

KUPPAM DEGREE COLLEGE

(Affiliated to S.V. University & Permitted by APSCHE, Govt. of A.P)

45/2A, Pedda Bangarunatham, KUPPAM-517425.Chittoor Dt. A.P

08570-255872
96184 22470

www.kdc.ac.in
mail@kdc.ac.in

LECTURE NOTES

UNIT-I SELF BALANCING SYSTEM

You have learnt that all business transactions are recorded first in journal or its sub-division and then posted into the concerned accounts in the ledger. A statement called Trial Balance is also prepared at the end of the accounting period primarily to check the arithmetical accuracy of the entries in the ledger, Normally the firms maintain one ledger for all the accounts involved. So long as the volume of transactions is small and the number of accounts is limited, this works fairly well. But, as the business expands and the number of accounts increases, especially those of the debtors and creditors, maintaining all accounts in a single ledger becomes impractical. The ledger becomes too bulky and location of errors involves more time. Hence many firms decide to introduce multiple ledger system whereby separate ledgers are kept for debtors and creditors and the entries are recorded in each ledger in such a way that a separate Trial Balance can be prepared for each ledger. This is called 'Self-balancing System'. Sometimes the firms, while maintaining more than one ledger, do not adopt the self-balancing system. In such a situation, though separate Trial Balance cannot be prepared for each ledger but the arithmetical accuracy can be duly certified by preparing certain control accounts. This is called 'Sectional Balancing'. In this unit you will learn about both the self-balancing and the sectional balancing systems:

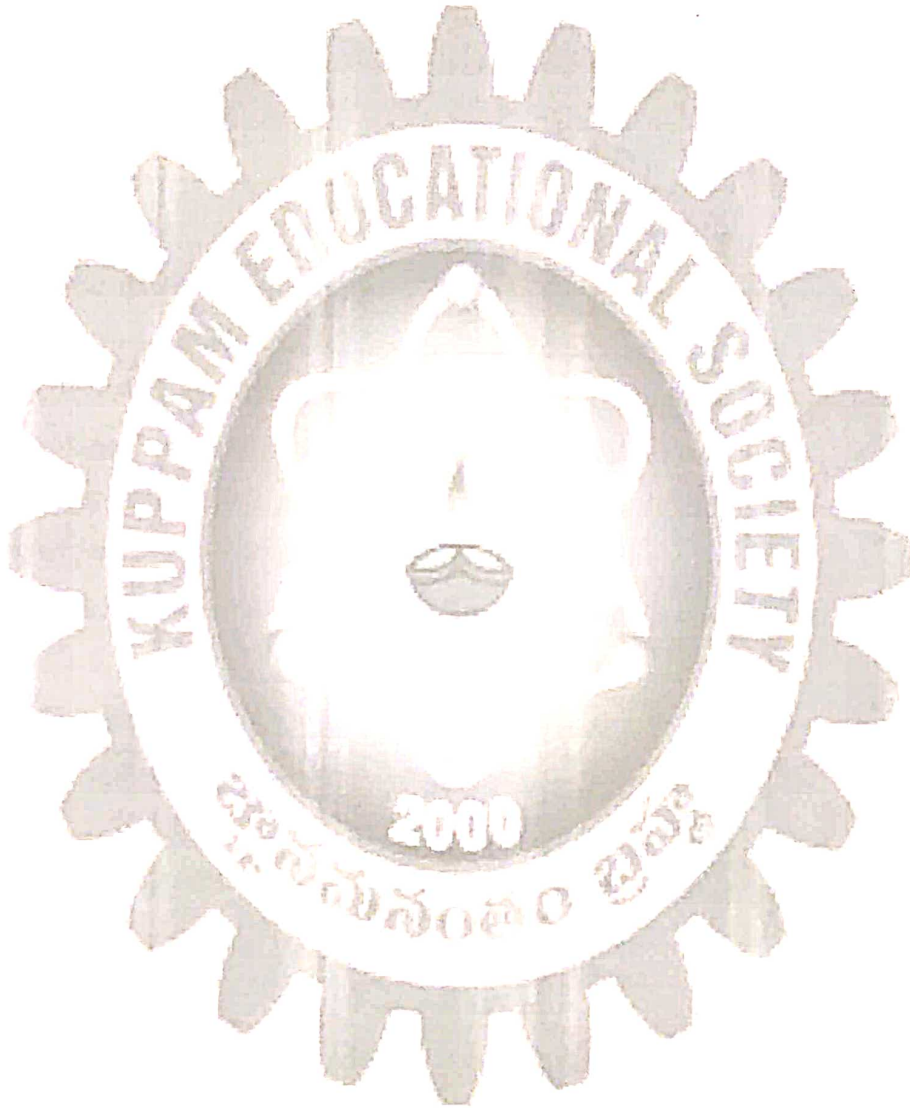
Meaning of Self Balancing Ledger

Self-balancing system is a system whereby separate Trial Balance can be taken out from each ledger. ... It is the reverse of the Total Debtors Account in Sales Ledger and Total Creditors Account in Bought Ledger. Under this system ledgers are made **self-balancing** by opening adjustment accounts

Advantages of Self Balancing System:

- Localizes the errors and facilitates in quick detection with minimum efforts;

- Responsibility for committing errors can be fixed;



- Possibility of collusion is lessened as the ledgers are maintained by different accounts staff;
- Facilitates the preparation of interim accounts and draft final accounts

Steps to introduce the system

The first step is that the ledger should be split up into certain number of ledgers as shown under:

1. **Debtors Ledger:** This ledger should contain the accounts only trade debtors (customers).
2. **Creditors Ledger:** This ledger should contain the accounts only trade creditors (suppliers)
3. **General Ledger:** This ledger should contain all the remaining accounts i.e other than trade debtors and trade creditors

The second step is that in each of the above ledgers the extra adjustment account or accounts should be opened as mentioned below:

1. **General Ledger Adjustment account:** This extra account should be opened in the “Debtors ledger” in addition to the usual accounts of all the debtors.
2. **General Ledger Adjustment account:** This extra account should be opened in the “Creditors ledger” in addition to the usual accounts of all the debtors.
3. **Debtors Ledger Adjustment account:** This extra account should be opened in the “General ledger” in addition to the usual other accounts.
4. **Creditors Ledger Adjustment account:** This extra account should be opened in the “General ledger” in addition to the usual other accounts.

