

SWAMI RAMANAND TEERTHA MARATHWADA UNIVERSITY, NANDED

Four Years Multidisciplinary UG Program in Commerce (NEP 2020)

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STUDY NOTES

FINANCIAL ACCOUNTING-I

Course Code: CCOMCT1101

Discipline Specific Core (DSC) Major | 4 Credits

B.Com. First Year, Semester I (Level 4.5)

Faculty of Commerce and Management

Academic Year 2026-27

Modules covered in these notes	Hours
1. Introduction to Financial Accounting	10
2. Subsidiary Books	12
3. Rectification of Errors	08
4. Final Account of Sole Trading Concern	15
5. Consignment Accounts	15
Total	60

About the Course

Course objectives

- To understand accounting standards and the process from journal to trial balance.
- To identify the various types of errors and rectify them.
- To prepare final accounts of a sole trading concern.
- To understand consignment business and its accounting.

Evaluation scheme (100 marks)

Component	Marks	Details
Two tests (CCA)	20	Two tests of 10 marks each covering at least 80% of the syllabus
Assignment / Oral / Presentation / GD	12	Covers the entire syllabus
Attendance	8	4 marks for 60-75%, 6 marks for 75-85%, 8 marks for 85% and above
Continuous Assessment (CCA)	40	
Semester End Assessment (SEA)	60	Theory paper
Total	100	

Semester end question paper pattern (60 marks)

- Four questions of 15 marks each have to be solved.
- **Q.1 is compulsory** and has sub-questions covering all modules (entire syllabus).
- Attempt any three questions from Q.2 to Q.6, covering all the modules.
- **Q.6 has four sub-questions**, of which any two have to be solved.

How to use these notes

- Read the theory part first and then solve each numerical problem yourself before looking at the solution.
- Practise journal entries daily; most marks in numerical questions come from correct entries and neat format.
- Use the "Important questions" at the end of each module for revision before tests.
- Always write the heading, date and narration in numerical answers.

Reference books (from the syllabus)

- Gupta R.L. and Radhaswamy M., Financial Accounting, Sultan Chand and Sons.
- Shukla M.S., Grewal T.S. and Gupta S.C., Advanced Accounts, S. Chand.
- Maheshwari S.N. and Maheshwari S.K., Financial Accounting, Vikas Publishing House.
- Monga J.R., Financial Accounting, Mayur Paper Books.
- Jain and Narang, Advanced Accounts; Kotalwar H.R., Advanced Accounting, Discovery Publication, Latur.
- ICAI, Compendium of Statements and Standards of Accounting.

Module 1: Introduction to Financial Accounting

Teaching hours: 10 | Units 1.1 to 1.4

1.1 Meaning and Definition of Accounting

Every business, whether a small kirana shop in Basmathnagar or a large company, carries out hundreds of transactions: buying goods, selling goods, paying wages, receiving money and so on. Memory alone cannot hold all this information, so transactions are written down in an orderly manner. This orderly record keeping and its use for decision making is called **accounting**.

Book-keeping

Book-keeping is the **art of recording** financial transactions in the books of account in a systematic and chronological way. It is the base on which accounting is built.

Accounting

The American Institute of Certified Public Accountants (AICPA) describes accounting as the art of recording, classifying and summarising, in terms of money, the transactions and events that are of a financial character, and of interpreting the results. The American Accounting Association views it as the process of identifying, measuring and communicating economic information so that users can make informed judgements and decisions.

Simple definition for exams

Accounting is the process of identifying, recording, classifying, summarising, analysing and interpreting financial transactions and communicating the results to the users of the information.

Main features of accounting

- **Art and science:** it has a body of principles (science) and needs skill in applying them (art).
- **Money measurement:** only transactions that can be expressed in money are recorded.
- **Process:** it covers recording, classifying, summarising and interpreting.
- **Communication:** the final output is information for users such as owners, banks and the government.

Book-keeping and accounting compared

Basis	Book-keeping	Accounting
Meaning	Recording of transactions in books	Recording, summarising, analysing and interpreting
Scope	Narrow; only journal, subsidiary books and ledger	Wide; includes book-keeping and final accounts
Main aim	Maintain a permanent record	Find profit or loss and financial position
Skill needed	Clerical, routine skill	Analytical and professional skill
Decision making	Does not help directly	Supports management decisions
Sequence	First stage	Starts where book-keeping ends

Branches of accounting

- **Financial accounting:** records transactions and prepares Trading, Profit and Loss Account and Balance Sheet for outsiders.
- **Cost accounting:** ascertains and controls the cost of products or services.
- **Management accounting:** supplies information to managers for planning and control.

