the balance does not tally. Therefore, it is important to determine the cause for the difference and display them in the bank reconciliation statement and then tally the two balances. The bank reconciliation statement helps in explaining the differences in the amount between the company's cash book and bank balance. The cash book and the bank passbook differences are caused by:

- The difference in timing recording the transactions: The difference in timing can be caused by many factors which are:
 - Bank-issued cheque but not yet deposited for payment
 - Paid cheque in the bank but yet not cleared

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- Bank made direct debit from the customer's side
 - Cheque/ amount deposited directly to the bank account
 - Dividends and Interest collected by the bank
 - Bank made direct payment from the customer's side
 - Cheques deposited/bills discounted dishonoured
- Errors made by the company or by the bank: In a few occasions, the error in two balances can be made from the bank side or in the company's cash book. Few errors are as follows:
 - Errors made while registering the transaction by the company
 - Errors made while registering the transaction by the bank

Need for Preparation of BRS

A Bank Reconciliation Statement is needed and is important because of the following reasons:

- It helps in knowing the actual Bank balance.
- It helps in discouraging the staff from embezzlement.
- Helps in identifying the reason for differences in the Cash Book and the Pass Book.
- It helps in identifying any undue delay in the clearance of cheques.
- Helps in detecting and preventing frauds and errors in recording the Banking transactions.
- It helps in incorporating certain expenditures/income debited/credited by Bank in the books of accounts.

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- Format of Bank Reconciliation Statement when the Bank Balance as per Cash Book

Particulars	Plus Items ()	Minus Items ()
A. Bank Balance as per Cash Book (Favorable i.e Debit Balance)	XXX	
Overdraft as per Cash Book (Unfavorable i.e Credit Balance)		XXX
B. Add: Transactions having the effect of higher balance in Pass Book		
• Cheque deposited in to the bank but not recorded in Cash Book	XXX	
• Cheque issued but not yet presented for payment	XXX	
• Interest allowed in Pass Book only	XXX	
• Bill Receivable directly collected by bank	XXX	
• Direct payment by a customers in to bank but not recorded in Cash Book	XXX	
• Cheques issued returned on technical grounds	XXX	
• A wrong credit given by bank in Pass Book	XXX	
C. Less: Transactions having the effect of lower balance in Pass Book		
• Cheque received and recorded in the Bank Column but not yet sent to bank for collection		XXX
• Cheque deposited but not yet collected by bank		XXX
• Bank charges, Interest on overdraft debited in Pass Book only		XXX
• Insurance Premium paid directly by bank under standing advice		XXX
• Cheque deposited for collection, returned dishonored and recorded in Pass Book only		XXX
• Discounted Bills Dishonored but not recorded in Cash Book		XXX
• A wrong debit given by bank in Pass Book		
	XXX	XXX

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Format of Bank Reconciliation Statement when the Bank Balance as per Pass Book

Particulars	Plus Items ()	Minus Items ()
D. Bank Balance as per Pass Book (Favorable i.e Credit Balance)	XXX	
Overdraft as per Pass Book (Unfavorable i.e Debit Balance)		XXX
E. Add: Transactions having the effect of lower balance in Pass Book		
• Cheque received and recorded in the Bank Column but not yet sent to bank for collection		XXX
• Cheque deposited but not yet collected by bank		XXX
• Bank charges, Interest on overdraft debited in Pass Book only		XXX
• Insurance Premium paid directly by bank under standing advice		XXX
• Cheque deposited for collection, returned dishonored and recorded in Pass Book only		XXX
• Discounted Bills Dishonored but not recorded in Cash Book		XXX
• A wrong debit given by bank in Pass Book		XXX
F. Less: Transactions having the effect of higher balance in Pass Book		
• Cheque deposited in to the bank but not recorded in Cash Book	XXX	
• Cheque issued but not yet presented for payment	XXX	
• Interest allowed in Pass Book only	XXX	
• Bill Receivable directly collected by bank	XXX	
• Direct payment by a customers in to bank but not recorded in Cash Book	XXX	
• Cheques issued returned on technical grounds	XXX	
• A wrong credit given by bank in Pass Book	XXX	
	XXX	XXX

Rectification Of Errors

In accounting, errors are the ‘mistakes’ committed by the book-keeper or accountant. These mistakes may occur while classifying the accounts, writing the subsidiary books, posting the entries to ledger accounts, casting totals, balancing the accounts, carrying the balances forward and so on. The process of finding and correcting these mistakes is called rectification of errors.

Classification of Accounting errors

Accounting errors are classified in to four types on the basis of nature of Errors. They are (1) Errors of Omission, (2) Errors of Commission, (3) Errors of Principles and (4) Compensating Errors.

1. Errors of Omission

The Errors of Omission will occur when a transaction is not recorded in the books of accounts or omitted by mistake. The Errors of Omission may happen as partial or complete.

The partial errors may happen in relation to any subsidiary books. This is the result of when a transaction is entered in the subsidiary book but not posted to the ledger.

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The complete omission may happen the transaction is completely omitted from the books of accounts.

2. Errors of Commission

When a transaction is entered in the books of accounts in wrongly, this may be entered as partially or incorrectly. This kind of errors are known as Errors of Commission. The Errors of Commission may happens because of ignorance or negligence of the accountant.

3. Errors of Principles

It Is an error occurring due to wrong application of basic Accounting Principles. The main reason behind such an error is incorrect classification of capital and revenue items.