Different names of ledgers

1. General ledger is also called as nominal ledger
2. Debtors ledger is also called as sales ledger, sold ledger or customer ledger
3. Creditors ledger is also called as purchases ledger, bought ledger or supplier ledger

Format of Self Balancing Ledger

In General Ledger Debtors Ledger Adjustment Account

Date	Particulars	Amount	Date	Particulars	Amount
	To Balance b/d (opening debit balance)	x		By Balance b/d (if any) (opening credit balance)	x
	To General Ledger Adjustment account			By General Ledger Adjustment account	
	Credit sales	x		Cash or cheques received from debtors	x
	Carriage and sundry charges debited to customers	x		Bad debts	x
	Bills receivable dishonored	x		Return inwards	x
	Cheques received dishonored	x		Discount allowed	x
	Interest ad charges	x		Other allowances	x
	Cash paid to customers	x		Bills receivable	x
	B/R discounted dishonored	x		Transfers	x
	B/R endorsed dishonored	x		By bal c/d	x
	Interest charged on overdue accounts	x			x
	To Bal c/d	x			
	Total	xxx		Total	xxx

The following transactions are to be excluded while preparing self balancing ledger

1. Cash sales
2. Provision for bad debts
3. Recovery of bad and doubtful debts
4. Trade discount
5. Bills receivable discounted or matured
6. Freight on purchase
7. Carriage inward
8. provision for discount on debtors

**In General Ledger
Creditors Ledger Adjustment Account**

Date	Particulars	Amount	Date	Particulars	Amount
	To Balance b/d (if any) (opening debit balance)	x		By Balance b/d (opening credit balance)	x
	To General Ledger Adjustment account			By General Ledger Adjustment account	
	Cash paid to creditors	X		Credit purchases	x
	Bills payable accepted Discount received	X		B/P dishonored	x
	Return outwards	x		Bills receivable endorsed to creditors dishonored	x
	Bills receivable endorsed to creditors	x		interest and charges	x
	Transfers	x		By bal c/d	x
	To bal c/d	x			
	Total	xxx		Total	xxx

The following transactions are to be excluded while preparing self balancing ledger

1. Cash purchases
2. provision for discount on creditors
3. Bills payable matured

**In Debtors Ledger
General Ledger Adjustment Account**

Date	Particulars	Amount	Date	Particulars	Amount
	To Balance b/d (if any) (opening credit balance)	x		By Balance b/d (opening debit balance)	x
	To Debtors Ledger Adjustment account			By Debtors Ledger Adjustment account	
	Cash or cheques received from debtors	x		Credit sales	x
	Bad debts	x		Carriage and sundry charges debited to customers	x
	Return inwards	x		Bills receivable dishonored	x
	Discount allowed	x		Cheques received dishonored	x
	Other allowances	x		Interest ad charges	x
	Bills receivable	x		Cash paid to customers	x
	Transfers	x		B/R discounted dishonored	x
	To bal c/d	x		B/R endorsed dishonored	x
		x		Interest charged on overdue accounts	x
				By bal c/d	x
	Total	xx		Total	xx

In Creditors Ledger
General Ledger Adjustment Account

Date	Particulars	Amount	Date	Particulars	Amount
	To Balance b/d (opening credit balance)	x		By Balance b/d (if any) (opening debit balance)	x
	To Creditors Ledger Adjustment account			By Creditors Ledger Adjustment account	
	Credit purchases	x		Cash paid to creditors	X
	B/P dishonored	x		Bills payable accepted Discount received	X
	Bills receivable endorsed to creditors dishonored interest and charges	x		Return outwards	x
	To bal c/d	x		Bills receivable endorsed to creditors	x
				Transfers	x
				By bal c/d	x
	Total	xxx		Total	xxx

Question 1. From the following particulars as extracted from the books of Bhima prepare debtors ledger adjustment account and creditors ledger adjustment account:

January 1, 2000

Balance of bought ledger (Dr) Rs 3500

Balance of bought ledger (Cr) Rs 47760

Balances of sold ledger (Dr) Rs. 58480

Balances of sold ledger (Cr) Rs.1960

January 31, 2000

Purchases Rs. 264720 Return

outwards Rs 10240 Sales Rs

349960

Return inwards Rs 4680

Cash received from customers Rs 304840

Discount allowed thereon Rs 11280

Cash paid to suppliers Rs 233720

Discount earned thereon Rs 6640 Cash

paid to customers Rs 520 Bills receivable

Rs 16480

Bills payable Rs 9000

Bills receivable dishonored Rs 1000 Bills

receivable discounted Rs 2000

Bills receivable endorsed to creditors Rs 2000 Bills

receivable endorsed dishonored Rs 1000 Bought

ledger balances (Dr) Rs. 3000

Sold ledger balance (Cr) Rs 73400

Solution

**In General Ledger
Debtors Ledger Adjustment Account**

Date	Particulars	Amount	Date	Particulars	Amount
1-1-10	To Balance b/d (opening debit balance)	58480	1/1/10	To Balance b/d (opening credit balance)	1960
31/1/10	To General Ledger Adjustment account		31/1/10	To General Ledger Adjustment account	
	Credit sales	3,49,960		Cash received from customers	3,04,840
	Cash paid to customers	520		Return inwards	4,680
	B/R dishonored	1000		Discount allowed	11,280
	B/R endorsed dishonored	1000		Bills receivable	16480
31/1/10	To bal c/d (balancing figure)	1680	31/1/10	By bal c.d	73400
		412640			412640
1-2-10	To bal b/d	73400	1-2-10	By bal b/d	1680

**General Ledger
Creditors Ledger Adjustment Account**

Date	Particulars	Amount	Date	Particulars	Amount
1-1-10	To Balance b/d (if any) (opening debit balance)	3500	1-1-10	By Balance b/d (opening credit balance)	47,760
31-1-10	To General Ledger Adjustment account		31-1-10	By General Ledger Adjustment account	
	Cash paid to suppliers	233720		Credit purchases	2,64,720
	B/R endorsed to creditors	2000		B/R endorsed to creditors dishonored	1000
	Bills payable issued	9000	31-1-10	By bal c/d	3000
	Discount earned	6640			
	Return outwards	10,240			
31-1-10	To bal c/d balancing figure)	51,380			
	ToTal		3,16,480	ToTal	3,16,480
1-2-10	To bal c/d	3000	1-2-10	By bal c/d	51,380

Note: purchase and sales treated as credit purchase and credit sales

Question 2

From the following particulars as extracted from the books of Bhima prepare debtors ledger adjustment account and creditors ledger adjustment account:

Debit balance of debtors (1-1-2014) Rs. 100,000 Debit balance of creditors (1-1-2014) Rs. 7,000 Credit balance of debtors (1-1-2014) Rs. 4000 Credit balance of creditors (1-1-2014) Rs 90,000 **Transactions during the month of January Credit purchase Rs500,000**