Users of accounting information

Group	Users	What they want to know
Internal	Owners, managers, employees	Profit earned, cost control, bonus and job security
External	Investors and lenders, banks	Safety of investment, repayment capacity
External	Creditors and suppliers	Whether the firm can pay dues on time
External	Government and tax authorities	Correct income tax and GST
External	Customers, researchers, public	Stability and growth of the business

Objectives of accounting

- To keep **systematic and permanent records** of all transactions.
- To ascertain the **profit or loss** of the business for a period.
- To show the **financial position** (assets and liabilities) on a given date.
- To provide information to **interested users** for decisions.
- To comply with **legal requirements** such as the Income Tax Act, GST law and the Companies Act.
- To help in **detecting and preventing** errors and frauds.
- To enable **comparison** with earlier years and with other firms.
- To provide **legal evidence** in courts and tax proceedings.

Advantages and limitations

Advantages	Limitations
Replaces memory with written record	Records only money-measurable facts
Shows profit and financial position	Based on historical cost; ignores inflation
Helps in raising loans and filing returns	Uses personal judgement in estimates such as depreciation
Helps in comparison and control	Does not show the true market value of assets

1.2 Types of Accounts, Rules of Accounts and Accounting Cycle

Types of accounts (traditional classification)

An **account** is a summary of all transactions relating to one person, thing, income or expense, shown in a ledger. Under the traditional approach accounts are of three types.

Type	Sub-types	Examples
Personal	Natural persons; artificial persons (firms, companies, banks); representative personal accounts (outstanding and prepaid items)	Ramesh A/c, SBI A/c, Outstanding Rent A/c
Real	Tangible (can be touched); intangible (no physical form)	Cash, Building, Machinery, Goodwill, Patents
Nominal	Expenses and losses; incomes and gains	Wages, Rent, Salary, Interest Received, Commission

Golden rules of accounting

Type of account	Debit	Credit
Personal	The receiver	The giver
Real	What comes in	What goes out
Nominal	All expenses and losses	All incomes and gains

Modern (accounting equation) approach

The accounting equation is **Assets = Liabilities + Capital**. Every transaction keeps this equation in balance, which is the base of the **double entry system**: each transaction has two aspects, a debit and an equal credit.

Class of account	Increase	Decrease
Assets	Debit	Credit
Liabilities	Credit	Debit
Capital	Credit	Debit
Revenue (income)	Credit	Debit
Expenses	Debit	Credit

Journal entries: worked illustration

The journal is the book of original entry. Each transaction is first analysed (which accounts, which type, which side) and then written as a journal entry. Study the following ten transactions.

Particulars	Dr. (₹)	Cr. (₹)
1. Started business with cash ₹1,00,000: Cash A/c Dr.	1,00,000	
To Capital A/c		1,00,000
2. Purchased goods for cash ₹20,000: Purchases A/c Dr.	20,000	
To Cash A/c		20,000
3. Purchased goods from Anil on credit ₹15,000: Purchases A/c Dr.	15,000	
To Anil A/c		15,000
4. Sold goods for cash ₹30,000: Cash A/c Dr.	30,000	
To Sales A/c		30,000
5. Sold goods to Sunil on credit ₹12,000: Sunil A/c Dr.	12,000	
To Sales A/c		12,000
6. Paid rent ₹5,000: Rent A/c Dr.	5,000	
To Cash A/c		5,000
7. Received commission ₹2,000: Cash A/c Dr.	2,000	
To Commission Received A/c		2,000
8. Paid Anil in full ₹15,000: Anil A/c Dr.	15,000	
To Cash A/c		15,000
9. Bought furniture for cash ₹10,000: Furniture A/c Dr.	10,000	
To Cash A/c		10,000

Particulars	Dr. (₹)	Cr. (₹)
10. Proprietor withdrew cash for personal use ₹3,000: Drawings A/c Dr.	3,000	
To Cash A/c		3,000

Ledger and trial balance

- **Ledger:** the principal book in which all journal and subsidiary book entries are posted account-wise. Each account has a debit side and a credit side; after posting, each account is **balanced**.
- **Trial balance:** a list of all ledger balances on a date. If total debits equal total credits, the books are arithmetically accurate. It does not prove that the books are completely free from errors (see Module 3).

Accounting cycle

The accounting cycle is the complete sequence of steps from the first transaction of a period to the preparation of financial statements, repeated every year.