4. Compensating Errors

If the effect of an error is counterbalanced or cancelled out by the effect of another error or errors then such errors are known as compensating errors. Since the compensating errors as a whole cancel out the effect of each other, the agreement of trial balance is not affected. Thus it becomes difficult to detect such errors.

Rectification of one sided errors

These errors affect only one side of An Account either debit or credit. Therefore these errors the Trial Balance.

Rectification of these errors is done differently, in these two cases i.e.

- (i) Before preparing the Trial Balance
- (ii) After preparing the Trial Balance

Case 1 : Rectification of one sided errors before preparing Trial Balance.

When there errors are rectified before preparing Trial Balance i.e. transferring the difference in the Trial Balance to the Suspense Account.

(Which will be explained later on), then it is done directly by debiting or crediting the concerned ledger account.

- For Short Debit Concerned A/c is Debited.
- For Excess Credit Concerned A/c is Debited
- For Short Credit Concerned A/c is Credited For Excess Debit Concerned A/c is Credited

Case II : Rectification of one Sided Error after Preparing Trial Balance

When the errors are detected after the preparation of Trial Balance then every single sided error is rectified by passing a Journal entry through Suspense Account.

- For short Debit Income Account Debit that Account and Credit the Suspense A/c
- Excess Credit in one Account Debit that Account and Credit the Suspense A/c
- Short Credit in one Account Credit that A/c and Debit the Suspense A/c
- Excess Debit in one Account Credit that A/c and Debit the Suspense A/c

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Rectification of two sided errors

Two sided errors are those errors which affect two sides of Accounts. These errors don't affect trial Balance as discussed earlier.

These Errors are rectified by passing a Journal entry irrespective of the time of depiction. In other words their rectifying entry will be same whether (a) the error is depicted before Trial Balance or (b) after the preparation of Trial Balance but before the Final A/s are prepared.

Steps for Rectification of two sided errors

- Locate the effect of Error on Different Accounts.
- The Account showing excess credit should be Debited.
- The Account showing excess Debit should be Credited.
- The Account showing short Debit should be Debited.
- The Account showing short Credit should be Credited.

Suspense account

Meaning:

Suspense account is the general ledger account that is used by the company for recording the transactions temporarily as at the time of recording those transactions, the accountant may be unsure of the type of account that is most appropriate to record those transactions.

Important

- When inspite of all the efforts the Trial Balance does not tally, the difference is put to a newly opened account named Suspense A/c.
- Suspense A/c is an imaginary account, opened temporarily for the purpose of reconciling a Trial Balance.
- Later on when the errors affecting the Trial Balance are located, rectification entries are passed through the Suspense A/c.
- When all the errors are located and rectified, the Suspense A/c will be auto material closed i.e., it will show zero balance.
- But if suspense A./c still shows a balance it will indicate that some errors are still to be discovered and rectified.

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UNIT-3

1. Bills of exchange	- மாற்றுச் சட்டு
2. Drawer	- சபறுநர்
3. Drawee	- ஏற்குநர்
4. Payee	- சசலுத்துநர்
5. Noting charges	- குடைக்கறக கட்டணம்
6. Retiring bill	- மாற்றுச்சட்டு முதிர்வு
7. Insolvency	- சநாடிப்பு நிறை
8. Accommodation bill	- பணவசதி மாற்றுச்சட்டு
9. Average due date	- சராசரி தவறண நாள்
10. Account current	- நடப்பு கணக்கு

Meaning of Bill of Exchange

According to the Negotiable Instruments Act 1881, a bill of exchange is defined as “an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument”.

Features of Bill of Exchange

- It is important to have a bill of exchange in writing
- It must contain a confirm order to make a payment and not just the request
- The order should not have any condition
- The bill of exchange amount should be definite
- Fixed date for the amount to be paid
- The bill must be signed by both the drawee and the drawer
- The amount stated on the bill should be paid on-demand or on the expiry of a fixed time
- The amount is paid to the beneficiary of the bill, specific person, or against a definite order

Types of Bill of Exchange

- **Documentary Bill-** In this, the bill of exchange is supported by the relevant documents that confirm the genuineness of sale or transaction that took place between the seller and buyer.
- **Demand Bill-** This bill is payable when it demanded. The bill does not have a fixed date of payment, therefore, the bill has to be cleared whenever presented.

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- **Usance Bill-** It is a time-bound bill which means the payment has to be made within the given time period and time.
- **Inland Bill-** An Inland bill is payable only in one country and not in any other foreign country. This bill is opposite to the foreign bill.
- **Clean Bill-** This bill does not have any proof of a document, so the interest is comparatively higher than the other bills.
- **Foreign Bill-** A bill that can be paid outside India is termed as a foreign bill. Two examples of a foreign bill are an export bill and import bill.
- **Accommodation Bill-** A bill that is sponsored, drawn, accepted without any condition is known as an accommodation bill.
- **Trade Bill-** This kind of bill is specially related only to trade.
- **Supply Bill-** The bill that is withdrawn by the supplier or contractor from the government department is known as the supply bill.

Parties of Bill of Exchange

A bill of exchange has three parties:

(1) Drawer:

- The drawer is the maker of a bill of exchange.
- The bill is signed by Drawer.
- A creditor who is entitled to receive payment from the debtor can draw a bill of exchange.

(2) Drawee:

- Drawee is the person upon whom the bill of exchange is drawn.
- Drawee is the debtor who has to pay the money to the drawer.
- He is also known as 'Acceptor'.

(3) Payee:

- The payee is the person to whom payment has to be made.
- The payee may be the drawer himself or a third party.