Returns outwards RS20,000

Credit sales Rs700000 Return inwards Rs50000

Cash received from debtors Rs600000

Discount allowed Rs25000

Cash paid to creditors Rs500000 Bills receivables Rs30000 Discount earned

Rs. 14000 Provision for bad debts Rs 3000 Bills payable Rs 20000

B/R dishonored Rs 2000 B/R discounted Rs 3000

Bills endorsed to creditors Rs 40

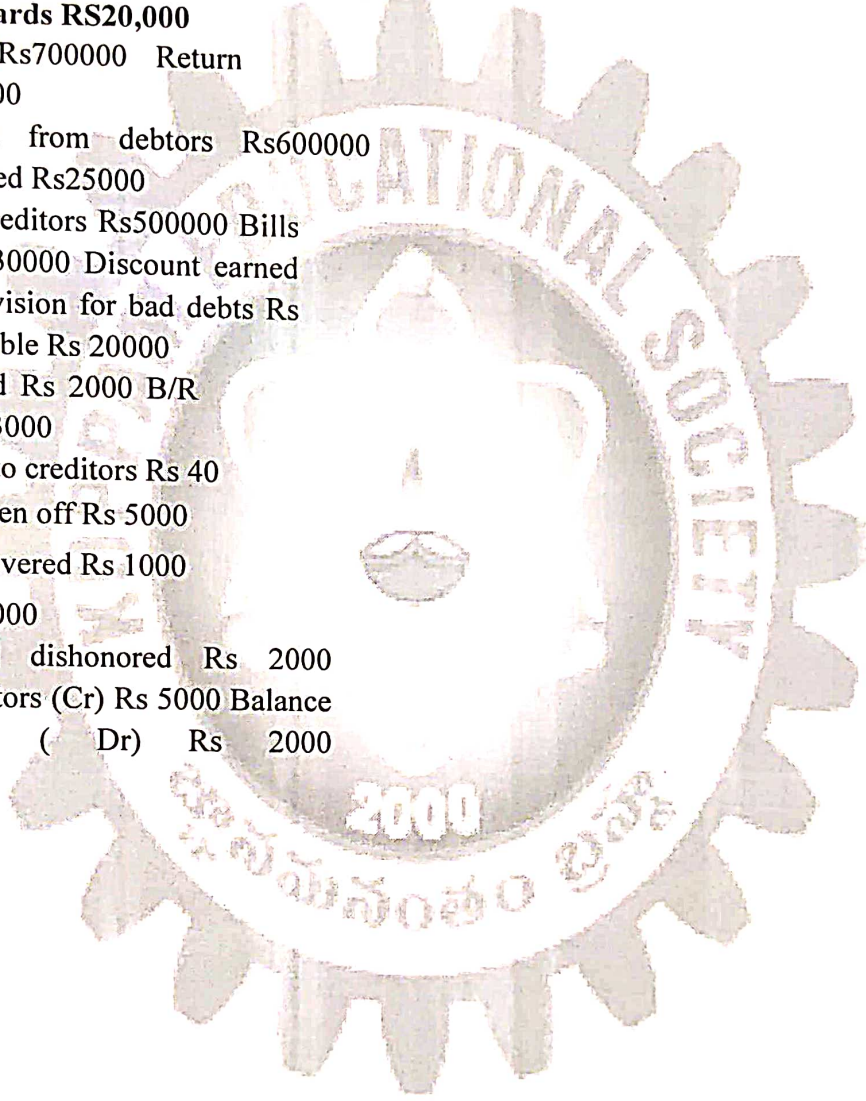
Bad debts written off Rs 5000

Bad debts recovered Rs 1000

Transfers Rs 6000

B/R endorsed dishonored Rs 2000

Balance of debtors (Cr) Rs 5000 Balance of Creditors (Dr) Rs 2000



Solution

**In General Ledger
Debtors Ledger Adjustment Account**

Date	Particulars	Amount	Date	Particulars	Amount
1-1-14	To Balance b/d (opening debit balance)	100,000	1/1/14	To Balance b/d (opening credit balance)	4000
31/1/14	To General Ledger Adjustment account		31/1/14	To General Ledger Adjustment account	
	Credit sales	700,000		Cash received from customers	6,00,000
	B/R dishonored	2000		Return inwards	50,000
	B/R endorsed dishonored	2000		Discount allowed	25,000
31-1-14	To bal c/d	5000		Bills receivable	30,000
				Bad debts	5000
				Transfers	5000
			31/1/14	By bal c/d	90000
		809000			809000
1-2-14	To bal b/d	90000	1-2-14	By bal b/d	5000

General Ledger

Creditors Ledger Adjustment Account

Date	Particulars	Amount	Date	Particulars	Amount
1-1-14	To Balance b/d (if any) (opening debit balance)	7000	1-1-14	By Balance b/d (opening credit balance)	90.000
31-1-14	To General Ledger Adjustment account		31-1-14	By General Ledger Adjustment account	
	Cash paid to suppliers	500,000		Credit purchases	5,00,000
	B/R endorsed to creditors	4000		B/R endorsed to creditors dishonored	2000
	Bills payable issued	20,000	31-1-14	By bal c/d	2000
	Discount earned	14,000			
	Return outwards	20,000			
	Transfers	5000			
31-1-14	To bal c/d (balancing figure)	24,000			
	ToTal	5,94,000		ToTal	5,94,000
1-2-14	To bal c/d	2000	1-2-14	By bal c/d	24000

Question 3 From the following particulars as extracted from the books of Bhima prepare debtors ledger adjustment account and creditors ledger adjustment account:

Debit balance of customers (1-1-2014) Rs. 60,000 Debit balance of suppliers (1-1-2014) Rs.600 Credit balance of customers (1-1-2014) Rs. 1000 Credit balance of suppliers (1-1-2014) Rs 30,000 **Transactions during the year 2014**

total purchase Rs 36000 sash purchase Rs. 10000 Returns outwards Rs 5000 Credit sales Rs42000

Cash sales Rs9000 Return inwards Rs 2000

Cash received from customers Rs 62000 Discount allowed to customers Rs1200 Cash paid to suppliers Rs31000

Bills drawn on debtors Rs 6000 Discount allowed by suppliers Rs. 1300 Provision for bad debts Rs 4000

Bills payable Rs 8000 B/R unpaid Rs 3000

Interest and noting charges on unpaid bills Rs 200 Bills endorsed to creditors Rs 1000

Bad debts written off Rs 1000

Bad debts written now recovered Rs 500

Transfers from customers ledger to suppliers ledger Rs 500

Carriage inward Rs. 2500

Balance of customers (Cr) on 31-12- 14 Rs 1500 Balance of Creditors (Dr) on 31-12-14 Rs 1200

Solution

**In General Ledger
Debtors Ledger Adjustment Account**

Date	Particulars	Amount	Date	Particulars	Amount
1-1-14	To Balance b/d (opening debit balance)	60000	1/12/14	To Balance b/d (opening credit balance)	1000
31/12/14	To General Ledger Adjustment account		31/12/14	To General Ledger Adjustment account	
	Credit sales	42000		Cash received from customers	62000
	B/R unpaid (dishonored)	3000		Return inwards	2000
	B/R endorsed dishonored			Discount allowed	1200
	Interest and noting charges on unpaid bills	200		Bills receivable	6000
31-12-14	To bal c/d	1500		Bad debts	1000
				Transfers	500
			31/12/14	By bal c/d (balancing figure)	33000
		106700			106700
1-1-15	To bal b/d	33000	1-1-15	By bal b/d	1500