Step	Stage	Description
1	Identify transactions	Collect source documents: invoice, cash memo, voucher, debit and credit notes
2	Journalise	Record in journal or subsidiary books
3	Post to ledger	Transfer entries to the respective accounts
4	Balance accounts	Find the closing balance of each ledger account
5	Trial balance	Prepare trial balance to test arithmetical accuracy
6	Adjusting entries	Record outstanding, prepaid, depreciation and other adjustments
7	Adjusted trial balance	Re-check after adjustments
8	Financial statements	Trading and Profit and Loss Account and Balance Sheet
9	Closing entries	Transfer nominal accounts to Profit and Loss Account
10	Opening entries	Carry balances forward to the next period

1.3 Accounting Concepts and Conventions

Concepts are the basic assumptions on which accounting is built. **Conventions** are customs or traditions followed by accountants to bring uniformity and clarity.

Accounting concepts

Concept	Meaning	Illustration
Business entity	Business is separate from its owner	Owner's personal expenses are shown as drawings
Money measurement	Only facts expressed in money are recorded	Employee skill is not recorded
Going concern	Business will continue for a long time	Assets are valued on cost, not on forced sale value
Accounting period	Life of the business is divided into periods, usually 12 months	Year ending 31 March
Cost concept	Assets are recorded at cost of acquisition	Land bought for ₹5 lakh stays at ₹5 lakh

Concept	Meaning	Illustration
Dual aspect	Every transaction has two effects	Debit equals credit; assets equal liabilities plus capital
Revenue recognition (realisation)	Revenue is recorded when earned, not when cash is received	Credit sale is revenue on delivery
Matching	Expenses of a period are matched with revenue of that period	Outstanding wages are charged to the year of service
Accrual	Record income and expenses when they arise, not when cash moves	Prepaid insurance
Objectivity	Records should be backed by verifiable evidence	Bills and vouchers

Accounting conventions

Convention	Meaning
Consistency	Same methods are followed year after year so that results are comparable
Conservatism (prudence)	Anticipate no profit but provide for all possible losses; stock valued at cost or market price, whichever is lower
Full disclosure	All material facts must be shown in the financial statements
Materiality	Only items important enough to influence decisions need separate disclosure; a small item such as a pencil is charged to expense

Capital expenditure and revenue expenditure

Basis	Capital expenditure	Revenue expenditure
Nature	Benefit lasts for more than one year	Benefit is used up in the current year
Purpose	Acquire or improve a fixed asset or earning capacity	Run the business and maintain assets
Treatment	Shown in Balance Sheet as an asset	Charged to Trading or Profit and Loss Account
Recurrence	Non-recurring	Recurring
Effect on profit	No effect in the year of spending (depreciation affects later)	Reduces profit of the current year
Examples	Purchase of machinery; wages paid for installing machinery; legal cost of buying land	Salaries, rent, repairs, depreciation, carriage on goods

Deferred revenue expenditure is revenue in nature but its benefit extends over several years, such as heavy advertisement for a new product. It is written off over a few years and the unwritten part is shown as an asset.

Capital receipts and revenue receipts

Capital receipts	Revenue receipts
Money received from owner as capital or from loans	Money received from the normal activity of the business

Capital receipts	Revenue receipts
Sale proceeds of fixed assets	Sale of goods and services, interest and commission received
Shown as liability or reduction in asset	Credited to Trading or Profit and Loss Account

Why is the distinction important?

If capital expenditure is wrongly treated as revenue, profit is understated and assets are understated. If revenue expenditure is wrongly treated as capital, profit and assets are overstated.

1.4 Accounting Standards (AS)

Meaning and scope

Accounting Standards are written policy documents which lay down the rules for recognition, measurement, presentation and disclosure of items in financial statements. In India they are issued by the **Accounting Standards Board (ASB)** of the **Institute of Chartered Accountants of India (ICAI)** and are made applicable to companies through the Companies Act, 2013 (Section 133) and the Companies (Accounting Standards) Rules. Large and listed companies follow Indian Accounting Standards (Ind AS) converged with IFRS, while other entities follow the AS notified earlier.

- **Objectives:** bring uniformity, reduce alternative treatments, make statements comparable and increase reliability.
- **Benefits:** helps users trust the statements, helps auditors, reduces manipulation.
- **Limitations:** standards cannot cover every situation and may not suit very small businesses.

AS-1: Disclosure of Accounting Policies

Accounting policies are the specific principles and methods adopted by a firm in preparing financial statements (for example method of depreciation or stock valuation).

