TUTOR MARKED ASSIGNMENT

Course Code	**:**	**ECO - 02**
Course Title	**:**	**Accountancy – I**
Assignment Code	**:**	**ECO – 02/TMA/2016-17**
Coverage	**:**	**All Blocks**

Maximum Marks: 100

Attempt all the questions.

1. Why is journal sub-divided? Name the special journals generally maintained by the business and state the type of transactions entered in each of them.

(20)

2. Why is distinction between capital and revenue important? Give examples to show how wrong classification can affect the ascertainment of profit.

(20)

3. Distinguish between normal loss and abnormal loss with examples. What procedure is followed for valuation of closing stock when the abnormal and normal losses occur simultaneously?

(20)

4. What is a single entry system? What are its drawbacks? Explain the two methods of ascertaining profit when accounting records are incomplete.

(20)

5. Raghav & Sons purchased a car for Rs. 1,00,000 on Ist January, 2012. The car was depreciated at 10% under the w.d.v. method on Ist January, 2015, they wanted to change the method of depreciation from w.d.v. method to straight line method without changing the rate. Show the asset account from 2012 to 2015.

(20)

ASSIGNMENT SOLUTIONS GUIDE (2016-2017)

E.C.O.-2

Accountancy-1

Attempt all the questions.

Q. 1. Why is journal sub-divided? Name the special journals generally maintained by the business and state the type of transactions enterred in each of them.

Ans. Subsidiary books are the book of original entry and it is also called primary records because the first entry of transaction is made in subsidiary books. On the basis of subsidiary books postings are made into concerned account afterwards.

Following types of books are used under subsidiary books:

1. Purchase book
2. Sales book
3. Cash book
4. Purchase return book
5. Sales return book
6. Bills received book

1. Purchase Book: This book is used for recording goods purchased on credit. This book is also known as invoice book, bought book or purchased journal. It must be noted that only credit purchases are recorded in this book. Things purchased on credit for personal use are not recorded in this book. It also does not record the fixed assets purchased.

It is not necessary to record the transaction in the journal book where they are enter in the purchase book, because this book contains the name and address of seller, date of transaction and amount of goods. After recording in purchases book separate amount is to be open in the ledger for each supplier of goods. The amount of each purchase will be credited to its respective personnel account.

Date	Particulars	Invoice No.	L.F.	Amount

Form of the Purchase Book

Usual Purchase book should have columns for date, invoice number, particulars, ledger folio, details and amount.

Invoice

When we purchase goods on credit we receive a statement from the supplier giving the particulars of the goods supplied by him. This statement is called an invoice. The invoice states the quantity, price and value of goods supplied. It also states the discounts allowable (trade and cash) and the conditions under which payment is expected.

Sales Book

In this book are recorded all goods sold on credit. The ruling is similar to that of purchases book. If there are cash sales they are recorded in cash book and sale of assets (distinguish between goods and assets) are recorded in the journal proper. The entries in the sales book are made from the copies of the invoices which have been sent to the customers along with the goods. Such copies of the invoices may be termed as ‘Outward invoice’ each such outward invoice should be numbered consecutively and the reference be given in the sales book along with the entry posting. The net amounts of the invoices are posted to the ledger as follows: Debit the personal accounts of the customers with the value of sales to them. Credit Sales account with the periodical total.

Purchases Returns Book

This book is also known as “Returns Outwards Book”. It records all returns of goods bought. Goods purchased may have to be returned to the supplier for various reasons such as not up to sample or not ordered or damaged during the transit etc. The ruling of the return books is identical with the ruling of purchases book.

Debit Note

While returning the goods to the suppliers a letter is sent to them for their information and stating therein that we have debited your account by this amount on account of goods being returned herewith for the reasons stated. Generally such ‘information letters’ are printed with counterfoil. Debit notes are sent to the parties concerned the counterfoils providing the base for writing up the purchases returns book.

Credit Note

When a debit note is received along with the goods returned from the customer, it’s a claim on us. If claim is accepted then Credit Note, usually printed in red ink, with full details is sent to the customer signifying our acceptance of the goods and customer’s account being given the required credit. Counterfoils provide the base for writing up the Sales Returns Book.

