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CA FOUNDATION

Principles & Practice of Accounting

Final Accounts of Sole Proprietors

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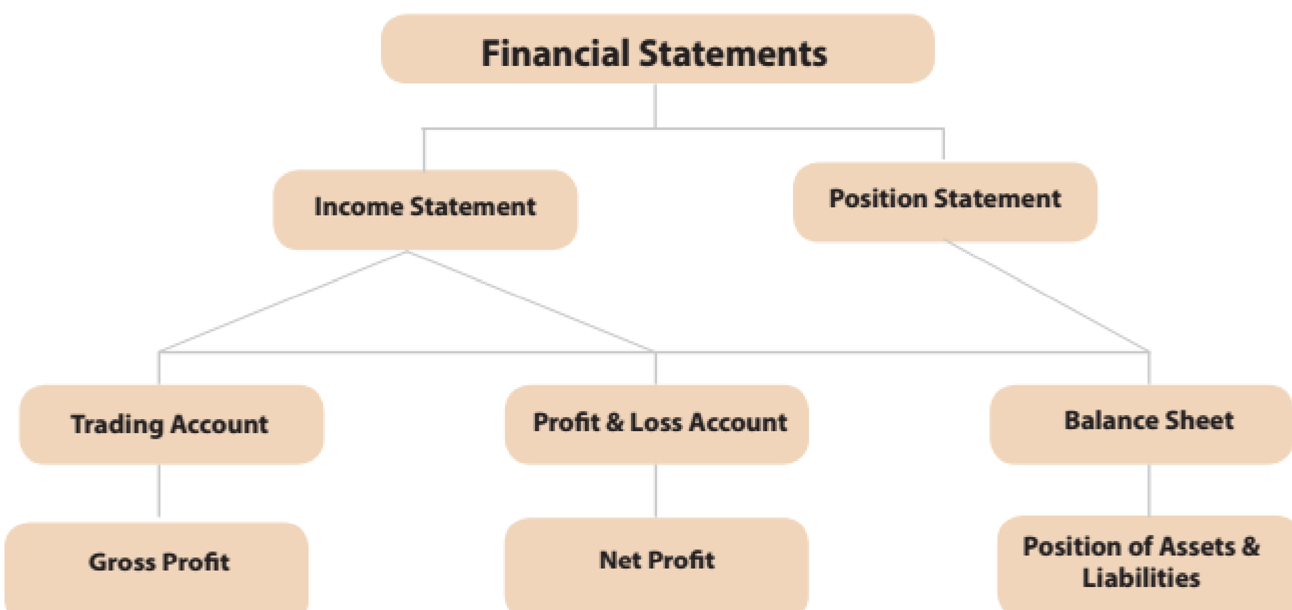
CHAPTER-7
PREPARATION OF FINAL ACCOUNTS OF SOLE PROPRIETORS

UNIT : 1

FINAL ACCOUNTS OF NON-MANUFACTURING ENTITIES

INTRODUCTION

Non-manufacturing entities are the trading entities, which are engaged in the purchase and sale of goods at profit without changing the form of the goods. In other words, non-manufacturing entities do not process the goods purchased and sell them in its original form. Meanwhile it indulges in some liabilities, makes some assets and also incurs some expenses like salaries, stationery expenses, advertisement, rent etc. to run the business. At the end of the accounting year, the entity must be interested in knowing the results of the business. To ascertain the final outcome of the business i.e., the income and financial position, they prepare financial statements at the end of the year.



➲ TRADING ACCOUNT

At the end of the year, as has been seen above, it is necessary to ascertain the net profit or the net loss. For this purpose, it is necessary to know the gross profit or gross loss. Gross Profit is the difference between the selling price and the cost of the goods sold. For a trading firm, the cost of goods sold can be ascertained by adjusting the cost of goods still on hand at the end of the year against the purchases. It is done as follow:-

Opening Stock	***
Add:- Purchases (Net)	**
Add:- Direct Expenses	**
	***
Less :- Cost of Goods Sold	(**)
Closing Stock	***

Trading Account of.....for the year ended.....

Rs.	By Sales	XXX		
To Opening Stock	XXX	*Less*: Returns Inwards		XXX
XXX				
To Purchases	XXX	XXX		
XXX				
Less: Returns outwards		By Closing Stock		XXX
To Direct expenses:	XXX	By Gross Loss c/d*		
Freight & Carriage	XXX			
Customs & Insurance	XXX			
Wages	XXX			
Gas, Water				
& Fuel	XXX			
Factory				
Expenses	XXX	XXX		
Royalty on production				
	XXX			
	XXX			XXX
To Gross Profit c/d*				

*Only one will appear

Points to Remember:-

- ➲ The opening inventory and purchases are written on the debit side.
- ➲ Sales and the closing inventory are entered on the credit side.
- ➲ If there are any direct expenses then they should also be written on the debit side of the Trading account.
- ➲ If the balance of credit side is more, the difference is written on the debit side as gross profit. This amount will also be carried forward to the Profit and Loss Account on the credit side.
- ➲ In case of gross loss, i.e., when the debit side of the Trading Account exceeds the credit side, the amount will be written on the credit side of the Trading Account and transferred to the debit side of the Profit and Loss Account.

If Closing Stock appears in the Trial balance:-

- The closing inventory is then not entered in the trading account, it is shown only in the balance sheet. This is because it has already been adjusted to arrive at Cost of Goods Sold
- The valuation principle is cost or net realisable value whichever is lower.

CLOSING ENTRIES IN RESPECT OF TRADING ACCOUNT

The following entries will be required:

(i) **For opening Inventory:** Debit Trading Account and Credit inventory Account.