General Ledger

Creditors Ledger Adjustment Account

Date	Particulars	Amount	Date	Particulars	Amount
1-1-14	To Balance b/d (if any) (opening debit balance)	600	1-1-14	By Balance b/d (opening credit balance)	30000
31-12-14	To General Ledger Adjustment account		31-12-14	By General Ledger Adjustment account	
	Cash paid to suppliers	31000		Credit purchases (36000-10000)	26000
	B/R endorsed to creditors	1000	31-12-14	By bal c/d	1200
	Bills payable issued	8000			
	Discount earned	1300			
	Return outwards	5000			
	Transfers	500			
31-12-14	To bal c/d (balancing figure)	9800			
	ToTal	57200		ToTal	57200
1-1-15	To bal c/d	1200	1-1-15	By bal c/d	9800

UNIT-II SINGLE ENTRY SYSTEM

Incomplete records are the accounting records that do not strictly follow the double entry system of accounting. For example: If one sided entry, or no entry for a transaction is recorded, it is classified as an incomplete record.

Features of Incomplete Records

Many times, small shopkeepers maintain incomplete records due to partial recording of transactions. In case of large organisations, the records may become incomplete due to loss by theft or fire, or due to natural calamities.

The features of incomplete records are as follows:

- 1) Incomplete records system is not a systematic method of recording transactions due to the partial recording of transactions.
- 2) In this system, the records for cash transactions and personal accounts are maintained properly, whereas no information is recorded regarding revenue/gains, expenses/losses, or assets and liabilities.
- 3) Cash books often contain records for the personal transactions of owners.
- 4) Comparability of accounts is not possible because there is no uniformity among the accounts of different organisations. This is because each organisation maintains records as convenient to them.
- 5) This system results in increased dependence on original vouchers because figures necessary to ascertain profit/loss or other information can be collected only from the original vouchers such as sales invoice or purchase invoice, etc.
- 6) The profit/loss for the year ascertained using this system is not highly reliable and accurate because it only provides an estimated profit/loss for the year. The balance sheet at the end of the year does not reflect a true and complete picture of the assets and liabilities in the business because of partial recording of assets and liabilities.

Reasons of Incompleteness and Its Limitations

Many businessmen prefer to keep incomplete records because:

- 1) Maintaining incomplete records is easier for the people who lack proper knowledge of accounting principles.
- 2) It is an inexpensive mode of maintaining records because maintaining incomplete records

is easier, and specialised accountants charging high costs are not required.

- 3) It saves time because only a few books need to be maintained.
- 4) The owners can record only the important transactions and not record the less important transactions as per their needs, making this mode a convenient mode of maintaining records.

Some of the limitations of maintaining incomplete records are:

- 1) Accuracy of accounts cannot be ensured. This is because the lack of a double-entry system means that a trial balance cannot be prepared to ascertain the accuracy of accounts.
- 2) The financial results of the business operations cannot be correctly ascertained and evaluated because reliable financial statements cannot be prepared.
- 3) Due to lack of reliable financial statements, important analysis such as analysis of profitability, liquidity, and solvency of the business cannot be made.
- 4) Lack of financial reliable statements and proper analysis makes it difficult to raise funds from external sources. This causes issues in planning future business activities.
- 5) It is difficult for the owners to claim insurance in case of loss of inventory by theft or due to fire.
- 6) The tax authorities cannot be convinced easily about the reliability of the computed income.

Statement of Affairs

If incomplete records are maintained, then the amount of change in the capital during the period is ascertained by preparing the Statement of asset and liabilities as at the beginning and at the end of the relevant accounting period. This statement is called the Statement of Affairs, which shows the assets and liabilities, just like a balance sheet.

The basic format of a Statement of Affairs is shown as follows:

Statement of Affairs as at _____

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Bills Payable Creditors Outstanding Expenses Capital (balancing figure)		Land and Building Machinery Furniture Stock Debtors Cash and Bank Prepaid Expenses Capital (balancing figure)	
	xxxx		xxxx

Difference between Statement of Affairs and Balance Sheet

The following table shows the fundamental differences between a Statement of Affairs and a Balance Sheet.

Basis of difference	Statement of Affairs	Balance Sheet
Reliability	The Statement of Affairs is less reliable because it is constructed using incomplete records that do not follow the Double-Entry system of bookkeeping.	The Balance Sheet is more reliable because it is constructed using records that follow the Double-Entry system of bookkeeping.
Objective	The Statement of Affairs is prepared to ascertain the amount of capital at the beginning of the year, or on a particular date.	The Balance Sheet is prepared to show the true and complete financial position of a business entity on a particular date.
Omission	If some assets or liabilities are omitted from the records, it is not easy to discover the ones that are not recorded.	If some assets or liabilities are omitted from the records, it is easy to discover them from the accounting records in the books.

Statement of profit and loss

The difference between the opening and closing capital, as ascertained using the Statement of

Affairs, represents the increase or decrease in capital. This increase or decrease is to be adjusted for any additional capital brought in, or any drawings taken out by the owners, to ascertain the profit/loss made during the period.

The Statement of Profit or Loss is prepared to make the necessary adjustments and thus, determine the exact amount of profit or loss made during the year.

The basic format of a Statement of Profit or Loss is shown as follows:

Statement of Profit or Loss for the year ended _____

Particulars	Amount (Rs.)
Capital as at the end of the year (computed from statement of affairs as at the end of the year)	xxxx
Add: Drawings during the year	xxxx
Less: Additional capital introduced during the year	(xxxx)
Adjusted capital at the end of the year	xxxx
Less: Capital as at the beginning of the year (computed from statement of affairs as at the beginning of the year)	(xxxx)
Profit or Loss made during the year	xxxx

The following equation shows the same computation as performed in the Statement of Profit or Loss.
Preparing Trading and Profit and Loss Account and the Balance Sheet

To prepare the proper and complete financial statements, complete information regarding details of various items is required. However, when incomplete records are maintained, the details of some items need to be ascertained using the logic of the double entry system of bookkeeping. This involves preparing a summary of cash, ledger accounts, etc. to find the balancing figures and use these details to prepare the financial statements.

The most common items missing from the records that need to be ascertained indirectly are:

- Opening capital
- Credit purchases
- Credit sales
- Bills payable accepted
- Bills receivable received
- Payments to creditors
- Payments to debtors
- Any other cash/bank related items

Ascertaining Credit Purchases

When incomplete records are maintained, some information related to the creditors might be missing. The missing information may be either credit purchases, payment made to creditors, or any other figure.