Sales Returns Book

This book is also known as “Returns inwards book”. It records all returns of goods sold. Goods sold may be returned by our customers for various reasons such as goods sent being of wrong description or inferior quality or damaged. Ruling is identical with the ruling of sales book. Credit Note: When a debit note is received along with the goods returned from the customer, it is a claim on us. If claim is accepted then Credit Note, usually printed in red ink, with full details is sent to the customer signifying our acceptance sof the goods and customer’s account being given the required credit. Counterfoils provide the base for writing up the Sales Returns Book.

Bills Receivable Book

All receipts of bills are entered in a book called bills receivable book. Whenever a bill of exchange is received its particulars are entered in the appropriate columns of the Bills Receivable Book. Posting from bills receivable book. The periodical total of the bills receivable book is posted to the debit of the bills receivable account in the ledger. Each entry in the book is posted to the credit of the individual account from whom the bill is received.

Bills Payable Book

The details of the bills accepted by a trader are recorded in the book known as Bills Payable Book. Posting of the bills payable book.The periodical total of the bills payable book is posted to the credit of the bills payable account in the ledger. Each entry in the book is posted to the debit of the individual account to whom the bill is granted.

JOURNAL PROPER

The introduction of subsidiary books to record credit purchases, credit sales, returns inwards, return outwards, cash transactions and bill transactions has reduced to very great extent the need for journalising a transaction, as the first entry is made in these subsidiary books and then posted to in the ledger. But still there are definitely some types of transactions left out. There are no separate subsidiary books for them. As such transactions are limited in number; it is not desirable to introduce separate subsidiary books for them. Therefore journal proper is used as a common account book to record such transactions and they get posted in the ledger. Such transactions normally include the following activities of the business concerns:

- Consignment of goods
- Joint venture
- Credit purchase and credit sales of business assets
- Personal consumption of goods by theft, fire etc.

- Loss or destruction of goods by theft, fire etc.
- Claims from insurance companies, railways etc.
- Dishonour of bills of exchange.

These and other types of business activities may not occur daily. Therefore they are conveniently journalised in the journal proper. The term 'Proper' is being used to distinguish the journal from the original concept of journal where all transactions are recorded.

Apart from the above seven types of transactions the following entries are also passed through the journal proper:

(a) Opening entries
(b) Transfer entries
(c) Rectifying entries
(d) Closing entries
(e) Adjusting entries.

1. Opening Entries: We know that accounts are closed at the end of the financial year and a balance sheet is prepared, but in subsequent year when the activities commence an opening entry has to be passed. Each asset should be debited separately and similarly each liability should be credited separately. e.g.

Sundry Assets (Each Separately) A/c. ....Dr.
To Sundry Liabilities A/c. ....
(Each Separately)...................................
To Capital A/c. ....
(Being last year's balance brought forward)

2. **Transfer Entries:** There are occasions when the balance of one account is to be transferred to another account e.g., When a debtor becomes insolvent and no amount from him is recoverable there is no point in showing the debtor's A/c in the ledger balances. So it is better to close it by transferring that debit balance to the bad debts A/c.

Bad Debts A/c Dr. ....
To X A/c...................................
(Being bad debts accounted for)

Another occasion is when the proprietor requires for his personal use at home certain pieces of furniture already brought for office use:

Drawing A/c Dr. ....
To Furniture A/c...............................
(Being furniture withdrawn for personal use)

Similarly, when the proprietor requires some of the goods for his personal consumption the entry will be:

Drawings A/c Dr. ....
To Purchases A/c ....
(Being goods withdrawn for the personal use)

It is credited to purchases account on the basis that the proprietor takes at the purchases price the purchases are reduced. If he takes at the sales price, the sales account may be credited, treating it as sales. In that case, the entry will be as follows:

Drawing A/c Dr. ....
To Sales A/c....................................

3. Rectifying Entries: It is not unusual that mistakes arise in book-keeping. Some times wrong heads of accounts are debited e.g. when furniture is purchased a wrong entry , debiting purchases account may be passed. We can't erase any entry in the accounts book so the only remedy is to rectify mistakes by passing rectification entry as:

Furniture A/c. Dr. ....
To Purchases A/c. ....

4. Closing Entries: At the year end, we have to find out the profit of the concern for this purpose, some of the accounts have to be closed e.g. Salaries A/c, Rent A/c and Office Expenses etc.