(ii) **For purchases returns:** Debit Returns Outward Account and Credit Purchases Account.

For returns inward: Debit Sales Account and Credit Returns Inwards Account. (In the trading account information is usually given both in respect of gross sales; and purchases and the respective returns).

(iii) **For purchases account:** Debit Trading Account and Credit Purchases Account, the amount being the net amount after return.

(iv) **For expenses** to be debited to the Trading Account, for example wages etc. Debit Trading Account and credit the concerned expenses accounts individually.

(v) **For sales:** Debit Sales Account with the net amount after returns, and Credit Trading Account.

The student will see that all the accounts mentioned above will be closed except for the Trading Account.

(vi) **For closing Inventory:** Debit Inventory Account and Credit Trading Account. The inventory Account will be carried forward to the next year.

Except entries mentioned in (ii) above, the other entries are usually summarised as follows:

(1) Trading Account Dr.

To Opening Inventory Account

To Purchases Account

To Wages Account

To Freight on Purchases Account, etc.

(2) Sales Account Dr.

Closing Inventory Account Dr.

To Trading Account

At this stage Trading Account will reveal the gross profit, if the credit side is more, or gross loss if the credit side is less. The gross profit will be transferred to the Profit and Loss Account.

- **PROFIT AND LOSS ACCOUNT**

Dr. **Profit and Loss Account for the year ended......** Cr.

Particulars	**Rs.**	**Particulars**	**Rs.**
To Gross Loss b/d		By Gross Profit b/d	
Management expenses		**Other Income**	
To Salaries (administrative)		By Discount Received	
To Office rent, rates and taxes		By Commission Received	
To Printing and stationery		**Non-trading Income**	

To Telephone charges		By Bank Interest	
To Postage and telegrams		By Rent of property let-out	
To Insurance		By Dividend from shares	
To Audit Fees		**Abnormal Gains**	
To Legal Charges		By Profit on sale of machinery	
To Electricity Charges		By Profit on sale of investment	
Maintenance expenses			
To Repairs & renewals		**By Net Loss (transferred to capital A/c)**	
To Depreciation on:			
Office equipment			
Office furniture			
Office Buildings			
Selling and Distribution expenses			
To Salaries (selling staff)			
To Advertisement			
To Godown rent			
To Carriage Outward			
To Bad Debts			
To Provision for bad debts			
To Selling commission			
Financial expenses			
To Bank charges			
To Interest on loans			
To Discount on bills			
To discount allowed to customers			
Abnormal Losses			
To Loss on sale of machinery			
To Loss on sale of investment			
To loss by fire			
To Net Profit (transferred to Capital A/c)			

We shall now consider a few items individually:

(i) **Drawings:** Drawings are not expenses for the firm but reduction of capital and therefore should not be debited to the Profit and Loss Account but to Capital account of the proprietor.

Capital A/c Dr.

To Drawings

If the proprietor has enjoyed some benefit personally, like use of the firm's car, a suitable amount should be treated as drawing and to that extent the charge to the Profit and Loss Account will be reduced, Drawings are debited to the proprietor's capital account.

(ii) Income Tax: In case of companies, the income tax payable is treated like other expenses. But in the case of sole proprietorship, income tax is treated as a personal expense. It is debited to the Capital Account and not to the Profit and Loss Account.

Capital A/c Dr.

To Income Tax A/c

This is because the amount of the tax will depend on the total income of the partners or proprietor besides the profit of the firm. In case of partnership business, firm's tax liability is to be debited to profit and loss account of the firm but partners' tax liability are not to be borne by the firm. Therefore if the firm pays income tax on behalf of partners, such payment of personal income tax should be treated as drawings.

(iv) Bad Debts: When a customer does not pay the amount due from him and all hopes of recovering the amount are lost, it is said to be a bad debt. It is a loss to the rm. Therefore, the bad debts account is debited, which is later on written in the Profit and Loss Account on the debit side. Since it is no use showing the amount due still as an asset, the account of the customer concerned is closed by being credited. The entry

Bad Debts Account Dr.

To Debtor's / Customer (by name) Account

Profit/Loss Account Dr.

To Bad Debts A/c

In case of Provision for Bad debts has already been prepared then bad debts should be written off Entry for it will be:

Provision for Bad Debts a/c Dr.

To Bad Debts a/c

If later on, the amount is recovered, it should be treated as a gain. It should not be credited to the party paying it. It should be credited to Bad Debts Recovered Account. It will be entered in the Profit and Loss Account on the credit side.

Bad Debts Recovered Account Dr.

To Profit/Loss Account

CLOSING ENTRIES

The entries that have to be made in the journal for preparing the Trading and the Profit and Loss Account that is for transferring the various accounts to these two accounts are known as closing entries. We have already seen the entries required for preparing the Trading Account and for transferring the gross profit to the profit and Loss Account. Now to complete the Profit and Loss Account, the under mentioned three entries will be necessary.

(a) For items to be debited to the Profit and Loss Account this account will be debited and the various accounts concerned will be credited. For example,

Profit and Loss Account Dr.

To Salaries Account

To Rent Account

To Interest Account

To Other Expenses Account

(b) Items of income or gain such as interest received or miscellaneous income will be credited to Profit and Loss Account.

Discount Received Account Dr.

Bad debts Recovered Account Dr.

To Profit and Loss Account

(c) At this stage, the Profit and Loss Account will show net profit or net loss. Both have to be transferred to the Capital Account. In case of net profit, i.e., when the credit side is bigger than the debit side, the entry is:

Profit and Loss Account Dr.