The missing figure can be ascertained by preparing the total creditors account, entering the given information related to the creditors in the account, and determining the balancing figure. The balancing figure provides the required missing information related to the creditors.

Ascertainment of Credit Sales

Similar to ascertainment of credit purchases, some information related to the debtors might be missing. The missing information may be either credit sales, payment received from debtors, or any other figure.

Ascertainment of Bills Receivable and Bills payable

In many cases, some information related to bills receivable or bills payable is missing. Even if all details related to the bills are available, it may happen that the figures of bills received and bills accepted during the accounting period are not given. To ascertain such figures, the total bills receivable account, or the total bills payable account is prepared, depending upon what figure is to be ascertained.

Ascertainment of Missing Information through Summary of Cash

A summary of the Cash Book is prepared to ascertain any missing figure related to cash transactions. It can be used to ascertain the missing amount paid to creditors, the missing amount received from debtors, the missing receipts or payments, or even missing opening and closing balances of the cash or bank.

Sometimes, two figures related to cash might be missing, which cannot be ascertained by just the summary of the cash book. For example, the amount received from debtors and the amount paid to creditors are both missing. In such a case, the total creditors account can be prepared to determine the amount paid to creditors. Then, the balancing figure of the summary of the cash book will represent the amount received from debtors.

It is also possible to prepare the total debtors account first, and then prepare the cashbook to ascertain the amount paid to creditors.

Illustration: Mrs. Surbhi started a business on April 01, 2016 with cash Rs. 50,000, furniture worth Rs. 10,000, goods worth Rs. 2,000, and machinery worth Rs. 20,000. During the year, she further introduced Rs. 20,000 in her business by opening a bank account. From the following information extracted from her books, you are required to prepare final accounts for the ended March 31, 2017.

Particulars	Amount (Rs.)
Receipts from debtors Cash sales	57,500
Cash purchases	45,000
Wages paid	25,000
Salaries to staff	5,000
Trade expenses	17,500
Electricity bill of factory Drawings of Surbhi	6,500
Cash paid to creditors Discount allowed	7,500
Discount received	3,000
Bad debts written-off	42,000
Cash balance at the end of year	1,200
	3,000
	1,300
	20,000

Books of Mrs. Surbhi

Trading and Profit and Loss Account
for the year ended March 31, 2017

Expenses/Losses	Amount (Rs.)	Revenues/Gains	Amount (Rs.)
To Opening stock To Purchases:	20,000	By Sales	1,75,000
To Cash		By Credit	25,000
25,000		<u>1,30,000</u>	
To Credit		By Closing stock	
<u>80,000</u>			
	1,02,500		
1,05,000	5,000		
Less: Goods used for private use	7,500		
<u>(2,500)</u>	65,000		
To Wages			
To Electricity bill of factory			
To Gross profit c/d			

	2,00,000		2,00,000
To Salaries	17,500	By Gross profit b/d	65,000
To Trade expenses	6,500	By Discount received	3,000
To Discount allowed	1,200		
To Bad debts	1,300		
To Depreciation:			
Furniture	1,000		
Land and Building	4,000		
To Net profit (transferred to capital account)	36,500		
	68,000		68,000

Balance Sheet of Mrs. Surbhi as at March 31, 2017

Liabilities	Amount (Rs.)	Assets	Amount(Rs.)
Creditors	35,000	Cash	20,000
Capital	1,00,000	Bank	13,000
Add: Net profit	<u>36,500</u>	Stock	25,000
1,36,500		Debtors	70,000
Add: Additional Capital	<u>20,000</u>	Furniture	10,000
1,56,500	1,18,000	Less: Depreciation	9,000
Less: Drawings		(1,000)	16,000
Cash	36,000	Machinery	20,000
Goods	<u>2,500</u>	Less: Depreciation	(4,000)
(38,500)			
	1,53,000		1,53,000

Working Notes:

Total Creditors Account

Dr.

Cr.

Date	Particulars	J F	Amount (Rs.)	Date	Particulars	J F	Amount(Rs.)
	To Cash		42,000		By Balance b/d		NIL
	To Discount received		3,000		By Purchase credit		80,000
	To Balance c/d		35,000		(balancing figure)		
			80,000				80,000

Total Debtors Account

Dr.

Cr.

Date	Particulars	J F	Amount (Rs.)	Date	Particulars	J F	Amount(Rs.)
	To Balance b/d		NIL		By Cash		57,500
	To Sales (credit)		1,30,000		By Discount allowed		1,200
	(balancing figure)				By Bad debts		1,300
					By Balance c/d		70,000
			1,30,000				1,30,000

Statement of Affairs as on March 31, 2016

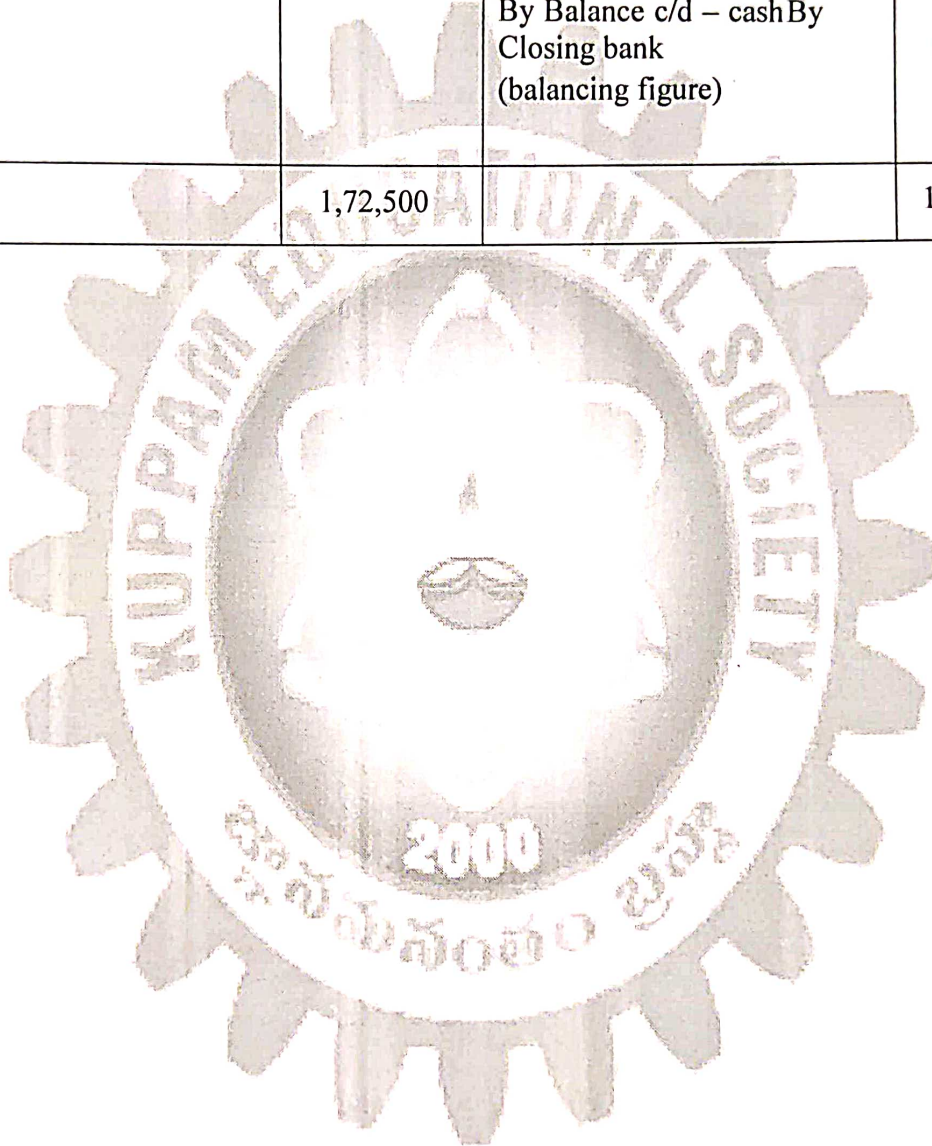
Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Capital (balancing figure)	1,00,000	Cash	50,000
		Stock	20,000
		Furniture	10,000
		Machinery	20,000
	1,00,000		1,00,000