Profit & Loss A/c Dr. ....
To Salaries A/c...............................

5. Adjusting Entries: To find out profit or loss accurately, some adjustments in the various accounts become necessary. Let us take the case of machinery which was purchased at the year beginning for Rs. 10,000 and it has been used throughout the year in the profit earning process. The machine would have undergone wear and tear. If we show it at its original value at the end of the year also, the account will not show true and fair view of the point. Therefore we have to charge depreciation.

Depreciation A/c Dr. ....

To Machinery A/c ....

Q. 2. Why is distinction between capital and revenue important? Give examples to show how wrong classification can affect the ascertainment of profit.

Ans. Capital Expenditure: Capital expenditure consists of expenditure, the benefit of which is not fully enjoyed in one accounting period but spread over several accounting periods. It includes assets acquired for the purpose of earning income or increasing the earning capacity of the business or effecting economy in the operation of an asset. These are not meant for sale. Expenditure incurred for improving assets and extending an existing asset is also capital expenditure.

The sum of invoice price, freight and insurance charges, installation and erection cost and custom duty etc. will be capitalised in the books of a firm. These capital items appear on the assets side of Balance Sheet.

Examples

(a) Interest on capital paid during the period of construction of Company (u/s 208 of Indian Companies Act.).
(b) Expenditure in connection with or incidental to the purchase or installation of an asset.
(c) Acquisition of new assets.
(d) Expenditure incurred for putting the old asset purchased, into working condition.
(e) Additions and extensions to existing assets.
(f) Interest and financing charges paid, brokerage and commission paid.
(g) Betterment of fixed assets or improvement of an asset to produce more, to improve its earning capacity or to reduce its operating expenses or to increase the life of asset.

The cost of assets will be written off by way of depreciation over a period of its life. The amount of depreciation is revenue expenditure and is debited to profit and loss account. The reason for charging depreciation to revenue i.e. profit and loss account is that the asset is used for earning revenue. Hence the depreciation is charged to profit and loss account. Thus, the benefit of capital expenditure does not exhaust in one year but extends over a number of years of its use or life of the asset.

Revenue Expenditure

Revenue expenditure consists of expenditure incurred in one period of the accounting, the full benefit of which is enjoyed in that period only. This does not increase the earning capacity of the business but it is incurred in order to maintain the existing earning capacity of the business. It includes all expenses which arise in normal course of business. The benefit of such expenditure is for a short period, say, one year only and it is not to be carried forward to the next year. The expenditure is of a recurring nature i.e. incurred every year.

Examples

(a) Purchase of raw materials for conversion into finished goods.
(b) Selling and distribution expenses incurred for sale of finished goods e.g. sales office expenses, delivery expenses, advertisement charges, etc.
(c) Establishment expenses like salaries, wages, rent, rates, taxes, insurance, and depreciation on office equipment.
(d) Depreciation of plant, machinery and equipment.
(e) Expenses incurred in order to maintain the existing fixed assets in an efficient and workable state such' as repairs to building, repairs to plant, white-washing and painting of building.

All these items appear on the debit side of trading and profit and loss account, in case of trading concerns or income and expenditure account, in case of non-trading concerns.

We have no hard and fast rule for distinguishing capital expenditure from revenue expenditure because, the same item of expenditure may be treated as capital, revenue or deferred revenue depending upon the circumstances e.g., to a machinery dealer purchase of machinery is a revenue expenditure, while machinery purchased for manufacturing goods is a capital expenditure. In the same way, wage is generally revenue expenditure, but wage paid for the installation and erection of machinery is a capital expenditure.

Following principles are followed to make a distinction between capital expenditure and revenue expenditure:

- Any expenditure that benefits the business for several accounting years is regarded as a capital expenditure; while any expenditure which is incurred again and again is revenue expenditure. Any expenditure which is not incurred repeatedly and regularly is a capital expenditure, while any expenditure which is incurred again and again is revenue expenditure.
- Any expenditure incurred to improve the concern or increases the profit-earning capacity of the concern is a capital expenditure. On the other hand, expenditure incurred to keep the activities of a concern going, is revenue expenditure. Expenditure incurred after buying second-hand asset to bring into proper working order is a capital expenditure. Expenditure incurred on the purchase and installation of a new asset is regarded as capital expenditure.