To Capital Account

In the case of net loss, the entry will be

Capital Account Dr.

To Profit and Loss Account

Commission based on profit: Sometimes commission is payable to manager based on net profit; in such a case calculation is done as follows:

(i) Commission on net profit before charging such commission =

$$\text{Profit before commission} \times \frac{\text{Rate of commission}}{100}$$

(ii) Commission on net profit **after** charging such commission =

$$\text{Profit before commission} \times \frac{\text{Rate of commission}}{100 + \text{rate of commission}}$$

BALANCE SHEET

ARRANGEMENTS OF ASSETS AND LIABILITIES

(1) Assets: Assets may be grouped in one of the following two ways:

(i) Liquidity: Under this approach, the asset, which can be converted into cash first, is presented first. Those assets, which are most difficult in this respect, are presented at the bottom. As per Liquidity the balance sheet can be prepared as follow:-

Liabilities	Amount Rs.	Assets	Amount Rs.
Bills Payable		Cash in Hand	
Trade Creditors		Cash at Bank	
Loans		Government Securities	
Outstanding Expenses		Other Investments	
Reserves & Surplus		Bills Receivable	
Capital		Sundry Debtors	
		Stock	
		Furniture & Fixtures	
		Plant & Machinery	
		Land and Building	

(ii) Permanence: Assets, which are to be used, for long term firm in the business and are not meant to be sold are presented first. Assets, which are most liquid, such as cash in hand, are presented at the bottom.

Balance Sheet as at

Liabilities	Amount Rs.	Assets	Amount Rs.
Capital		Land and Building	
Reserves & Surplus		Plant & Machinery	
Outstanding Expenses		Furniture & Fixtures	
Loans		Stock	
Trade Creditors		Sundry Debtors	
Bills Payable		Bills Receivable	
		Other Investments Government Securities	
		Cash at Bank	
		Cash in Hand	

Note:- Some of the assets may be capable of being sold easily like investment in government securities or shares of some companies. They should be treated as liquid or permanent according to the intention of the firm.

(2) Liabilities: Liabilities may also be shown according to the urgency with which payment has to be made. One way is to first show the capital, then long-term firm liabilities and last of all short term firm liabilities like amounts due to suppliers of goods or bills payable. The other way is to start with short-term firm liabilities and then show long term firm liabilities and last of all capital.

CLASSIFICATION OF ASSETS AND LIABILITIES

Assets are basically of two types:

Current Assets: - these assets are meant to be converted into cash as quickly as possible. Generally within one year. For Example:- Cash in hand, Cash at Bank, Trade receivables, Inventories.

Long Term firm Assets: - Those that are meant to be used by the firm over a long period and not sold the former type of assets is also called fixed assets. For Example Machinery, Building, Long term firm Investment.

Intangible Assets: - the assets which have no physical existence and cannot be seen or touched are called as Intangible Assets. For example Patents, Copyrights etc.

It is desirable that in the balance sheet the two types of assets should be shown separately and prominently.

This would give meaningful and logical information.

Liabilities to outsider will be of two types:

Current Liabilities: - this liability must be settled in one year or less. It is also called as short term firm liability.

For Example:- Creditors, Bills Payable etc.

Long Term firm Liability: - those liabilities which exists for more than one year are Long term firm liabilities. For example long term firm loans from banks. Of course, it will include undistributed profits also.

Sole proprietors generally present Balance Sheet in a horizontal form with "Capital and Liabilities" on the left hand side and 'Assets' on the right-hand side. In the Balance Sheet the various items should be grouped suitably as indicated below:

Balance Sheet as on

Liabilities	**Amount Rs.**	**Assets**	**Amount Rs.**
Capital A/c:		Tangible Fixed Assets :	
Balance		Land and Building	
Add : Net Profit/*Less*: Net Loss		Plant and Machinery	
Less : Drawings		Furniture and Fixture	
Long Term Loans :		Vehicles	
Term Loans		Intangibles :	
Other Loans			
Goodwill			
Short Term Loans :		Patent Rights	
Cash Credit		Designs and Brand Names	
Overdrafts			
Other Loans		Investments	
Current Liabilities :		Long term investments	
Trade payables		Current Assets :	
Outstanding Expenses		Inventory in Trade	
Advances Taken		Trade receivables	
Provision :		Short term investments	
Provision for Bad debts		Prepayments	
Provision for Retirement Benefits		Advances	
Provision for Taxation		Bank Balances	
		Cash In Hand	

➲ SEQUENCE OF ACCOUNTING PROCEDURE OR THE ACCOUNTING CYCLE

What has been done so far shows that the accounting process in the following order :

(i) recording the transactions in the journal or journalising;

(ii) preparing ledger accounts on the basis of the journal or posting into the ledger;

(iii) taking out the trial balance to check arithmetical accuracy;

(iv) preparing the trading and profit and loss account or the income statement for the period concerned; and

(v) preparing the balance sheet to show the financial position at the end of the period.

➲ PROVISIONS AND RESERVES

Provision means "any amount written off or retained by way of providing for depreciation, renewal or diminution in the value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy". A provision is a liability which can be measured only by using a substantial degree of estimation.

Thus, a provision may be either in respect of loss in the value of an asset provided or written off on the basis of an estimate or the one in respect of a liability for expenses incurred in respect of a claim which is disputed i.e. when it is a contingent liability. On the occurrence of a diminution in asset values due to some of them having become irrecoverable or Inventory items are lost as a result of some natural calamity, amounts contributed or transferred from profit to make good the diminution also are described as provision.