Renewal Of Bill Of Exchange

- When the acceptor is not in his capacity to pay his bill on the due date.
- He may request the drawer of the bill to cancel the original bill and draw a new Bill in place of the old Bill.
- If drawer agrees and a new bill is drawn, it is known as Renewal of a Bill.

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Journal Entries

Drawer books:

(a) When the old bill is cancelled:

Personal account of the acceptor [Dr.]

To Bill receivable account [Cr.]

(b) When interest is charged by the drawer:

Drawee account [Dr.]

To Interest account [Cr.]

(c) When acceptance on new bill is received:

Bill receivable account [Dr.]

To Drawee [Cr.]

Drawee books:

(a) When the old bill is cancelled:

Bill payable account [Dr]

To Drawer's account [Cr]

(b) When interest is charged by the drawer:

Interest account [Dr]

To Drawer's account [Cr]

(c) When a fresh bill is accepted:

Drawer's account [Dr]

To bill payable account [Cr]

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Noting Charges

When a bill of exchange is dishonoured, the holder can get such fact noted on the bill by a notary public. The advantages of noting is that the evidence of dishonoured is secured. The noting is done by recording the fact of dishonoured, the date of dishonour, the reason of dishonour, if any. For doing all this the notary public charges his fees which is called noting charges.

Journal Entries

Drawer books:

a) When the retained bill dishonoured

Drawee account [Dr.]

To Bills receivable account [Cr.]

To Cash account (noting charges) [Cr.]

(b) When the discounted bill dishonoured

Drawee account [Dr.]

To Bank [Cr.]

(c) When the endorsed bill dishonoured

Drawee account [Dr.]

To endorsee account [Cr.]

(d) When the bill sent for collection dishonoured

Drawee account [Dr.]

To bill sent for collection account [Cr.]

Drawee books:

Bill payable account [Dr.]

Noting charges [Dr.]

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To Drawer account [Dr.]

Retiring a bill

Retiring a bill means making payment before the date of maturity. When the acceptor of a bill is prepared to make the payment of the bill before the due date, he may ask the holder to accept the payment, provided he receives some rebate or discount for the unexpired period. Such a rebate or discount is an expense to the party receiving the payment and gain to the party making the payment.

Journal entries

Drawer books:

When the bill is retired under rebate

Cash account (actual amount received) [Dr]

Discount account [Dr]

To Bill receivable account [Cr]

Drawee books:

When the bill is retired under rebate

Bill payable account [Dr]

To cash account [Cr]

To Discount account [Cr]

Insolvency

Insolvency of a person means that he is unable to pay his liabilities. This will mean that bill accepted by him will be dishonoured. Therefore, when it is known that a person has become insolvent, entry for dishonour of his acceptance should be passed, Later something may be received from his estate.

Journal entries

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Drawer books:

When the Drawee becomes insolvent

Drawee account [Dr]

To Bills Receivable account [Cr]

When the drawer receive part of the amount due.

Cash account [Dr]

Bad debts account [Dr]

To Drawee account [Cr]

Drawee books:

When the Drawee becomes insolvent

Bills payable account [Dr]

To Drawer account [Cr]

When the drawer receive part of the amount due.

Drawer account [Dr]

To Cash account [Cr]

To Deficiency account [Cr]

Accommodation Bill

An accommodation bill of exchange is a bill of exchange which has been drawn for the mutual financial accommodation of the parties involved. Generally it is drawn not for value received. In order to oblige friends, many times bills are drawn, accepted and endorsed by businessmen without any consideration. By accepting such a bill the acceptor is able to lend his name, and the other party (drawer) taking advantages of the reputation of the acceptor gets it discounted with his bank. After meeting his aim with this temporary finance, he (drawer) sends back money to the acceptor thus making it possible for him to meet the bill on the due date. Since such bills are accepted without consideration, therefore, there is no liability of the acceptor to the drawer but since the third party takes such a bill for value, therefore, the acceptor is liable to the third party.

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Trade Bill	Accommodation Bill
Trade bills are drawn for trade purposes.	Accommodation bills are drawn and accepted for financial assistance
These are drawn against proper consideration.	These are drawn in absence of any consideration
These bills are proof of debt	These are not a proof of debt
If discounted full sum retains with holder of the bill	If discounted the amount may be divided between drawer and acceptor in pre-determined ratio.
For obtaining the debt from drawee, drawer can resort to legal action.	Legal action cannot be resorted for recovery of amount against these bills by the immediate parties

Average Due Date

In the present scenario in business enterprises, there are numbers of receipts and payments involved related to a single party. These may occur at different points of time. To simplify the calculation of interest involved in such transactions, we use the concept of the average due date. In this concept, a person pays all his dues on a particular date, in a manner so that neither the debtor nor the creditor suffers loss or gain by way of interest. This date is the Average due date (ADD).

Calculation Of Average Due Date

The concept of Average due date (ADD) is generally used in the following situations:

- Calculating interest on drawings of partners;
- For settling accounts between principle and agent;

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- For settling contra accounts e.g. where parties sell goods to each other;
- Making lump sum payment against various bills drawn on different dates with different due dates

Important Points about ADD

1. Base date/ zero date may be taken as the due date of the first transaction or the due date of the last transaction or any other due date between the first and the last but preferably an earlier due date may be taken.
2. While calculating the number of days always ignore the first day and include the last day.
3. If the due date is in the fraction, round it off.
4. If the amount is paid before the due date, a rebate is given. While, where the amount is paid after the due date, then interest will be charged.
5. Whenever there is a sale of goods by two persons to each other on different dates, the formula for calculating average due date is

$$\text{Average due date} = \frac{\text{Total of Products}}{\text{Total of Amounts}} + \text{Base date}$$

6. Due date: Due date means the date on which the amount becomes payable.
7. Maturity date: Always calculate the Maturity date after taking into consideration three days of Grace. Calculation of Due Date when there is a Holiday on maturity day, due date is the next preceding working or business day.