Accounting fraud occurs because management chooses to classify revenue expenditure as capital expenditure. The revenue expenditure should be taken up into the Income Statement but instead now being suspended or deferred into the Balance Sheet. In the process, lesser expenses are being charge into the Income Statement, hence profit are overstated to impress the investors or outsiders.

Strong GAAP and Accounting standards have classified what should be assets, what should be deferred in the balance sheet so that there should be a clearer demarcation between Capital and Revenue expenditure.

We need to note that certain expenses are recognised as being of a capital nature, although no tangible property may have been acquired as a result. Examples are research and development expenditure, pre-incorporation and preliminary expenses, interest on borrowings for building, legal expenses to acquire property, additional renovations to properties and others.

The classification of what is capital expenditure of a company might not be applicable to another company that is not in the same industry. Say in a property based company, most land and buildings are revenue expenditure as they are purchase with the intent for re-sale.

As we learned from the above, when the purpose of expenditure is to maintain the business it is revenue and if it is to improve the business it is capital. However, at times in a company, the classification of pure capital or revenue expenditure in a company is not so straightforward especially when there is a mixture of both capital and revenue expenditure in nature.

The following points of difference between capital expenditure and revenue expenditure gives the importance of the distinction:

(a) Capital expenditure increases the earning capacity of business whereas revenue expenditure is incurred to maintain the earning capacity.

(b) Capital expenditure benefits more than one accounting year where as revenue expenditure normally benefits one accounting year.

(c) Capital expenditure is incurred to acquire fixed assets for operation of business whereas revenue expenditure is incurred on day-to- day conduct of business. In other words, revenue expenditure is generally recurring expenditure and capital expenditure is non-recurring in nature.

(d) Capital expenditure (in case of Depreciation) is recorded in Balance Sheet whereas revenue expenditure (subject to adjustment for outstanding and prepaid amount) is recorded in either Trading or Profit and Loss Account.

When the management chooses to classify revenue expenditure as capital expenditure, the revenue expenditure that is ought to be taken up into the Income Statement is suspended or deferred into the Balance Sheet. In this process, lesser expenses are being charged into the Income Statement, hence profit are overstated to impress the investors or outsiders. Thus wrong classification of expenses can affect the ascertainment of profit.

Q. 3. Distinguish between normal loss and abnormal loss with examples. What procedure is followed for valuation of closing stock when the abnormal and normal losses occur simultaneously?

Ans. Normal loss and Abnormal loss: Normal loss occurs due to the inherent characteristics of goods such as evaporation, subdivision, drying up of goods, etc. Whereas the loss which occurs on account of the reasons which are accidental or very rare, the loss is termed as abnormal loss. e.g. loss due to theft of goods, destruction of goods etc.

(i) Normal Loss: Such losses occur due to the inherent characteristics of goods. It is obvious that because of this, the value of stock will be lower than otherwise. This will reduce the amount of gross profit and net profit automatically. The amount of loss of goods is credited to the trading account and debited to the profit and loss A/c.

The entries to be passed

Normal Loss A/c or

To Trading A/c

Profit/ A/c

To Normal Loss

Abnormal Loss: Such losses occur because of fire, earthquakes or accidents. These may destroy fixed assets of the firm. In such a case the asset account is credited and the profit and loss Account is debited, the debit may be spread over two or three years.

Stock of goods may also be destroyed or damaged by fire etc. It is obvious that because of this, the value of stock will be lower than otherwise. This will reduce the amount of the gross profit and the net profit automatically. It is however, better to assertion the gross profit which would have been earned in absence of the loss since this enables the firm to judge its trading operations properly. This will be possible by the amount of the loss of goods is credited to the trading account and debited to the profit and loss Account. The increase in the gross profit will be neutralized by the debit to the profit and loss Account. Thus the net profit will not be affected. The entries to be passed.

Loss by five (abnormal loss) A/c ...Dr.

To trading A/c (for stock of good)

To other asset (By name) those that may have been damaged.

Profit and loss A/c ...Dr

To Loss by fire (Abnormal Loss) A/c

If there is an insurance policy to cover the goods or assets concerned, part or the whole of the loss may be covered by the claim admitted by the insurance company. The amount received will be credited to the loss by fire (abnormal loss) A/c, only the remaining account will be transferred to the profit and Loss Account.