The following are instances of amount retained in the business out of earning for different purposes that are described as provisions.

(1) Amount provided for meeting claims which are admissible in principle but the amount whereof has not been ascertained.

(2) An appropriation made for payment of taxes still to be assessed.

(3) Amount set aside for writing o bad debts or payment of discounts.

The portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability is known as reserves. The reserves are primarily of two types: capital reserves and revenue reserves. Also provisions in excess of the amount considered necessary for the purposes these were originally made, are to be considered as reserves. ***It is thus evident that provisions are a charge against profits, while reserve is an appropriation of profits.*** Also provisions that ultimately prove to be in excess of amounts required or have been made too liberally are reserves. Such a distinction is essential for disclosing truly in the Balance Sheet the amount by which the equity of shareholders has increased with the accumulation of undistributed profits.

Reserve Fund: It signifies the amount standing to the credit of the reserve that is invested outside the business in securities which are readily realisable e.g., when the amounts set apart for replacement of an asset are invested periodically, in government securities or shares. The account to which these amounts are annually credited is described as the Reserve Fund.

CLASS WORK

Q-1 From the following particulars extracted from the books of Ganguli, prepare trading and profit and loss account and balance sheet as at 31st March, 2016 after making the necessary adjustments:

Ganguli's capital account (Cr.)	5,40,500	Interest received	7250
Stock on 1.4.2015	2,34,000	Cash with Traders Bank Ltd.	40,000
Sales	14,48,000	Discounts received	14,950
Sales return	43,000	Investments (at 5%) as on 1.4.2015	25,000
Purchases	12,15,500	Furniture as on 1-4-2015	9,000
Purchases return	29,000	Discounts allowed	37,700
Carriage inwards	93,000	General expenses	19,600
Rent	28,500	Audit fees	3,500
Salaries	46,500	Fire insurance premium	3,000
Sundry debtors	1,20,000	Travelling expenses	11,650
Sundry creditors	74,000	Postage and telegrams	4,350
Loan from Dena Bank Ltd. (at 12%)	1,00,000	Cash in hand	1,900
Interest paid	4,500	Deposits at 10% as on 1-4-2015 (Dr.)	1,50,000
Printing and stationery	17,000	Drawings	50,000
Advertisement	56,000		

(1) Value of stock as on 31st March, 2016 is Rs. 3,93,000. This includes goods returned by customers on 31st March, 2016 to the value of Rs. 15,000 for which no entry has been passed in the books.

(2) Purchases include furniture purchased on 1st January, 2016 for Rs.10,000.

(3) Depreciation should be provided on furniture at 10% per annum.

(4) The loan account from Dena bank in the books of Ganguli appears as follows

31.3.2016 To Balance c/d	1,00,000	1.4.2015 By Balance b/d	50,000
		31.3.2016 By Bank	50,000
	1,00,000		1,00,000

(5) Sundry debtors include Rs. 20,000 due from Robert and sundry creditors include Rs. 10,000 due to him.

(6) Interest paid include Rs. 3,000 paid to Dena bank.

(7) Interest received represents Rs. 1,000 from the sundry debtors and the balance on investments and deposits.

(8) Provide for interest payable to Dena bank and for interest receivable on investments and deposits.

(9) Make provision for doubtful debts at 5% on the balance under sundry debtors. No such provision need to be made for the deposits.

Q-2 Sengupta & Co. employs a team of eight workers who were paid Rs.30,000 per month each in the year ending 31st December, 2015. At the start of 2016, the company raised salaries by 10% to Rs.33,000 per month each.

On July 1, 2016 the company hired two trainees at salary of Rs.21,000 per month each. The work force are paid salary on the rst working day of every month, one month in arrears, so that the employees receive their salary for January on the rst working day of February etc.

You are required to calculate:

(i) Amount of salaries which would be charged to the profit and loss for the year ended 31st December, 2016.

(ii) Amount actually paid as salaries during 2016 Outstanding Salaries as on 31st December, 2016

Q-3 Mr. Kotriwal is engaged in business of selling magazines. Several of his customers pay money in advance for subscribing his magazines. Information related to year ended 31st March 2017 has been given below:

On 1.4.2016 he had a balance of Rs. 2,00,000 advance from customers of which Rs. 1,50,000 is related to year 2016-17 while remaining pertains to year 2017-18. During the year 2016-17 he made cash sales of Rs. 5,00,000. You are required to compute:

i) Total income for the year 2016-17.

ii) Total money received during the year if the closing balance in advance from customers account is Rs. 1,70,000.

Q-4 Mr. Birla is a proprietor engaged in business of trading electronics. An excerpt from his Trading & P&L account is as follows:

Trading and P&L A/c for the year ended 31st March, 2017

Particulars	**Rs.**	**Particulars**	**Rs.**
To Cost of Goods Sold	45,00,000	By Sales	C
To Gross Profit c/d	D		
	F		
			F
To Rent A/c	26,00,000	By Gross Profit b/d	D
To Office Expenses	13,00,000	By Miscellaneous Income	E
To Selling Expenses	B		
To Commission to Manager			
(on Net Profit	2,00,000		
before charging such commission)			
To Net Profit	A		
	G		60,00,000

Commission is charged at the rate of 10%.

Selling Expenses amount to 1% of total sales.

You are required to compute the missing figures.

Q-5 On 1st Jan. 2017 provision for Doubtful Debts existed at Rs. 40,000. Trade receivables on 31.12.2017 were Rs. 15,00,000; bad debts totalled Rs. 1,00,000. It is required to write o the bad debts and create a provision equal to 5% of the Trade receivables' balances.