Account Current

An Account Current is a statement of transactions which represents running transactions between parties. We prepare Account Current for a specific period of time. It includes interest received or charged on transactions. There are two parties involved, one who prepares the Account and the other for whom the account is prepared.

METHOD OF PREPARATION OF ACCOUNT CURRENT:

- 1) With the help of interest table.
- 2) By means of products;

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(1) With the help of interest table:

Under this method all the transactions are arranged in the form of an account. Two additional columns are made on both the sides of such an account.

- One column is meant to indicate the number of days counted from the due date of each transaction to the date of rendering the account.
- Other column is meant for writing interest.

The interest column of both the sides are totaled up and balance is drawn.

Note:- If no specific date is mentioned as the date, on which payment is due, the date of the transactions is presumed to be the due date.

(2) By means of products:

Under this method, interest columns are replaced by "Product" columns. Product in this case is calculated by multiplying the amount with the number of days for which it has been outstanding. Products of the debit side and the product of the credit side are totaled separately. Interest is calculated for one day on the difference of the two side totals and is entered on the bigger side. There are two methods of calculating interest:-

- (a) **Forward method**
- (b) **Backward method (Epoque method)**

RED-INK INTEREST:-

In case the due date of a bill falls after the date of closing the account, then no interest is allowed for that period. However, interest from the date of closing to such due date is written in "Red-Ink" in the appropriate side of the 'Account current'. This interest is called **Red- Ink interest**. This Red Ink interest is treated as negative interest

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Unit-4

- | | |
|-------------------------------|------------------------------|
| 1. Asset | - ரசாத்து |
| 2. Depreciation | - லதய்஁ானம் |
| 3. Straight line method | - லநர்க்கலகாட்டு முலற |
| 4. Diminishing balance method | - குலறந்த ரசல் ஁ேதிப்பு முலற |
| 5. Annuity method | - ஆண்டித்ரதாலக முலற |
| 6. Sinking fund method | - கலனறடப்பு நிதி முலற |
| 7. Insurance policy method | - முலனேம் முலற |
| காப்படு | |
| 8. Interest | - வட்டி |

Meaning of Depreciation

Depreciation can be defined as a continuing, permanent and gradual decrease in the book value of fixed assets. This type of shrinkage is based on the cost of assets utilised in a firm and not on its market value.

Definition

According to **J.R. Batliboi**, "Depreciation means permanent decline in the value of assets due to wear and tear or from any other cause."

According to **R.G. Williams**, "Depreciation may be defined as a gradual deterioration in value of assets due to use."

Causes of Depreciation

Internal Causes of Depreciation

Wear and tear, exhaustion, depletion, deterioration etc.. causes depreciation of assets which are internal in nature.

1. Wear and tear

Assets diminish in their value as they are constantly used in the organization. The difference between the value of an asset when it was bought and its value being used for sometime represents wear and tear. Although assets are kept in working conditions, a time comes when only scrap value remains.

2. Exhaustion

Assets are bound to lose their value as time progress. Consequently, productivity declines. Assets exhaust their value and are found useless after the elapse of a certain fixed period. It is true that assets have their definite age.

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3. Depletion

Natural resources such as mines, quarries and oil wells are of a wasting character. As a result of gradual exhaustion, the value of wasting assets declines. They are consumed gradually. The process of earning income through extraction causes depletion of wasting assets.

4. Deterioration

Deterioration means erosion in value of those assets which have a very short life. Proper repairs and maintenance of these assets cause an additional loss by way of deterioration.

External Causes of Depreciation

Factors external to causes of depreciation include passage of time, obsolescence, permanent fall in market value and weather and accidental elements. These factors are not connected to the asset. Even then they cause depreciation.

1. Passage of time

The utility of some fixed assets is confined to a time frame. Assets like leasehold property become useless after a period. Relevant statutes may limit the period for which an organization can use assets in the production process. Assets like trademark, patents lose their value with the passage of time.

2. Obsolescence

Obsolescence implies the chance of an asset becoming out of fashion. This is a loss arising on account of new invention, technological changes, improvement in production methods, legal restraints etc. These factors make it economical to replace the assets though they are still usable. Market changes are also a disturbing factor. For example, the demand for a product or service falls to such a level that it is no longer viable to continue with that product or service.

3. Permanent fall in the market value

Assets like investments lose their value due to a downfall in their market value. It is only the permanent fall in the value of asset. Temporary shrinkage in the value of assets should be ignored for depreciation calculation.

4. Weather and accidental elements

Assets lose their value due to weather, rain, sunshine or any accident like fire, earthquake, flood, tidal forces or similar other disasters. The effect of these factors enters into calculating depreciation.

Methods for Calculating Depreciation

Straight Line Method:

This method assumes that depreciation is a function of time rather than use. This method is based on the assumption that each accounting period receives same a benefits from using the assets. It allocates an equal amount of depreciation in each accounting periods of the service life of the assets. Therefore, it is called Straight Line Method.