Summary of Cash

Dr.

Cr.

Receipts	Amount (Rs.)	Payments	Amount(Rs.)
To Balance b/d To Capital (Bank) To Debtors To Sales	50,000 20,000 57,500 45,000	By Purchases By Wages By Salaries By Trade expensesBy Electric bill By Drawings By Creditors By Balance c/d – cashBy Closing bank (balancing figure)	25,000 5,000 17,500 6,500 7,500 36,000 42,000 20,000 13,000
	1,72,500		1,72,500



UNIT-III
Accounting for Not-for-Profit Organization

Introduction to Not-for-Profit Organisation

Meaning, Features and Financial Statements of a Not-for-Profit Organisation:

- Meaning and Concept of Not-for-Profit Organisations:
 - i. These are the institutions/organisations that are set-up with general or specific objectives for rendering services and providing other social activities to enhance the welfare of general or a particular group of people.
 - ii. The aim of such institutions is not to earn profit, however, the organisations are capable of earning profit.
 - iii. A separate legal entity not owned by any individual or an enterprise.
 - iv. Examples of such organisations are schools, colleges, public hospitals, literacy societies for promoting sports, arts, culture, etc.

- Characteristics or Features of Not-for-Profit Organisations:
 - i. **Formed by Promoters:** These organisations are formed by the promoters who can be either individual or groups of individuals and enterprises.
 - ii. **Separate Existence:** These organisations have separate existence from its members, i.e. the life of an NPO is unaffected by the life of its members.
 - iii. **Purpose:** Its purpose is to further cultural, educational, religious, professional or public service objectives.
 - iv. **Form:** It is set-up as a charitable society or trust.
 - v. **No Profit Motive:** Its aim is not to earn profit, however, the organisation is capable of earning profit. Any surplus is used by the organisation for its prescribed objectives rather than distributing it among the members.
 - vi. **Management:** It is managed by a group of individuals known as Trustees or Managing Committee.
 - vii. **Funding:** The main source of their income is subscription, donations, government grants and other receipts
 - viii. **Accounts:** Unlike profit-seeking organisations, NPOs do not prepare Profit and Loss Account; rather they prepare Income and Expenditure Account to show a summary of revenue incomes and revenue expenses. The NPOs prepare final accounts every year which comprises of Receipt and Payment Account, Income and Expenditure Account and Balance Sheet.

- Difference between Not-for-Profit Organisation and Profit Earning Organisation:

Sr. no.	Basis	Not-for-Profit Organization	Profit Earning Organization (Business Firm)
1	Purpose	To render services	Its purpose is to earn profits.
2	Formation & Management Funds	Formed by Promoters and managed By Trustees It raises funds by way of Membership Fee, Donations, and Surplus from Operations which are shown in the books as General or Capital or Corpus funds.	Formed by Entrepreneur(s) and managed by Owners or Managers It receives funds from the proprietor, partners in the form of capital (in case of proprietorship and partnership) and from shareholders in the form of Share Capital (in case of Companies). Profits which are not distributed to partners and shareholders are shown as reserves.
3	Financial Statements	Final accounts are prepared every year that comprises of Receipt and Payment Account, Income and Expenditure Account and Balance Sheet.	Final accounts prepared comprises of Trading, Profit and Loss Account and Balance Sheet.
4	Surplus/Profit	Excess of income over expenditure in the Income and Expenditure Account is termed as Surplus/Profit.	Excess of credit side over the debit side of the Profit and Loss Account is termed as Net Profit.

• **Financial Statements of a Not-for-Profit Organisation:**

- i. It prepares annual or final accounts every year showing the financial transactions of the organisation.
- ii. These annual or final accounts are prepared for its members and to comply with statutory requirements.
- iii. Financial Statements of an NPO comprise of the following:
 - a. Receipts and Payments Account,
 - b. Income and Expenditure Account and
 - c. Balance Sheet.

Understanding Receipts and Payments Account

Meaning, Features, Format and Limitations of Receipts and Payments Account:

- **Meaning:** It is an account that shows the summary of all cash and bank transactions

occurred during an accounting period. It starts with the opening balances of cash and bank and ends with the closing balances of cash and bank. This account is a Real Account and lays the basis for the preparation of Income and Expenditure Account and the Balance Sheet.

• **Features:** Following are the features of Receipts and Payments Account:

- i. **Nature:** It is a summary of cash receipts and payments and hence, it an Asset Account/Real Account
- ii. **Recording:** It provides the summary of all cash and bank transactions in a chronological order.
- iii. **Basis of Preparing:** It is prepared on cash basis, i.e., it records only cash inflow and outflow. Accrued and outstanding transactions are not recorded in this account.
- iv. **Capital and Revenue:** It records all the transactions whether capital or revenue.
- v. **Period:** It records all the cash and bank transactions irrespective of whether they relate to current, previous or succeeding accounting periods.
- vi. **Opening and Closing Balances:** Opening balance of this account is the cash in hand/ bank at the beginning of the accounting year and the closing balance shows cash in hand/bank at the end of the accounting period.
- vii. **Adjustment:** Adjustments for accrued, outstanding items and depreciation is not required to be made in this account.
- viii. **Purpose:** The purpose of preparing this account is to show amount received and paid under various heads during the accounting year and also to know the cash position of the entity.