- **Fundamental assumptions:** going concern, consistency and accrual. If followed, no separate disclosure is needed; if not followed, the fact must be disclosed.
- **Considerations in selecting policies:** prudence, substance over form and materiality.
- **Disclosure:** all significant accounting policies must be disclosed in one place, and any change in policy with its effect must be disclosed.

AS-6: Depreciation Accounting

Depreciation is the decrease in the value of a fixed asset due to use, passage of time or obsolescence. It is a non-cash expense charged to Profit and Loss Account so that the cost of the asset is spread over its useful life.

- **Factors:** historical cost, estimated useful life, estimated scrap (residual) value.
- **Causes:** wear and tear, expiry of legal rights, obsolescence, passage of time.

Basis	Straight Line Method (SLM)	Written Down Value Method (WDV)
Charge	Fixed amount every year	Fixed percentage on opening book value; amount falls every year
Formula	$(\text{Cost} - \text{Scrap value}) / \text{Life}$	$\text{Opening book value} \times \text{rate } \%$
Asset value	Reaches scrap value at end of life	Never reaches zero
Suitable for	Leases, patents, furniture	Machinery, vehicles with heavy early use

Illustration. A machine costs ₹1,00,000, scrap value ₹10,000, life 5 years. SLM depreciation = $(1,00,000 - 10,000) / 5 = ₹18,000$ every year. Under WDV at 20 per cent: Year 1 = ₹20,000 (book value ₹80,000); Year 2 = ₹16,000 (₹64,000); Year 3 = ₹12,800 (₹51,200).

AS-9: Revenue Recognition

Revenue is the gross inflow of cash, receivables or other consideration arising from ordinary activities such as sale of goods, rendering of services, and use of enterprise resources by others (interest, royalties, dividends).

Source of revenue	When recognised
Sale of goods	When property in goods passes to the buyer and significant risks and rewards of ownership are transferred, and collection is reasonably certain
Rendering of services	As the service is performed (proportionate completion) or on completion of the contract
Interest	On a time basis according to the amount outstanding and rate
Royalties	On accrual as per the terms of the agreement
Dividends	When the owner's right to receive payment is established

AS-10: Accounting for Fixed Assets

A fixed asset is an asset held to produce or supply goods or services, not for sale in the ordinary course, and expected to be used for more than one period.

- **Initial measurement:** at cost, which includes purchase price, import duties and non-refundable taxes, and all costs directly needed to bring the asset to working condition (freight, installation, professional fees).
- **Self-constructed assets:** cost of materials, labour and directly related overheads.
- **Subsequent expenditure:** added to the asset only if it increases future benefits or life; otherwise it is a repair charged to expense.
- **Revaluation:** if an asset is revalued, the whole class of assets must be revalued, and the policy disclosed.
- **Disposal:** profit or loss on sale (sale price less book value) is shown in Profit and Loss Account.
- **Disclosure:** gross and net book value, additions and deductions during the year.

Important questions: Module 1

- Define accounting and explain its objectives.
- Explain golden rules of accounting with examples. Write journal entries for given transactions.
- Explain any five accounting concepts and four conventions.
- Distinguish between capital and revenue expenditure.
- Write short notes: AS-1, AS-6, AS-9, AS-10.
- Explain the accounting cycle.

Module 2: Subsidiary Books

Teaching hours: 12 | Units 2.1 to 2.4

2.1 Meaning, Need and Types of Subsidiary Books

In a big business there may be hundreds of purchases, sales and cash transactions every day. If all of them are written in one journal, the journal becomes bulky, one person alone must write it, and posting to the ledger is slow. To solve this, the journal is **divided into separate books**, one for each class of similar transactions. These are called **subsidiary books** (also called journal subdivisions or books of original entry).

Definition

Subsidiary books are the books in which transactions of the same nature are recorded together, in chronological order, so that the journal is split into specialised books.

Need for subsidiary books

- **Division of work:** different clerks can record different books at the same time.
- **Saves time and labour:** only the total of the book is posted to the ledger account, not every single entry.
- **Quick information:** total purchases, sales or returns for any period are available at once.
- **Reduces errors and fraud:** specialisation and internal check improve accuracy.
- **Reduces ledger size:** the Purchases, Sales and Returns accounts show only periodic totals.