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Advantages of straight line depreciation method

- Simplest depreciation method to compute
- Can be applied to all long-term assets
- The same for each period of assets' service life
- Widely acceptable and usable accounting method

Disadvantages of straight line depreciation method

- Does not reflect accurately the difference in usage of an asset from one period to the other
- Does not necessary match costs with revenues in different types of long-term assets
- Might not be appropriate for some depreciable assets due to rapidly developing technology, such as computers

Cost of Asset – Salvage Value

$$\text{Depreciation Per Year} = \frac{\text{Cost of Asset – Salvage Value}}{\text{Useful Life of Asset}}$$

Where:

Cost of the asset is the purchase price of the asset

Salvage value is the value of the asset at the end of its useful life

Useful life of asset represents the number of periods/years in which the asset is expected to be used by the company

Diminishing Balance Method:

Under this method, a fixed percentage is applied to book value of the assets (cost of assets). In other words, the depreciation is calculated on the reducing balance (assets cost-depreciation) and not on the original cost. The procedure is that depreciation calculated is deducted from the cost of assets and balance known as the written down value. The written down value at the end of the estimated useful life of the assets should equal the estimated salvage or scrap value.

Advantages Diminishing Balance of method

- **Equal charge against income**

In the initial years depreciation is high and repair charges are low. When the asset becomes older, the amount of depreciation charged is less but repair charges are high. Hence, the total burden on profit in respect of depreciation and repairs put together remains almost similar year after year.

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➤ **Logical method**

In the earlier years, when the asset is more productive, high depreciation is charged. In the later years when the asset becomes less productive, the depreciation charge is less.

Disadvantages Diminishing Balance of method

➤ **Assets cannot be completely written off**

Under this method, the value of an asset even if it becomes obsolete and useless, cannot be reduced to zero and some balance would continue in the asset account.

➤ **Ignores the interest factor**

This method does not take into account the loss of interest on the amount invested in the asset. The amount would have earned interest, had it been invested outside the business is not considered.

➤ **Difficulty in determining the rate of depreciation**

Under this method, the rate of providing depreciation cannot be easily determined. The rate is generally kept higher because it takes very long time to write off an asset down to its scrap value.

➤ **Ignores the actual use of the asset**

Under this method, a fixed rate of depreciation is provided on the written down value of the asset by applying the predetermined rate of depreciation on its original cost. But, the actual use of the asset is not considered in the computation of depreciation.

Diminishing Balance Method = (Cost of Asset - Salvage value of the asset) × Rate of Depreciation

Annuity Method:

The annuity method of depreciation is a depreciation technique that focuses on achieving a constant rate of return on an asset. It is more likely to be used for more expensive fixed assets that are expected to have a long useful life.

steps:

1. Estimate the future cash flows that will be associated with an asset.
2. Calculate the internal rate of return on those cash flows.

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3. Multiply the internal rate of return by the initial book value of the asset.
4. Subtract the result from the cash flow for the current period.
5. The residual value is the depreciation to charge to expense in the current period.

The annuity method is not endorsed by generally accepted accounting principles. This approach is also called the compound interest method of depreciation.

Advantages Of Annuity Method Of Depreciation

The following are the advantages of annuity method:

- Annuity method takes interest on capital invested in the asset into account.
- Annuity method is regarded as most exact and precise from the point of view of calculations. So it is a scientific method.

Disadvantages Of Annuity Method Of Depreciation

The following are the disadvantages of the annuity method:

- The annuity method is difficult to understand.
- The burden on profit and loss account goes on increasing with the passage of time whereas the amount of depreciation charged each year remains constant. The amount of interest credited goes on diminishing as years pass by, the ultimate consequence being that the net burden on profit and loss account grows heavier each year.
- When the asset requires frequent addition and extensions, the calculation have to be changed frequently, which is very inconvenient.

Sinking Fund Method:

Under this method, the amount of depreciation goes on accumulating till the asset is completely worn out. This method provides necessary cash to replace the asset at end of its useful life. The amount of depreciation is fixed and remains same for every year and is charged to P&L A/c.

The amount of depreciation is invested outside the business every year. The process of investing amount of depreciation and interest goes on till the time of replacement of asset. At the time of replacement all the investments are sold out and cash received, and the new asset purchased.

Advantages of sinking fund method

- A sinking fund helps the company to pay its liability well in advance.
- A company is able to pay the debt in time because a company has already pulled a money well before.

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(Being Premium of an Insurance policy paid)

2) Profit/loss A/c Dr

To Depreciation Reserve A/c

(Being dep. of the year transferred to P/L A/c)

In the Last Year: –

1) Depreciation Insurance Policy A/c A/c Dr.

To Bank A/c

(Being Premium of an Insurance policy paid)

Profit/loss A/c Dr

To Depreciation Reserve A/c

(Being dep. of the year transferred to P/L A/c)

Bank A/c Dr.

To Depreciation Insurance Policy a/c

(Being received the amount of insurance policy)

Depreciation Insurance Policy A/c A/c Dr.

To Depreciation Reserve A/c

(Being transferring profit on insurance)

Depreciation Reserve A/c Dr

To Asset A/c

(Being transferring accumulated depreciation to the asset account)

Purchase of new asset

New Asset A/c Dr

To Bank A/c

(Being new asset purchased)

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UNIT 5

- | | |
|--------------------------|-------------------------------------|
| 1. Single entry method | - ஒற்றை பதிவு முறை |
| 2. Double entry system | - இடத்தை பதிவு முறை |
| 3. Statement affairs | - நிலை அறிக்கை, |
| 4. Insurance | - காப்பீடு |
| 5. Self balancing ledger | - தாபன சரிக்கட்டிக்காள்ளும் பப்பரடு |
| 6. Sectional balancing | - பிரிவு சேநிலை |

Meaning

A single entry system of accounting is a form of bookkeeping in which each of a company's financial transactions are recorded as a single entry in a log. This process does not require formal training and is usually used by new small businesses because of its simplicity and cost effectiveness.