Required

Show how you would compute the amount debited to the Profit and Loss Account.

Q.6 The balance sheet of Thapar on 1st January, 2017 was as follows:

Liabilities	**Amount Rs.**	**Assets**	**Amount Rs.**
Trade payables	15,00,000	Plant & Machinery	30,00,000
Expenses Payable	1,50,000	Furniture & Fixture	3,00,000
Capital	50,00,000	Trade receivables	14,00,000
		Cash at Bank	6,50,000
		Inventories	*13,000,000*
	66,50,000		**66,50,000**

During 2017, his Profit and Loss Account revealed a net profit of Rs.15,30,000. This was after allowing for the following :

(a) Interest on capital @ 6% p.a.

(b) Depreciation on Plant and Machinery @ 10% and on Furniture and Fixtures @ 5%.

(c) A provision for Doubtful Debts @ 5% of the trade receivables as at 31st December, 2017.

But while preparing the Profit and Loss Account he had forgotten to provide for (1) outstanding expenses totaling Rs.1,80,000 and (2) prepaid insurance to the extent of Rs.20,000.

His current assets and liabilities on 31st December, 2017 were : Inventories Rs. 14,50,000; Trade receivables 20,00,000; Cash at Bank Rs. 10,35,000 and Trade payables Rs. 11,40,000. During the year he withdrew Rs.6,00,000 for domestic use.

Q-7 The following is the schedule of balances as on 31.3.17 extracted from the books of Shri Gavaskar, who carries on business under the same name and style of Messrs Gavaskar Viswanath & Co., at Bombay:

Particulars	**Dr. Rs.**	**Cr. Rs.**
Cash in hand	14,000	
Cash at bank	26,000	
Sundry Debtors	8,60,000	
Stock on 1.4.2016	6,20,000	
Furniture & xtures	2,14,000	
office equipment	1,60,000	
Buildings	6,00,000	
Motor Car	2,00,000	
Sundry Creditors		4,30,000
Loan from Viswanath		3,00,000
Provision for bad debts		30,000
Purchases	14,00,000	
Purchase Returns		26,000
Sales		23,00,000
Sales Returns	42,000	
Salaries	1,10,000	
Rent for Godown	55,000	
Interest on loan from Viswanath	27,000	

Rates & Taxes	21,000	
Discount allowed to Debtors	24,000	
Discount received from Creditors		16,000
Freight on purchases	12,000	
Carriage Outwards	20,000	
Drawings	1,20,000	
Printing and Stationery	18,000	
Electricity Charges	22,000	
Insurance Premium	55,000	
General o ce expenses	30,000	
Bad Debts	20,000	
Bank charges	16,000	
Motor car expenses	36,000	
Capital A/c		16,20,000
TOTAL	**47,22,000**	**47,22,000**

Prepare Trading and Profit and Loss Account for the year ended 31st March 2017 and the Balance Sheet as at that date after making provision for the following:

1. Depreciate: (a) Building used for business by 5 percent; (b) Furniture and fixtures by 10 percent; One steel table purchased during the year for Rs. 14,000 was sold for same price but the sale proceeds were wrongly credited to Sales Account; (c) Office equipment by 15 percent; Purchase of a typewriter during the year for Rs. 40,000 has been wrongly debited to purchase; and (d) Motor car by 20%.
2. Value of stock at the close of the year was Rs. 4,40,000.
3. Two month's rent for godown is outstanding.
4. Interest on loan from Viswanath is payable at 12 percent per annum, this loan was taken on 1.5.2016.
5. Reserve for bad debts is to be maintained at 5 percent of Sundry Debtors.
6. Insurance premium includes Rs. 40,000 paid towards proprietor's life insurance policy and the balance of the insurance charges cover the period from 1.4.2016 to 30.6.17.

HOME WORK

Q-1 You are required, prepare a Trading and Profit and Loss Account for the year ending 31st March, 2016 and a Balance Sheet as on that date from the Trial Balance given below:

Particulars	Rs.	Particulars	Rs.
Debit Balance:			
Trade receivables	3,50,000	Salaries	2,20,000
Inventory 1st April, 2015	5,00,000	Purchases	12,50,000
Cash in Hand	5,60,000	Plant and Machinery	15,70,000
Wages	3,00,000	Credit Balance:	
Bad Debts	50,000	Capital	25,00,000
Furniture and Fixtures	1,50,000	Trade payables	9,00,000
Depreciation	1,50,000	Sales	17,00,000

On 31st March, 2016 the Inventory was valued at Rs.10,00,000.

Ans. Hint :

Gross Profit = Rs.6,50,000

Net profit = Rs. 2,30,000

Total balance sheet = 36,30,000

Q-2

	Rs.
Opening Inventory	1,00,000
Purchases	6,72,000
Carriage Inwards	30,000
Wages	50,000
Sales	11,00,000
Returns inward	1,00,000
Returns outward	72,000
Closing Inventory	2,00,000

Required

From the above information, prepare a Trading Account of M/s. ABC Traders for the year ended 31st March, 2017 and Pass necessary closing entries in the journal proper of M/s. ABC Traders.

Ans. Hint :

Gross Profit = Rs.4,20,000

CLASS WORK

MULTIPLE CHOICE QUESTIONS

(1) A debit to an account may

(a) increase expense (b) decrease an asset.

(c) increase a liability. (d) increase income.

(2) Prepayment of insurance premium will appear in the Balance Sheet and in the Insurance Account respectively as:

(a) a liability and a debit balance. (b) an asset and a debit balance.

(c) an asset and a credit balance. (d) a liability and a credit balance.