Types of subsidiary books

Book	Records
Cash Book (including Petty Cash Book)	All cash and bank receipts and payments
Purchase Book (Purchase Journal)	Credit purchases of goods meant for resale
Sales Book (Sales Journal)	Credit sales of goods
Purchase Return Book (Return Outward)	Goods returned to suppliers
Sales Return Book (Return Inward)	Goods returned by customers
Bills Receivable Book	Bills of exchange or promissory notes received from customers
Bills Payable Book	Bills accepted or notes issued to suppliers
Journal Proper	Transactions that cannot be recorded in any other book

2.2 Advantages of Subsidiary Books and Difference from Principal Book

Advantages

- Division of labour and specialisation.
- Saving of time and effort in journalising and posting.
- Easy location of errors and easy checking.
- Information about each class of transactions is readily available.
- Several persons can work together; efficiency improves.
- Better internal control and less chance of fraud.

Distinction between principal book and subsidiary book

The **principal book** is the **ledger** (and the cash book, which acts as both a subsidiary book and a principal book). The subsidiary books are books of original entry.

Basis	Subsidiary book	Principal book (Ledger)
Nature	Book of original entry	Book of final entry
Order	Chronological (date-wise)	Classified (account-wise)
Purpose	First record of transactions	Summary of transactions of each account
Posting	Totals are posted to ledger	Posted from subsidiary books
Number	Many books	One book with many accounts
Use	Helps in preparing the ledger	Helps in preparing trial balance and final accounts

2.3 Cash Book

The **cash book** records all receipts and payments of cash (and bank transactions). It is a book of original entry and also a ledger (the cash account), so no separate Cash Account is required. Cash receipts are written on the **debit** side and payments on the **credit** side. The cash balance can never be a credit balance.

Types of cash book

- **Single column cash book:** only a cash column.
- **Double column cash book:** cash and discount columns, or cash and bank columns.
- **Three column cash book:** discount, cash and bank columns.
- **Petty cash book:** records small, regular payments.

Discount

- **Discount allowed** (to customers who pay early) is a loss, written on the **debit** side of the cash book.
- **Discount received** (from suppliers) is a gain, written on the **credit** side.
- The discount columns are totals only; they are posted to Discount Allowed A/c (Dr.) and Discount Received A/c (Cr.) at the end of the period. Individual discounts are posted to the personal accounts.

Contra entries

A transaction that affects both the cash and bank columns is a **contra entry**. It is recorded on both sides of the cash book and marked **C** in the ledger folio, and no ledger posting is required. Examples: cash deposited in bank (cash column credit, bank column debit); cash withdrawn for office use (bank credit, cash debit).

Numerical problem 1: three column cash book

Record the following in a three column cash book of Mr. Patil: April 1: cash in hand ₹20,000, bank balance ₹50,000. April 2: purchased goods for cash ₹5,000. April 3: sold goods to Ram, received cheque ₹12,000 and deposited it in bank. April 5: paid Shyam by cheque ₹8,000, he allowed discount ₹200. April 8: received from Mohan cash ₹3,000, allowed him discount ₹100. April 10: withdrew from bank for office use ₹4,000. April 12: paid salary in cash ₹6,000. April 15: deposited cash into bank ₹5,000.

Date	Particulars	Discount (₹)	Cash (₹)	Bank (₹)
Debit side (receipts)				
Apr 1	To Balance b/d		20,000	50,000
Apr 3	To Sales (Ram)			12,000

Date	Particulars	Discount (₹)	Cash (₹)	Bank (₹)
Apr 8	To Mohan	100	3,000	
Apr 10	To Bank (C)		4,000	
Apr 15	To Cash (C)			5,000
	Total	100	27,000	67,000
Credit side (payments)				
Apr 2	By Purchases		5,000	
Apr 5	By Shyam	200		8,000
Apr 10	By Cash (C)			4,000
Apr 12	By Salary		6,000	
Apr 15	By Bank (C)		5,000	
Apr 15	By Balance c/d		11,000	55,000
	Total	200	27,000	67,000

Closing balances: cash ₹11,000 and bank ₹55,000. Discount allowed ₹100 is posted to the debit of Discount Allowed A/c, and discount received ₹200 is posted to the credit of Discount Received A/c.

Bank overdraft

If a firm withdraws more than its bank balance, the credit side of the bank column exceeds the debit side. The difference is a **bank overdraft**, which is a liability. It is balanced by writing "To Balance c/d" on the debit side, and the next period begins with "By Balance b/d" on the credit side.

Petty cash book

Large firms have many small payments such as postage, tea, conveyance and stationery. To save the chief cashier's time, a **petty cashier** keeps a **petty cash book**. The head cashier gives a fixed amount at the start of a period, and this is the **imprest**. At the end of the period the petty cashier reports the expenses and the head cashier **reimburses** exactly the amount spent, which brings the balance back to the imprest. This is the **imprest system**.