The salient features of Single Entry System

- (i) This system is followed by a sole proprietorship firm or a partnership firm. The companies cannot follow this system.
- (ii) Under this system, only one Cash Book is maintained which mixes up both the private and business transactions.
- (iii) Usually personal accounts are recorded only, i.e., Real and Nominal accounts are ignored.
- (iv) Lack of uniformity is noticed if accounts are kept under Single Entry basis.
- (v) Profit or loss, under this system, can be ascertained but not the financial position as a whole.
- (vi) Arithmetical accuracy of the account is not possible since Trial Balance cannot be prepared.
- (vii) Practically, this system is the admixture of Single Entry, Double Entry and no entry.

Advantages of Single Entry System:

- (i) Since this system is very simple, anyone can maintain it without any adequate knowledge of accounting.
- (ii) Limited accounts are to be opened under this system since the transactions relating to personal accounts are recognised only and not the Real and Nominal accounts.

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(iii) Since the number of books is limited, expenses related to the keeping of records are also very nominal.

(iv) In the case of accounting for an event, i.e., household, social and festival etc., it is very helpful.

Disadvantages of Single Entry System:

(i) Arithmetical accuracy of the books of account is not possible since the Trial Balance cannot be prepared under this system.

(ii) It is also not possible to ascertain the correct amount of profit or loss of the firm—i.e., results from operation—since the nominal accounts are missing under this system.

(iii) Similarly, Balance Sheet cannot be prepared since the real accounts are not recognised. Therefore, the real financial position cannot be known at the end of the accounting period.

(iv) As arithmetical accuracy is not possible, possibility of committing fraud or manipulation is greater in comparison with Double Entry System.

(v) Any statistical information relating to the business or the comparison between the two firms or the interim accounts etc.—which help the management to take decision or to formulate policy in future—is not possible under this system.

(vi) Outsiders (e.g., Income-tax authorities, Bank etc.) do not rely on this system.

Differences between Single entry system and Double entry system

Single entry system	Double entry system
<ul style="list-style-type: none">• Tells about cash, debtors and creditors cash balances only.• Records transactions related to business only.• Incomplete system of recording the transactions.• Can easily record fraud transactions.• Hard to find errors.	<ul style="list-style-type: none">• Tells about every business financial entity.• Records all effects of transactions.• Complete system of recording the transactions.• Difficult to record fraud transactions.• Easy to identify errors.• All accounts are considered.

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<ul style="list-style-type: none">• Persons accounts and cash accounts are included.• Not accepted by taxation department.• Takes lot of time in calculation profit/loss.• Suitable for small business.• Cost of implementation is not required.• Reconciliation of accounts is not possible.• Special knowledge is not required in maintaining books.• Trail balance can't be prepared.• Not suitable for tax purpose• Difficult to prepare financial statement• Difficult to tell about financial position	<ul style="list-style-type: none">• Accepted by taxation department.• Easy to calculate profit/loss.• Suitable to all types of business.• Cost of implementation is required.• Reconciliation of accounts is possible.• Special knowledge is required in maintaining books.• Trail balance can be prepared.• Suitable for tax purpose.• Easy to prepare financial statements.• Can easily tell about financial position.
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Statement of affairs

Meaning

A statement of affairs (SOFA) is a structured document which provides important information on the assets and liabilities a company has at a given moment in time and any other relevant information pertinent to its financial situation.

This document tends to be produced when a company is facing insolvency and the creditors need to know the position of the company. The SOFA will give an indication of what money is available to pay back creditors. An insolvency practitioner or turnaround professional will put together the document with the help of the directors.

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Steps to be followed to find out the profit or loss by preparing statement of affairs

Following are the steps to be followed to find out the profit or loss when a statement of affairs is prepared:

1. Ascertain the opening capital by preparing a statement of affairs at the beginning of the year by taking the opening balances of assets and liabilities.
2. Ascertain the closing capital by preparing a statement of affairs at the end of the accounting period after making all adjustments such as depreciation, bad debts, outstanding and prepaid expenses, outstanding income, interest on capital, interest on drawings, etc.
3. Add the amount of drawings (both in cash and/in kind) to the closing capital.
4. Deduct the amount of additional capital introduced, to get adjusted closing capital.
5. Ascertain profit or loss by subtracting opening capital from the adjusted closing capital.
 - (a) If adjusted closing capital is more than the opening capital, it denotes profit
 - (b) If adjusted closing capital is lesser than the opening capital, it denotes loss

Following format is used to find out the profit or loss:

Particulars	₹
Capital at the end of the year	xxx
Add: Drawings during the year	xxx
	xxx
Less: Additional capital introduced during the year	xxx
Adjusted closing capital	xxx
Less: Opening Capital	xxx
Profit or loss for the year	xxx

Statement of affairs to preparing balance sheet

A statement of affairs is a statement showing the balances of assets and liabilities on a particular date. The balances of assets are shown on the right side and the balances of liabilities on the left side. It is prepared from incomplete records to find out the capital of a business unit on a particular date. This statement resembles a balance sheet. The difference between the total of assets and total of liabilities is taken as capital.

$$\text{Capital} = \text{Assets} - \text{Liabilities}$$

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Although the statement of affairs is a list of assets and liabilities, it is not called balance sheet because the values of all assets and liabilities shown in the statement of affairs are not fully based on the ledger balances. Some items are taken from accounts maintained, some items from relevant documents and some balances are mere estimates based on memory.