Abnormal loss:

The two losses occurred simultanceusy the entries will be

Abnormal Loss A/c ---------------------------Dr.

Normal Loss A/c ---------------------------Dr.

To trading A/c (For stock of goods)

To other Assets (by name) those that have been damaged

Insurance company A/c----------------------------A/c

Profit and Loss A/c ---------------------------Dr.

To Abnormal A/c

To Normal Loss

Q. 4. What is a single entry System? What are its drawbacks? Explain the two methods of ascertaining profit when accounting records are incomplete.

Ans. Two common book-keeping methods used by businesses and other organizations are the single-entry book-keeping system and the double-entry book-keeping system. Single-entry bookkeeping uses only income and expense accounts, recorded primarily in a Revenue and Expense Journal. Single-entry book-keeping is adequate for many small businesses. Double-entry book-keeping requires posting (recording) each transaction twice, using debits and credits.

1. **No checking of Arithmetical Accuracy:** Arithmetical accuracy of the accounts can not be checked because no agreed trial balance can be prepared.
2. **No True Financial Performance:** True financial performance can not be ascertained because trading and Profit & Loss Account cannot be prepared.
3. **No True Financial Position:** True financial position cannot be ascertained because Balance Sheet cannot be prepared.
4. **No Recognition under Laws:** such records are not recognised by the Courts, Sales Tax and Income Tax Authorities.

5. It is difficult to conduct the audit of such records.
6. It is difficult to operate internal control system.
7. It is difficult to operate internal check system.
8. It is difficult to exercise control over assets.
9. It is difficult to detect fraud.

Features of Single Entry:

1. **Suitable for sole traders and partnership firms:** The single entry system is suitable only for sole traders and partnership firms. Companies cannot keep books on single entry system because of legal provisions.

2. Only personal accounts and cash accounts are kept: In this system it is very common to keep only personal accounts and to avoid real and nominal accounts. It also keeps one cash book which mixes up business as well as private transactions.

3. All transactions are not recorded: All business transactions are not recorded in the books of account. Some of them are recorded in the books of accounts, certain transactions are noted in the diary and some of them are in the memories.

4. Lack of uniformity: This system lacks uniformity as it is a mere adjustment of double entry system, according to the convenience of the individual.

5. Collection of information from original documents: It is quite often seen that for information one has to depend on original vouchers. For example, To know total purchases and sales, one has to depend on copies of invoices.

6. Profit only an estimate: Profit under this system is only an estimate.

7. True financial position cannot be ascertained: True financial position cannot be ascertained as Balance Sheet is not prepared due to the absence of nominal and real accounts.

8. Not accepted by Tax Authorities: Due to incompleteness, inaccuracy, and unsystematic nature, it is not accepted by tax authorities.

Accounting records may be incomplete due to any of the following reasons:

1. The businessman may be ignorant of the separate legal entity assumption.
2. The businessman may not intentionally maintain proper accounts to evade taxation.
3. The businessman may be ignorant of the double entry accounting principles .
4. Destruction of books of accounts due to fire, flood etc.
5. It is less expensive as compared to double entry system.

LIMITATIONS

Maintenance of incomplete records suffers from the following limitations:

1. Incomplete and unscientific method: This system is incomplete, because real and nominal accounts are not prepared and also due to the fact that the debit and credit aspect of all transactions are not recorded.

2. Trial Balance cannot be prepared: Quite often this system does not record both the aspects of transactions; therefore, at the end of the year arithmetical accuracy of the books cannot be checked by preparing a trial balance.

3. Performance of the business cannot be ascertained: Trading, profit and loss account cannot be prepared and hence the gross profit, net profit and rate of net profit on sales cannot be known.

4. True financial position cannot be ascertained: It is very difficult to prepare balance sheet, so the true financial position cannot be ascertained.

5. **Comparison with previous year's performance is not possible:** Due to incomplete information and non-availability of previous years' information, comparison between the current and previous years' performance cannot be made. Comparison is required to identify the areas of weakness and rectification.

6. **Unacceptable to tax authorities:** Tax authorities (income tax and sales tax) do not accept accounts prepared according to single entry system for computation of taxes.

7. Difficulty in obtaining loan: Accounts prepared according to this system are not accepted by banks and other money lending institutions, so it is very difficult to obtain loan.