• **Format:**

Receipts and Payments Account for the year ended ...

Dr.

Receipts	Amount	Payments	
To Balance b/d(Opening Balance):		By Balance b/d (Opening Balance)(incase of Bank	
Cash in Hand	...	Overdraft)	
Cash at Banks	...	By Salaries	
To Subscriptions:		By Rent	
For Previous Year	...	By Postage Expenses	
For Current Year	...	By Newspapers and Magazines, etc.	
For Next Year	...	By Repairs	
To General Donations	...	By Audit Fee	
To Entrance/Admission Fees	...	By Maintenance Expenses	
To General Grants	...	By Insurance	
To Sale of Newspaper, Grass, etc.	...	By Secretary's Honorarium	
To Sale of Old Used Sports	...	By Honorarium	
Materials	...	By Municipal Tax	
To Interest on Investments	...	By Prize	
To Income from Concerts/Lectures	...	Distributed	
		By Office	
		Expenses	
		By Expenses on	
		Show	

To Dividends	...	By Miscellaneous Payments	..
To Rent Received	...	By Purchase of Fixed Assets (e.g., Furniture)	..
To Interest Received	...	By Sports Equipment By	..
To Miscellaneous Receipts	...	Investments	..
To Life Membership Fees	...	By Books	..
To Subscriptions for Specific Purpose	...	By Loan (Repayment) By	..
To Donation for Specific Purpose	...	Building	..
To Legacies	...	By Balance c/d (Closing Balance): Cash in	..
To Endowment Fund	...	Hand	..
To Sale of Fixed Assets	...	Cash at Bank*	..
To Receipts on Account of Special Fund, i.e., Match Fund, Prize Fund, etc.
To Balance c/d (Bank Overdraft)*

*Either of the two will appear.

If the receipts side is more than the payments side then, Closing balance of cash and bank will appear on the **credit side** of this account.

If the payments side is more than the receipts side then, Closing balance of bank will appear (**as Bankoverdraft**) on the **debit side** of this account.

• Limitations of Receipts and Payments Account:

i. It follows cash basis of accounting and therefore, does not show incomes and expenses on accrual basis.

ii. It is not capable of showing whether the NPO is able to meet its day-to-day expenses out of its income or not as the credit transactions are ignored.

iii. It is not a perfect substitute of Trial Balance as this account fails to reveal the closing balances of all accounts.

• Difference between Receipts and Payments Account and Cash Book:

Following are the points of differences between Receipts and Payments Account and Cash Book

Sr. No.	Basis	Receipts and Payments Account	Cash Book
1	Statement vs. Account	It can be regarded as statement rather than an account. Unlike ordinary accounts, it does not show Date and Ledger Folio columns.	It can be regarded as an account as it works both as Journal as well as ledger and its balances are directly shown in the Balance Sheet.
2	Period	It is prepared at the end of the accounting period.	It is written on daily basis.

3	Date	It does not require the transactions to be written date-wise. Even date column is not present in the R&P A/c	It requires the date-wise recording of the transactions.
4	Institutions	It is prepared by the Not-for-Profit Organisation.	It is prepared by all types of organisation be it a commercial or Not-for-Profit organisation.
5	Side	It has receipts and payments side instead of debit and credit.	It is divided into debit and credit sides.
6	Ledger Folio	It does not have column for ledger folio.	It has a separate column for Ledger Folio.

Understanding Income and Expenditure Account

Meaning, Features, Format and Important Terms of Income and Expenditure Account:

- Meaning:
 - i. It is like Profit and Loss Account of an enterprise or business firm.
 - ii. It shows all revenue income earned and revenue expenses incurred during an accounting period.
 - iii. It is prepared at the end of the accounting period on accrual basis of accounting.
 - iv. It determines the result of the organisation's operations, whether it has surplus or deficit.
 - v. It has 2 sides namely, debit and side. All the incomes and gains are recorded on the credit side and all the expenses and losses are recorded on the debit side.
 - vi. Excess of credit side over the debit side is termed as surplus, whereas, excess of debit side over the credit side is termed as deficit.
 - vii. Such surplus or deficit, as the case maybe, is either added to or deducted from the Capital Fund in the Balance Sheet.
- Features:
 - i. **Nature:** It is a Nominal Account and therefore, all revenue expenses and losses incurred are recorded on the debit side and all revenue incomes and gains earned are recorded on the credit side of this account.
 - ii. **Basis of Recording:** It follows the accrual basis of accounting to ascertain Surplus or Deficit arising after meeting all revenue expenses against all revenue incomes at the end of an accounting period
 - iii. **Period:** It records only those expenses and incomes which relate to the current accounting period.
 - iv. **Opening and Closing Balances:** It has no opening balance, however, balance at the end is either surplus or deficit which is then transferred to Capital Fund in the Balance Sheet.
 - v. **Adjustments:** Since, it follows accrual basis of accounting, all the adjustments are to be given effect which are necessary to record the incomes, gains, expenses and losses relating to the current accounting period.

- Format:

Dr. Income and Expenditure Account for the period ended...
 cr

Expenditure	Amount	Income	Amount
To Salaries		By Subscriptions	
Add: Outstanding at the end ...		Add: Outstanding at the end	
Less: Outstanding at the beginning ...		Advance in the beginning	
To Rent	...	Less: Outstanding at the beginning ...	
To Insurance Premium	
To Audit Fees	...	Less: Advance at the end	...
To Printing and Stationery	...	By Entrance Fees	...
To Honorarium	...	By Donations	...
To Telephone Expenses	...	By Sale of Old Newspapers	...
To Repairs	...	By Hall Rent	...
To Depreciation	...	By Sundry Receipts	...
To Sports Material Used	...	By Deficit	
(excess of income over expenditure)*	...	(excess of expenditure over income)*	

*Either of the two will appear

Expenditure side to record: All **revenue expenses** for current period (*after making adjustment for outstanding and prepaid expenses*)

Income side to record: All revenue income for current period (after making adjustments for outstanding and advance income)

Capital Expenditure:

- i. It is an expenditure, which benefits the organisations for more than one accounting period.
 - ii. It results in the acquisition of assets which are used for the furtherance of activities carried on by the NPO.
 - iii. Examples include cost of land, building, furniture and any addition thereto.
- o Revenue Expenditure:
- i. It is an expenditure, the benefits of which expire within the accounting period.
 - ii. In case of an NPO, such expenditure means expenditure incurred for social or charitable activities carried on by the NPO.
 - iii. Examples include Materials used, rent, insurance, salaries, honorariums paid, etc.

- o Revenue Receipts:
 - i. Any income received from the activities carried out by organisation is termed as revenue receipts.
 - ii. Examples include Subscription from members, General Donations, Rent Received, etc.
- o Capital Receipts:
 - i. Receipts other than revenue receipts are termed as Capital Receipts.
 - ii. Receipts from donor for the specified purpose are also termed as Capital Receipts.
 - iii. Examples include Life Membership Fee, Corpus Donations, Furniture Fund, etc.