Format of statement of affairs to preparing balance sheet

In the books of -----

Statement of affairs as on -----

Liabilities	₹	Assets	₹
Sundry creditors	xxx	Cash in hand	xxx
Bills payable	xxx	Cash at bank	xxx
Outstanding expenses	xxx	Sundry debtors	xxx
Bank overdraft	xxx	Bills receivable	xxx
Capital (Balancing figure)	xxx	Stock-in-trade	xxx
		Prepaid expenses	xxx
		Fixed assets	xxx
	xxx		xxx

Conversion method

The Conversion Method of Single Entry System tries to convert the records from Single Entry to Double Entry system and then prepare Final Accounts from the same.

The steps in conversion of single entry to double entry can be listed as follows:

1. First we need to find out the opening capital by preparing the opening Statement of Affairs.
2. An opening journal entry needs to be passed to incorporate all assets, liabilities and capital in the books of accounts:

AssetsDr
ToLiabilities
To Capital (Balancing Figure)

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3. The Cash Book/Cash Account should be prepared carefully to find out missing figures such as sales, expenses, drawings, closing balance of Cash/Bank etc.
4. Total Debtors Account, Total Creditors Account, Bills Receivable Account and Bills Payable Account should be prepared. These accounts will help to find out figures like Credit Sales, Credit Purchases, Balances of Debtors, Creditors, Bills payable and Bills receivable respectively.
5. Total Sales will be Cash Sales + Credit Sales. Total Purchases will be Cash Purchases + Credit Purchases
6. The nominal accounts for expenses and revenues should be prepared with the help of the information ascertained from the Cash Book. If there are any cash transactions related to Real Accounts, those should also be recorded by preparing ledger accounts.
7. Necessary journal entries for the adjustments should be made as per information provided in the problem.
8. Finally the Profit and Loss Account and The Balance Sheet can be prepared.

Insurance claim

Meaning

There are several different reasons by which a business may suffer abnormal losses such as fire, theft, burglary, strike, etc. among them most common which destroys or causes severe damage to the assets like plant, machinery, furniture, etc. is fire.

So these losses are recovered through insurance so business has to pay their insurance premium at regular intervals.

Then only company or business can claim their losses through these insurance policies. So, insurance can be studied under two parts:

1. Claim for loss of stock
- . 2. Claim for loss of profit.

Loss of Stock:

When a fire occurs, it destroys a number of assets such as building, machinery, furniture, stock, etc. The books of account maintain accounts of all the assets except (usually) stock-in-trade. The value of stock on hand on the date of fire, therefore, has to be estimated.

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Steps to find out

1. Find out fire broke out date.
2. Find out Previous financial year starting date and year ending date.
3. Find out Memorandum Trading Account period -which is related to current year starting date upto the fire broke out date.
4. Find out the value at which stock were given whether it was at cost price or under cost or above cost
5. Find out abnormal items or free samples that were given out.
6. To Separate the given information according to Trading Account (for Previous financial year) and Memorandum Trading Account (from the start of current year to the date of fire break out)

Steps for problem solving

1. Prepare Trading Account- to find out Gross Profit.
2. Calculate Gross Profit Ratio using following formula
$$\text{Gross Profit} \div \text{Sales} \times 100$$
3. Prepare Memorandum Trading Account- to find out stock on date of fire
4. Prepare Statement of Loss of Stock using following format

Particulars	Rs
Stock on date of fire	XXX
Less: Salvaged of Stock	XXX
Loss of Stock	XXX

*Whenever the Average Clause is not applied, Loss of Stock amount is applicable for the claim.

5. Average Clause Calculation-If the Insurance Policy Amount is given and the Average Clause is included then the claim amount calculate using to following Average Clause formula

$$\text{Claim Amount} = \text{Insurance policy value} \div \text{Actual value of stock on the date of fire} \\ \times \text{Actual value of stock destroyed}$$

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Loss of Profits

The **Loss of Profits** Policy is formulated to cover the likely monetary **loss** occurring from break in business activity that may arise due to physical **loss** of property by an event covered for insurance.

How to ascertain the amount of claim under Loss of Profit Policy

Step

1. Ascertain the short sale (i.e. excess of standard turnover over actual turnover) during the period of dislocation.
2. Find out the rate of Gross Profit.
3. Calculate the Loss of Profit by applying the rate of Gross Profit.
4. Add thereto (Step 3) the net increased cost of working on account of short sales.
5. Any savings in expenses are deducted (from Step 4).
6. The result of Step 5 is the amount of gross claim.
7. Finally, the amount calculated will be adjusted, by applying average clause, if necessary. The figure so calculated will be the amount of claim for loss of profit to be lodged with the insurance company.

$$\frac{\text{Net Profit} + \text{Insured Standing Charges}}{\text{Turnover}} \times 100$$

In case of net loss, the rate of gross profit will be determined as follows:

$$\frac{\text{Insured Standing Charges} - \text{Net Loss}}{\text{Turnover}} \times 100$$

If all the standing charges are not insured, the amount of net loss will have to be reduced as follows:

$$\frac{\text{Net Loss} \times \text{Insured Standing Charges}}{\text{All Standing Charges}}$$

Further, increased working expenses will be allowed subject to the limit which is lower of the two figures calculated as follows:

(a) $\frac{\text{Net Profit} + \text{Insured Standing Charges}}{\text{Net Profit} + \text{All Standing Charges}} \times \text{Increased Cost of Working}$

(b) $\text{Short sales avoided through increased cost of working} \times \text{Rate of Gross Profit}$

Meaning of Self-Balancing Ledger:

A self-balancing ledger is one whose balances, when extracted, form a complete trial balance. In other words, each ledger is self-balancing. Under this system, each ledger is maintained under double entry principle, i.e., the principle of double entry is completed within the ledger itself.