(3) Gross profit is the diff erence between:

(a) sales and purchases (b) sales and cost of sales.

(c) sales and total expenses. (d) Sales and total liabilities.

(4) Payment made to a creditor subject to cash discount will :

(a) reduce a liability, reduce an asset and add to expenses.

(b) reduce a liability, add to an asset, and add to revenue.

(c) reduce an asset, reduce a liability, and add to revenue.

(d) reduce a liability, reduce an asset and decrease expenses.

(5) A customer returns goods already charged to him. We should:

(a) debit his account. (b) credit his account.

(c) make no entry on his account. (d) None of the above.

(6) Capital is the difference between

(a) Income and expenses (b) Sales and Cost of goods sold

(c) Assets and liabilities (d) None of the above.

(7) The capital of a sole trader would change as a result of:

(a) A creditor being paid his account by cheque.

(b) Raw materials being purchased on credit.

(c) Fixed assets being purchased on credit.

(d) Wages being paid in cash.

(8) A decrease in the provision for doubtful debts would result in:

(a) An increase in liabilities. (b) A decrease in working capital.

(c) An increase in net profit. (d) None of the three.

(9) A Company wishes to earn a 20% profit margin on selling price. Which of the following is the profit mark up on cost, which will achieve the required profit margin?

(a) 33% (b) 25% (c) 20% (d) 30%

(10) If sales is ` 2,000 and the rate of gross profit on cost of goods sold is 25%, then the cost of goods sold will be

(a) ` 2,000. (b) ` 1,500. (c) ` 1,600. (d) ` 1,000.

(11) Sales for the year ended 31st March, 2016 amounted to ` 10,00,000. Sales included goods sold to Mr. A for ` 50,000 at a profit of 20% on cost. Such goods are still lying in the godown at the buyer's risk. Therefore, such goods should be treated as part of

(a) Sales. (b) Closing Inventory.

(c) Goods in transit. (d) None of the above.

(12) If sales revenues are `4,00,000; cost of goods sold is ` 3,10,000 and expenses are `60,000, the gross profit is

(a) ` 30,000. (b) ` 90,000.

(c) ` 3,40,000. (d) ` 4,00,000.

UNIT : 2

FINAL ACCOUNTS OF MANUFACTURING ENTITIES

INTRODUCTION

The manufacturing entities generally prepare a separate Manufacturing Account as a part of Final accounts in addition to Trading Account, Profit and Loss Account and Balance Sheet. The objective of preparing Manufacturing Account is to determine manufacturing costs of finished goods for assessing the cost effectiveness of manufacturing activities. Manufacturing costs of finished goods are then transferred from the Manufacturing Account to Trading Account.

(a) Trading account shows Gross Profit while Manufacturing Account shows cost of goods sold which includes direct expenses.

(b) Manufacturing account deals with the raw material, and work in progress while the trading account would deal with finished goods only.

➲ MANUFACTURING COSTS

Manufacturing costs are classified into :

\+ Raw Material Consumed

\+ Direct Manufacturing Wages ....

\+ Direct Manufacturing Expenses Direct Manufacturing Cost

\+ Indirect Manufacturing expenses or Manufacturing Overhead

= Total Manufacturing Cost

Raw Material consumed is arrived at after adjustment of opening and closing Inventory of raw materials:

Raw Material Consumed = Opening inventory of Raw Materials + Purchases – Closing inventory of Raw Materials

If there remain unfinished goods at the beginning and at the end of the accounting period, cost of such unfinished goods (also termed as Work-In-Process) is shown in the Manufacturing Account –

Opening inventory of Work-in-Process is posted to the debit of the Manufacturing Account Closing inventory of Work-in-Process is posted to the credit of the Manufacturing Account.

Direct Manufacturing Expenses

Direct manufacturing expenses are costs, other than material or wages, which are incurred for a specific product or saleable service.

Examples of direct manufacturing expenses are (i) Royalties for using license or technology if based on units produced, (ii) Hire charge of the plant and machinery used on hire, if based on units produced, etc.

When royalty or hire charges are based on units produced, these expenses directly vary with production.

INDIRECT MANUFACTURING EXPENSES OR OVERHEAD EXPENSES

These are also called Manufacturing overhead, Production overhead, Works overhead, etc. Overhead is defined as total cost of indirect material, indirect wages and indirect expenses.

Overhead = Indirect Material + Indirect Wages + Indirect Expenses

Indirect material means materials which cannot be linked directly with the units produced, for example, stores consumed for repair and maintenance work, small tools, fuel and lubricating oil, etc.

Indirect wages are those which cannot be directly linked to the units produced, for example, wages for maintenance works, holding pay, etc.

Indirect expenses are those which cannot be directly linked to the units produced, for example, training expenses, depreciation of plant and machinery, depreciation of factory shed, insurance premium for plant and machinery, factory shed, etc.

Accordingly, indirect manufacturing expenses comprise indirect material, indirect wages and indirect expenses of the manufacturing division.

BY-PRODUCTS

In most manufacturing operations, the production of the main product is accompanied by the production of a subsidiary product which has a value on sale. For example, the production of hydrogenated vegetable oil is accompanied by the production of oxygen gas and the production of steel yields scrap. The subsidiary product is termed as a by-product because its production is not consciously undertaken but results out of the production of the main product. It is usually very difficult to ascertain the cost of the product. Moreover, its value usually forms a very small percentage of the main product.

By-product is a secondary product. This is produced from the same raw materials, which are used for producing the main product and without incurring any additional expenses from the same production process in which the main product is produced. **Some examples of by-product are given below:**

(i) Molasses is the by-product in sugar manufacturing;

(ii) Butter milk is the by-product of a dairy which produces butter and cheese, etc.