8. Difficult to locate frauds: It is difficult to locate frauds under this system and so employees may become dishonest and negligent. It encourages misappropriation, fraud and carelessness.

METHODS OF ASCERTAINING PROFITS

When accounts are kept under single entry system, the following methods are adopted to find out profit or loss of the business:

1. Statement of affairs method or Net worth method or Capital comparison method.
2. Conversion method .

Statement of Affairs Method: The following procedures are adopted to calculate profit:

Step 1 - Ascertain opening capital: A statement of affairs at the beginning of the year is prepared to find out the amount of capital in the beginning. A statement affair is like a Balance sheet. The difference between assets and liabilities side represents "Opening Capital."

Format of Statement of Affairs

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	xxxx	Cash in Hand	xxxx
Bills Payable	xxxx	Cash at Bank	xxxx
Outstanding Expenses	xxxx	Sundry Debtors	xxxx
Bank Overdraft	xxxx	Bills Receivable	xxxx
Capital (Balancing figure)	xxxx	Stock in Trade	xxxx
		Prepaid Expenses	xxxx
		Fixed Assets	xxxx
	xxx		xxx

Step 2 - Ascertainment Closing Capital: Prepare a statement of affairs (after all adjustments*) at the end of the accounting period, to ascertain closing capital.

Step 3 - Add the amount of drawings (whether in cash or in kind) to the closing capital.

Step 4 - Deduct the amount of Additional Capital introduced, from the above, to get Adjusted capital.

Step 5 - Ascertainment profit or loss by deducting opening capita from the adjusted closing capital. Adjusted closing capital = Closing capital + Drawings Additional capital introduced during the year.

**** Adjustments:** Depreciation, interest on capitals, interest on drawings Provision for Bad debts etc.*

Distinction between Statement of Affairs and Balance Sheet:

Statement of affairs which looks like a balance sheet differs from the balance sheet in the following respects.

Basis of Distinction	Balance Sheet	Statement of Affairs
1. Objectives	To Know the financial position of the business.	To find out the capital of business.
2. Accounting method	When accounting is maintained under double entry system, balance sheet is prepared.	Statement of affairs is prepared when accounts are maintained under single entry system of accounting.
3. Basis of preparation	It is prepared exclusively on the basis of ledger accounts.	It is prepared on the basis of some ledger accounts and estimates,
4. Reliability	It is regarded as a reliable statement.	It is not regarded as reliable.
5. Missing of Facts	Since both the aspects of all transactions are duly recorded, no chance for missing of facts.	There remains always a possibility for missing of facts, because the accounts are incomplete.

NET WORTH METHOD

Under this method profits are calculated by comparing the net worth at the beginning of the accounting period with the net worth at the end of the accounting period. This method does not involve the preparation of trading and profit and loss account. It is considered most suitable when the information available is too limited.

Q. 5. Ragav & Sons purchased a car for Rs. 1,00,000 on Ist January, 2012. The car was depreciated at 10% under the w.d.v. method on Ist January, 2015 they wanted to change the method of depreciation from w.d.v. method to straight line method without changing the rate. Show the asset account from 2012 to 2015.

Ans. Machinery A/c of M/s Raghav and Sons

Date	Particulars	Amount	Date	Particular	Amount
2012 January	To Bank A/c	1,00,000	2012 December 12	By Depreition A/c	10,000
				By Balance c/d	90,000
		1,00,000			1,00,000
2013 January	To Balance B/d	90,000	2013 December 31	By Depreciation A/c	9000
				By Balance C/d	81,000
		90,000			90,000
2014 January	To Balance B/d	81,000	2014 December 31	By Deposit in A/c	8100
				By Balance C/d	72900
		81,000			81,000
2015 January	To Balance B/d	72900	2015 December 15	By Depreiation see notes	12,900
				By Balance C/d	60,000
		72,900			72,900
2016 January	To Balance B/d	60,000			

Working Notes	Rs
Depreciation on machinery @ 10 % P.	
Under Straight line method from	
1-1-2012 to 31-12-2012 (1000 × 4)	40,000
Less Deprciation already charged on	
Machinery under written	
Down value method from 1-1-2012 to	
31-12-2014 (10,000 + 9000 + 8100)	27,100
Depreciation Charged for the Year ending 31-12-2015	12900

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