- **Simple petty cash book:** like a normal cash book with the expenses listed in a single column.
- **Analytical (columnar) petty cash book:** expenses are classified in separate columns such as postage, stationery, travelling and sundry, so posting is easy.

Numerical problem 2: analytical petty cash book

On 1 June the head cashier gave ₹5,000 as imprest. Expenses: June 2 postage ₹300; June 5 stationery ₹450; June 9 conveyance ₹250; June 15 postage ₹200; June 20 stationery ₹500; June 28 tea and refreshments ₹400 (sundry). Reimbursement at the end of the month is claimed.

Receipts (₹)	Date	Particulars	Total (₹)	Postage	Stationery	Travel	Sundry
5,000	Jun 1	To Cash					
	Jun 2	By Postage	300	300			
	Jun 5	By Stationery	450		450		
	Jun 9	By Conveyance	250			250	
	Jun 15	By Postage	200	200			

Receipts (₹)	Date	Particulars	Total (₹)	Postage	Stationery	Travel	Sundry
	Jun 20	By Stationery	500		500		
	Jun 28	By Refreshments	400				400
		Total	2,100	500	950	250	400
2,100	Jun 30	To Cash (reimbursed)					
	Jun 30	By Balance c/d	5,000				
7,100		Total	7,100				

Balance in hand before reimbursement is 5,000 - 2,100 = ₹2,900. After the head cashier reimburses ₹2,100, the balance carried down is again the imprest of ₹5,000.

2.4 Other Subsidiary Books and Journal Proper

Purchase book

Records only **credit purchases of goods** meant for resale. Cash purchases go to the cash book and purchases of assets (such as furniture) go to the journal proper. Entries are made from the **supplier's invoice**, with the date, name of supplier, invoice number and net amount after trade discount. Trade discount is deducted in the book itself and is never entered in accounts.

Posting: each supplier's account is credited with the net amount; at the end of the period the **total** of the purchase book is debited to Purchases A/c.

Illustration. January 5: purchased from A & Co. goods ₹10,000 less 10% trade discount. January 12: purchased from B Traders goods ₹20,000 less 5% trade discount.

Date	Particulars (supplier)	Invoice No.	L.F.	Amount (₹)
Jan 5	A & Co. (10,000 less 10%)	101		9,000
Jan 12	B Traders (20,000 less 5%)	102		19,000
	Total transferred to Purchases A/c (Dr.)			28,000

Sales book

Records only **credit sales of goods**. It is written from the carbon copy of the **sales invoice**. Each customer's account is debited and the total of the sales book is credited to Sales A/c. Sales of assets and cash sales are not entered here.

Illustration. February 3: sold to Kiran goods ₹15,000 less 10% trade discount. February 18: sold to Latif goods ₹8,000 net. Sales book total = 13,500 + 8,000 = **₹21,500**, credited to Sales A/c; Kiran A/c is debited ₹13,500 and Latif A/c ₹8,000.

Purchase return book and sales return book

Basis	Purchase return (return outward)	Sales return (return inward)
Meaning	Goods returned to the supplier	Goods returned by the customer
Document	Debit note sent to supplier	Credit note sent to customer
Supplier / customer account	Debited (our liability falls)	Credited (customer owes less)
Total posted to	Purchase Returns A/c (Cr.)	Sales Returns A/c (Dr.)
Shown in final accounts	Deducted from purchases	Deducted from sales

Illustration. Of the goods bought from A & Co., goods worth ₹1,000 were returned on January 8. Entry: A & Co. A/c is debited ₹1,000 and Purchase Returns A/c is credited ₹1,000 (at the period end).

Bills receivable book and bills payable book

A **bill of exchange** is an unconditional written order by the drawer directing the drawee to pay a certain sum on a fixed date to a named person. The **Bills Receivable Book** records bills which the firm is to receive, and the **Bills Payable Book** records bills which the firm has accepted and is to pay.

Item	Bills receivable book	Bills payable book
Records	Bills accepted by customers in our favour	Bills we have accepted in favour of suppliers
Personal account	Drawee or customer is credited	Drawer or supplier is debited
Total posted to	Bills Receivable A/c (Dr.)	Bills Payable A/c (Cr.)
Nature of account	Asset	Liability
Columns	Date received, from whom, drawer, acceptor, date and term, due date, amount	Date of acceptance, to whom, drawer, payee, term, due date, amount

Journal proper

The **journal proper** records transactions that do not find a place in any other subsidiary book. Typical entries are:

- **Opening entry:** at the start of a new business year, balances of assets and liabilities are brought forward.
- **Closing entries:** transfer of expense and income accounts to Trading and Profit and Loss Account.
- **Adjustment entries:** outstanding and prepaid expenses, depreciation, provisions.
- **Rectification entries:** correction of errors (see Module 3).
- **Credit purchase or sale of assets:** for example, furniture bought on credit.
- **Bad debts, discount allowed or received** where not otherwise recorded.
- **Goods taken by the proprietor for personal use** and goods distributed as free samples.
- **Transfer entries** and **dishonour of cheque** where handled in journal.