By-products generally have insignificant value as compared to the value of main product. They are **generally valued at net realizable value,** if their costs cannot be separately identified. It is often treated, as "Miscellaneous income" but the correct treatment would be to credit the sale value of the by-product to Manufacturing Account so as to reduce to that extent, the cost of manufacture of main product.

DESIGN OF A MANUFACTURING ACCOUNT

There is no standardized design for the presentation of a Manufacturing Account. Given below is a format covering various elements:

Manufacturing Account

Particulars	**Units**	**Amount**	**Particulars**	**Units**	**Amount**
To Raw Material Consumed:			By By-products at net realizable value		
Opening inventory			By Closing Work-in- Process		
Add: Purchases			By Trading A/c		
Less: Closing inventory			Cost of production		
To Direct Wages					
To Direct expenses:					
Prime cost					
To Factory overheads:					
Royalty					
Hire charges					
To Indirect expenses:					
Repairs & Maintenance					
Depreciation					
Factory cost					
To Opening Work-in-process					

Tutorial Note: Frequently, problems are set, in which all the ledger balances are not given. Instead, details are given regarding the number of items in Inventories, quantity manufactured etc. the figures for Inventories, sales etc., would therefore have to be worked out independently from the data given.

The following general rules may be observed.

(a) The Manufacturing Account should have columns showing the quantities and values. Frequently, all the quantities are not given and the quantities applicable to one or more of the items would have to be worked out. For example, if the question does not state the total number of items sold, the quantity can be worked out by adding opening inventory and units manufactured and deducting closing inventory. It is, therefore, useful to have quantity columns in the account so that it can be seen that both sides balance.

(b) The Manufacturing Account will show the quantity of raw materials in inventory at the beginning and at the end of the year and the purchases during the year. As regards finished goods, it will only show the quantity manufactured and, as regards work-in-progress, the opening and closing amounts

(c) The Trading Account will show the quantities of finished goods manufactured and sold and the opening and closing inventory. It will not show the quantity of raw materials or work-in-progress.

(d) For determining the value of closing inventory, in the absence of specific instruction to the contrary, it must be assumed that sales have been on " first in- first out" basis, that is, the closing inventory consists as far as possible of goods produced during the year, the opening inventory being sold out.

It may be mentioned here that nowadays no manufacturing business entity prepares manufacturing account as part of its final set of accounts. Even the items of manufacturing account are shown either in trading account (in case of non-corporate entities) or in Statement of Profit and loss (in case of corporate entities).

The procedure of preparation of Trading Account, Profit and Loss Account and Balance Sheet have already been explained in earlier chapter. Students should refer the earlier unit for attempting the problems based on the preparation of complete set of final accounts of a sole proprietor.

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Less: Closing inventory			Cost of production		
To Direct Wages					
To Direct expenses:					
Prime cost					

To Factory overheads:					
Royalty					
Hire charges					
To Indirect expenses:					
Repairs & Maintenance					
Depreciation					
Factory cost					
To Opening Work-in-process					

Tutorial Note: Frequently, problems are set, in which all the ledger balances are not given. Instead, details are given regarding the number of items in Inventories, quantity manufactured etc. the figures for Inventories, sales etc., would therefore have to be worked out independently from the data given.

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CLASS WORK

Q-1 Mr. Vimal runs a factory which produces soaps. Following details were available in respect of his manufacturing activities for the year ended on 31.3.2016:

Opening Work-in-Process (10,000 units)	16,000
Closing Work-in-Process (12,000 units)	20,000
Opening inventory of Raw Materials	1,70,000
Closing inventory of Raw Materials	1,90,000
Purchases	8,20,000
Hire charges of machine @ Rs. 0.60 per unit manufactured	
Hire charges of factory	2,20,000
Direct wages-Contracted @ Rs. 0.80 per unit manufactured and @ Rs. 0.40 per unit of Closing W.I.P.	
Repairs and Maintenance	1,80,000
Units produced – 5,00,000 units	

Required

Prepare a Manufacturing Account of Mr. Vimal for the year ended 31.3.2016.

Q-2 Mr. Pankaj runs a factory which produces motor spares of export quality. The following details were obtained about his manufacturing expenses for the year ended on 31.3.2016.

W.I.P.	- Opening	3,90,000	
	- Closing		5,07,000
Raw Materials	- Purchases		12,10,000
	- Opening		3,02,000
	- Closing		3,10,000
	- Returned		18,000
	- Indirect material		16,000
Wages	- direct		2,10,000
	- indirect		48,000
Direct expenses	- Royalty on production		1,30,000
		- Repairs and maintenance	2,30,000
		- Depreciation on factory shed	40,000
		- Depreciation on plant & machinery	60,000

By-product at selling price 20,000

You are required to prepare Manufacturing Account of Mr. Pankaj for the year ended on 31.3.2016.

Q-3 Following are the Manufacturing A/c, Creditors A/c and Trading A/c provided by Ms. Shivi related to 2016-17. There are certain figures missing from these accounts.

Raw Material A/c

Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
	To Opening Stock A/c	1,00,000	By	Raw Material Consumed	
	To Creditors A/c				
				By Closing Stock A/c	

Creditors A/c

Date	Particulars	Amount `	Date	Particulars	Amount `
	To Bank A/c	22,00,000		By Balance b/d	15,00,000
	To Balance c/d	6,00,000			

Manufacturing A/c

Particulars	Amount `	Particulars	Amount `
To Raw Material Consumed		By Trading A/c	17,94,000
To Wages	3,50,000		
To Depreciation	2,00,000		
To Direct Expenses	2,44,000		

Additional Information:

1) Purchase of machinery worth Rs. 10,00,000 has been omitted. Machinery are chargeable at a depreciation rate of 10%.