Thus, for proper book-keeping, large businesses opt for the Self Balancing System where the following ledgers are maintained:

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1. **Debtors or Sales or Sold Ledger:** It contains **personal accounts of all trade debtors** to whom goods are sold on **credit**.
2. **Creditors or Purchases or Bought Ledger:** It contains **personal accounts of trade creditors** from whom goods are purchased on **credit**.
3. **General or Nominal Ledger:** Contains **all other accounts** except the debtors and creditors.

The division of the Ledger into the three ledgers shown above eases the process of book keeping but also brings some problems which we will discuss below. These problems will help you understand why the Self Balancing System was developed.

Advantages or Uses of Self Balancing Ledger

We implement the Self Balancing System for the following advantages:

- Errors are detected locally and quickly
- If errors creep into a particular ledger, only that ledger is required to be checked. Other ledgers need not be compared.
- Serves as a basis for internal check system
- A number of persons are engaged for different ledgers. Unless all of them enter into any collusion, frauds can be minimised. It ensures accountability of the persons maintaining the ledgers.
- Volume of work of a particular ledger remains manageable

Self balancing journal entries

- a. Journal entries to make sales ledger self balancing

- I. For items appearing on the debit side of debtors account

Sales Ledger Adjustment Account (in General Ledger) Dr

To General Ledger Adjustment Account (in sales ledger) Cr

- II. For items appearing on the credit side of debtors account

General Ledger Adjustment Account (in sales ledger) Dr

To Sales Ledger Adjustment Account (in General Ledger) Cr

- b. Journal entries to make purchases ledger self balancing

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- I. For items appearing on the credit side of creditors account

General Ledger Adjustment Account (in purchases ledger) Dr

To purchases Ledger Adjustment Account (in General Ledger) Cr

- II. For items appearing on the debit side of the purchases account

Purchases Ledger Adjustment Account (in General Ledger) Dr

To General Ledger Adjustment Account (in purchases ledger) Cr

under **sectional-balancing**, only a **section** of the group of the **ledgers** is made to balance. Thus, when only one of the three different **ledgers** is made to balance, it may be known as **sectional balancing**.

Differences between Self-Balancing and Sectional Balancing

Self-Balancing :

- (i) Control accounts are prepared in all the ledgers. In the general ledger, debtor's ledger adjustment account and creditor's ledger adjustment account are prepared.
- (ii) A trial balance can independently be prepared from each one of the ledgers.
- (iii) All the ledgers form part of double entry system.

Sectional :

- (i) Control accounts are prepared in general ledger only. The names of these control accounts are total debtors accounts and total creditors account. Personal ledgers namely debtors ledger and creditors ledger have no control account.
- (ii) A trial balance can be prepared only from the general ledger.
- (iii) Double entry system is completed in the general ledger only. Debtor's ledger and creditor's ledger serve only as memorandum books of account.

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In the General Ledger

Debtors Ledger Adjustment Account

Particulars	Rs	Particulars	Rs
To Balance b/f	XXX	By Balance b/f (if any)	XXX
To General ledger Adjustment A/c:		By General ledger Adjustment A/c:	
Sales (sales credit)	XXX	Sales Returns	XXX
B/R Dishonored	XXX	Cash & received	XXX
Interest charged	XXX	Bill receivable	XXX
Notary charges	XXX	Discount allowed	XXX
Cash paid	XXX	Bad debts	XXX
To Balance c/d (if any)	XXX	Transfer (if any)	XXX
		By Balance c/d	XXX

Creditors Ledger Adjustment Account

Particulars	Rs	Particulars	Rs
To Balance b/d (if any)	XXX	By Balance b/d	XXX
To General ledger Adjustment A/c:		By General ledger Adjustment A/c:	
Cash & Cheque paid	XXX	Purchases (Credit)	XXX
Returns onwards	XXX	B/R Dishonored	XXX
Discount received	XXX	By Balance c/d	XXX

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Bills payable accepted	XXX		
Transfer (if any)	XXX		
To Balance c/d	XXX		

In the Debtors Ledger

General Ledger Adjustment Account

Particulars	Rs	Particulars	Rs
To Balance b/f (if any)	XXX	By Balance b/d	XXX
To Debtors ledger Adjustment A/c:		By Debtors ledger Adjustment A/c:	
Sales Returns	XXX	Sales (credit)	XXX
Cash & cheque received	XXX	B/R Dishonored	XXX
Bill receivable received	XXX	Interest charged	XXX
Discount allowed	XXX	Notary charges	XXX
Bad debts	XXX	Cash paid	XXX
Transfer (if any)	XXX	By Balance c/d (if any)	XXX
To Balance c/d	XXX		

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In the Creditors Ledger

General Ledger Adjustment Account

Particulars	Rs	Particulars	Rs
To Balance b/d	XXX	By Balance b/d (if any)	XXX
To creditors ledger Adjustment A/c:		By creditors ledger Adjustment A/c:	
Purchases (Credit)	XXX	Cash & Cheque paid	XXX
Cheque & B/R Dishonored	XXX	Returns onwards	XXX
To Balance c/d (if any)	XXX	Discount received	XXX
		Bills payable accepted	XXX
		By Balance c/d	XXX