Numerical problem 3: journal proper

Particulars	Dr. (₹)	Cr. (₹)
1. Bought furniture on credit from Modern Furniture ₹25,000: Furniture A/c Dr.	25,000	
To Modern Furniture A/c		25,000
2. Goods costing ₹4,000 taken by proprietor for personal use: Drawings A/c Dr.	4,000	
To Purchases A/c		4,000
3. Amount due from Gopal ₹3,000 became bad debt: Bad Debts A/c Dr.	3,000	
To Gopal A/c		3,000
4. Depreciation on machinery ₹6,000: Depreciation A/c Dr.	6,000	
To Machinery A/c		6,000
5. Wages outstanding at year end ₹1,500: Wages A/c Dr.	1,500	

Particulars	Dr. (₹)	Cr. (₹)
To Outstanding Wages A/c		1,500

Important questions: Module 2

- What are subsidiary books? Explain their need and advantages.
- Distinguish between subsidiary book and principal book.
- Explain the imprest system. Prepare an analytical petty cash book from given data.
- Prepare a three column cash book from given transactions.
- Prepare purchase book, sales book and return books and show posting to ledger.
- Short notes: contra entry, bills receivable book, journal proper.

Module 3: Rectification of Errors

Teaching hours: 08 | Units 3.1 to 3.4

3.1 Meaning, Need and Procedure of Rectification of Errors

Even with great care, mistakes occur while recording transactions, posting to the ledger, totalling the books or preparing the trial balance. An **error** is an unintentional mistake in the books of account. **Rectification** means locating the errors and correcting them by passing proper entries so that the books show the correct position.

Need for rectification

- To prepare **correct final accounts** and show true profit or loss.
- To show the **true financial position** in the Balance Sheet.
- To get **correct balances** of customers and suppliers.
- To make the **trial balance agree** and to close the suspense account.
- To comply with tax and audit requirements.

Procedure of rectification

- **Step 1:** Identify the error and decide which accounts were wrongly debited or credited.
- **Step 2:** Find out what the correct entry should have been.
- **Step 3:** Find out what was actually done in the books.
- **Step 4:** Pass a rectifying entry which removes the wrong effect and gives the right effect. Do not overwrite or erase; use a journal entry with a clear narration.
- **Step 5:** If an error was one-sided (the trial balance did not agree), use the **Suspense Account** in the rectifying entry.

Method to solve any rectification problem

Ask three questions: (1) What was actually done in the books? (2) What should have been done? (3) What entry removes the wrong effect and gives the right effect? Use the Suspense Account only when the error was one-sided and the trial balance was disturbed.

3.2 Types of Errors

Type	Meaning	Example
Errors of omission	A transaction is completely or partly left out of the books. Complete omission has no effect on the trial balance; partial omission (entered on one side only) disturbs it	Credit purchase from X ₹5,000 not recorded at all; cash received from A credited to A but not entered in the cash book
Errors of commission	Wrong entry made through carelessness: wrong amount, wrong posting, wrong totalling, wrong balancing, wrong carry forward	Sale to Y posted to the account of Z; sales book overcast by ₹1,000
Errors of principle	Accounting principle is violated, usually mixing capital and revenue items	Purchase of furniture debited to Purchases A/c; repairs debited to Building A/c
Compensating errors	Two or more errors cancel the effect of each other, so the trial balance agrees	Rent account debited ₹100 too much and Commission Received account credited ₹100 too much

Type	Meaning	Example
Errors of original entry	Wrong amount recorded in the book of original entry; both aspects use the same wrong amount	Purchase of ₹5,400 recorded as ₹4,500 in the purchase book
Errors of reversal	Entry made on the wrong sides of the correct accounts	Goods sold to Mohan debited to Sales A/c and credited to Mohan A/c
Errors of duplication	The same transaction recorded twice	One invoice entered twice in the sales book

Classification by effect on the trial balance

Errors that do NOT affect the trial balance (two-sided)	Errors that DO affect the trial balance (one-sided)
Complete omission	Partial omission (one aspect missing)
Errors of principle	Wrong totalling or balancing of an account
Compensating errors	Posting to wrong side or wrong amount in one account
Errors of original entry	Wrong carry forward, or posting a different amount to one account
Posting to a wrong account (right side, right amount)	Total of a subsidiary book not posted

A trial balance that agrees is **not conclusive proof** of accuracy, because the first group of errors does not disturb it.