2) Wages include the following

   Paid to Factory Workers - Rs. 3,00,000

   Paid to labour at force 50,000

3) Direct Expenses include following:

   Electricity charges of Rs. 80,000 of which 30% pertained to

   office Fuel Charges of Rs. 20,000

   Freight Inwards of Rs. 35,000

   Delivery charges to customers - Rs. 20,000.

You are required to prepare revised Manufacturing A/c, and Raw Material A/c.

MULTIPLE CHOICE QUESTIONS

1. Under-statement of closing work in progress in the period will

(a) Understate cost of goods manufactured in that period.

(b) Overstate current assets.

(c) Understate net income in that period.

(d) None of the three.

2. Sales is equal to

(a) Cost of goods sold – Gross prot. (b) Cost of goods sold + Gross prot.

(c) Gross prot – Cost of goods sold. (d) Net prot + cost of goods sold.

3. Indirect Manufacturing expenses are also called

(a) Manufacturing overhead. (b) Production overhead.

(c) Works overhead. (d) All the three.

4. Sale value of the by-product is credited to

(a) Manufacturing account. (b) Capital account.

(c) Overheads account. (d) Trading account.

5. Manufacturing account shows

(a) Total cost of manufacturing the nished products.

(b) It provides details of factory cost.

(c) It facilitates reconciliation of nancial books with cost records.

(d) All the three.

❑

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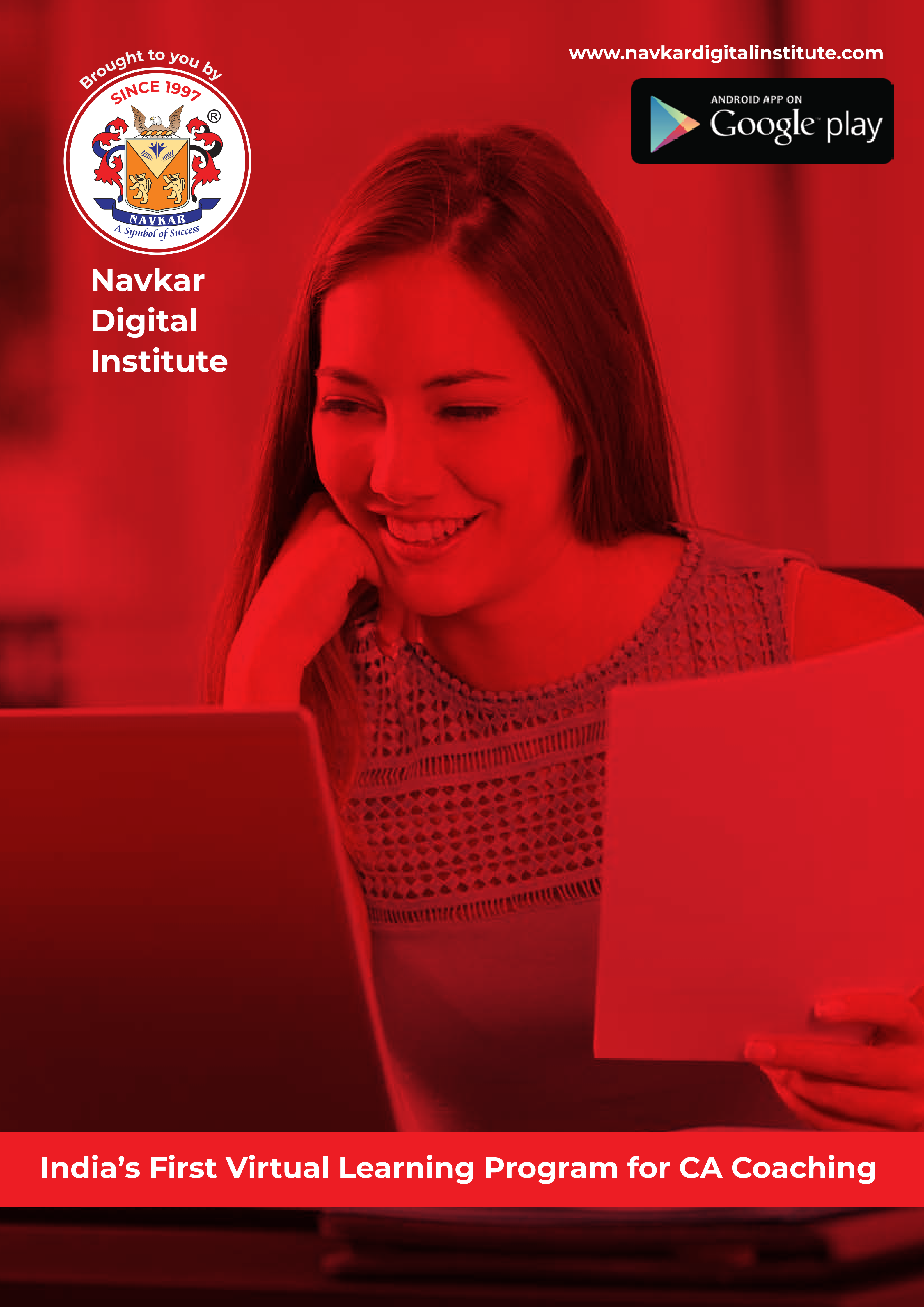

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