- Difference between Income and Expenditure Account and Profit and Loss Account:

Sr.n o.	Basis	Income and Expenditure Account	Profit and Loss Account
1	Object	Its main object is to determine surplus, i.e., excess of income over expenditure or deficit i.e., excess of expenditure over income.	Its main object is to determine net profit or net loss.
2	Prepared by	It is prepared by Not-for-Profit Organisations.	It is prepared by business enterprises.
3	Method	If an organisation maintains a complete set of books, this account is prepared from Trial Balance. If complete set of books is not maintained, it is prepared from Receipt and Payment Account and the additional information available.	It is prepared from Trial Balance and other information.
4	Balance	Balance in this account is termed as either a surplus or a deficit.	Balance in this account is termed as either net profit or net loss.

- Difference between Receipts and Payments Account and Income and Expenditure Account:

Sr.n	Basis	Receipts and Payments Account	Income and Expenditure Account
1	Purpose	It is prepared to show difference between two sides showing Cash/Bank balance at the end.	It shows net result of activities undertaken during the year resulting in surplus or deficit.
2	Nature	It is a classified summary of cash transactions showing receipts and payments under different heads for the period, hence is a real account in nature.	It is like a Profit and Loss Account and therefore is a nominal account.

3	Form	It records receipts on the debit side and payments on the credit side.	It records all the expenses and losses on the debit side and all the incomes and gains on the credit side of the account.
4	Balance	Opening balance means cash in hand and bank balance in the beginning and closing balance means cash in hand and bank balance at the end.	Opening balance does not exist in this Account. Any closing balance at the end is either a surplus or deficit.
5	Capital and e Items	It records receipt and payment items of capital as well as revenue nature.	It records incomes and expenses during the accounting period which are of revenue nature only. Items of capital nature are not recorded in this account.
6	Contents	It records receipts and payments during the year whether they relate to past, current or succeeding year.	It records incomes and expenditures of the current year only.
7	Adjustments	It follows cash system of accounting and therefore, no adjustments are made.	It follows accrual system of accounting and therefore, adjustments are to be made for prepaid and outstanding incomes and expenses.
8	Depreciation	It records only cash items and non-cash items like depreciation are ignored.	It records non-cash items and therefore, non-cash items depreciation can be recorded in this account.

Understanding Balance Sheet

Meaning, Format and Important Points to prepare Balance Sheet:

- Meaning:
 - i. It is a statement that reveals the financial position of an organisation at a particular date.
 - ii. It shows assets, liabilities and Capital Fund.
 - iii. It is prepared in the same manner as that for a business firm.
 - iv. It is prepared after the Income and Expenditure Account.
 - v. Any surplus or deficit in the Income and Expenditure Account is transferred to Capital Fund, where, $\text{Capital Fund} = \text{Total Assets} - \text{Total Liabilities}$

Opening Balance Sheet- It shows the balances of all the assets, liabilities, funds and reserves in the beginning of an accounting period. It is usually prepared to ascertain the capital fund in the beginning or any other missing item.

Need for Preparing Opening Balance Sheet

In case, the Capital Fund is not mentioned in the question, then in order to ascertain the Capital Fund we need to prepare the Opening Balance Sheet. All the opening balances of assets such as, building, furniture, outstanding subscription (at the beginning), etc.

and all the opening balances of liabilities such as, creditors, advance subscription (at the beginning), outstanding expenses etc. are recorded in this balance sheet. The excess of the total of the Assets over the total of the Liabilities is regarded as Capital Fund.

Closing Balance Sheet- It is prepared to assess the true and fair financial position of an organisation at the end of an accounting period.

- **Following points should be kept in mind while preparing the Balance Sheet:** In order to prepare Balance Sheet, following are the points that are required to be kept in mind:
 - i. **Expenses and Incomes:** Expenses that are outstanding or prepaid and Incomes that are receivable or received in advance will appear in the Balance Sheet as Assets or Liabilities based on the nature of the respective items.
 - ii. **Special Receipts:** Special items like specific donations for building, sports, etc. will not appear in the Income and Expenditure Account. Instead they are shown as liabilities in the Balance Sheet.
 - iii. **Surplus and deficit:** Balancing of Income and Expenditure Account will either give a surplus or a deficit. This surplus/deficit is then added to or reduced from the Capital Fund Balance and only the net amount is shown in Balance Sheet.
 - iv. **Assets:** Amounts of assets that are shown in the opening Balance Sheet are to be adjusted for all current year transactions related to the respective assets which includes purchase of asset, sale of asset and depreciation. Such adjusted amount will then appear in the closing Balance Sheet.
 - v. **Liabilities:** Amounts of liabilities that are shown in the opening Balance Sheet are to be adjusted for all current year transactions related to the respective liability which shall include payments made against them or additional liability being created. Such adjusted amount will then appear in the closing Balance Sheet.
 - vi. **Loans and Advances:** Opening amount of loan taken should be adjusted for all repayments made during the year against it and only the net amount should be shown as a liability. In case of advances, opening balance should be adjusted for all the amounts recovered during the year and only the net amount should be shown as an asset.
- Format of Opening Balance Sheet of a Not-for-Profit Organisation.

Opening Balance Sheet as at ...

Liabilities	Amount	Assets	Amount
Bank Overdraft, if any	...	Cash in Hand	...
Outstanding Expenses	...	Cash at Bank	...
Advance Subscription	...	Fixed Assets, if any	...

Capital Fund*(balancing figure)	...	Investments, if any	...
		Outstanding Subscriptions	...
		Prepaid Expenses	...

- Format of Balance Sheet of a Not-for-Profit Organisation.

Name of the Organization

Balance Sheet as at ...

Liabilities	Amount	Assets	Amount
Capital Fund or General Fund or Corpus Fund:		Fixed Assets:	
Opening Balance		Building:	
Add: Surplus (or Less: Deficit)	...	Opening Balance	
Building Fund:		Additions	
Opening Balance		Less: Depreciation	...
Add: Donation for Building		Furniture: Opening	
Income from Building Fund Investment	...	Balance	
Sports Fund:		Additions	
Opening Balance		Less: Depreciation	...
Add: Donation for Sports Fund		Current Assets:	
Income on Sports Fund Investment		Cash in Hand	
Less: Sports Prize	...	at Bank	...
Awarded Current		Subscriptions in Arrear	...
Liabilities:		Accrued Interest	...
Outstanding		Investments:	
Expenses:		Building Fund Investments	...
Rent	...	Sport Fund Investments	...
Salaries	...	Prepaid	...
e		Expenses: Insurance	...
s		Rent	...
Electricity/Water Charges			...
Subscriptions Received in Advance			...