3.3 Rectification Before Preparing the Trial Balance

Errors detected before the trial balance is prepared are corrected directly. Two-sided errors are rectified by journal entries between the accounts concerned. One-sided errors are corrected in the account that was wrongly posted, usually by writing the correction in the account and an explanation. In examination problems, journal entries are normally asked for.

Illustrations

Particulars	Dr. (₹)	Cr. (₹)
(a) Complete omission. Goods purchased from X for ₹5,000 were not recorded. Purchases A/c Dr.	5,000	
To X A/c		5,000
(b) Wrong personal account. Goods sold to Y ₹3,000 were debited to Z. Y A/c Dr.	3,000	
To Z A/c		3,000
(c) Error of principle. Furniture bought for ₹10,000 was debited to Purchases A/c. Furniture A/c Dr.	10,000	
To Purchases A/c		10,000
(d) Capital item as revenue. Wages ₹2,000 paid for installing machinery were debited to Wages A/c. Machinery A/c Dr.	2,000	
To Wages A/c		2,000

Particulars	Dr. (₹)	Cr. (₹)
(e) Revenue item as capital. Repairs to building ₹4,000 were debited to Building A/c. Repairs A/c Dr.	4,000	
To Building A/c		4,000
(f) Private expense. Proprietor's insurance premium ₹1,200 was debited to Insurance A/c. Drawings A/c Dr.	1,200	
To Insurance A/c		1,200
(g) Error of reversal. Goods sold to Mohan ₹6,000 were debited to Sales and credited to Mohan. Mohan A/c Dr. (2 x 6,000)	12,000	
To Sales A/c		12,000

3.4 Rectification After Preparing the Trial Balance

When a trial balance does not agree, the difference is temporarily placed in a **Suspense Account** so that the trial balance tallies and the final accounts can be prepared. If the difference is on the **credit side** (credit total is short), the Suspense Account is **credited**; if the debit total is short, it is **debited**.

When the errors are later found, the **Suspense Account** is used in the rectifying entries. The account finally shows no balance when all one-sided errors have been corrected.

Rules for using the suspense account

If the error caused	Rectifying entry
Debit side short (a debit was omitted)	Concerned account Dr. To Suspense A/c
Credit side short (a credit was omitted)	Suspense A/c Dr. To Concerned account
Debit side excess (debited too much)	Suspense A/c Dr. To Concerned account
Credit side excess (credited too much)	Concerned account Dr. To Suspense A/c

Illustrations of one-sided errors

Particulars	Dr. (₹)	Cr. (₹)
(a) Cash received from A ₹2,500 was credited to A but not entered in cash book. Cash A/c Dr.	2,500	
To Suspense A/c		2,500
(b) Sales book overcast by ₹1,000 (credit side excess). Sales A/c Dr.	1,000	
To Suspense A/c		1,000
(c) Purchase returns ₹1,500 posted to the debit instead of credit of Purchase Returns A/c (debit wrongly shown, so credit short by 2 x 1,500). Suspense A/c Dr.	3,000	
To Purchase Returns A/c		3,000
(d) Salary paid ₹5,000 was posted as ₹500 to Salary A/c (debit short by ₹4,500). Salary A/c Dr.	4,500	
To Suspense A/c		4,500
(e) Total of purchase book ₹40,000 was not posted to Purchases A/c (debit omitted). Purchases A/c Dr.	40,000	
To Suspense A/c		40,000

Numerical problem: suspense account

The debit total of the trial balance of a trader is ₹2,15,000 and the credit total is ₹2,00,000. The difference is transferred to a Suspense Account. Later the following errors are found: (i) the sales book was undercast by ₹10,000; (ii) cash received from P ₹5,000 was debited in the cash book but not credited to P's account. Pass rectifying entries and prepare the Suspense Account.

Solution. Credit total is short by ₹15,000, so Suspense A/c is credited by ₹15,000. Both errors left the credit side short.

Particulars	Dr. (₹)	Cr. (₹)
(i) Suspense A/c Dr.	10,000	
To Sales A/c (sales book undercast)		10,000
(ii) Suspense A/c Dr.	5,000	
To P A/c (credit to P omitted)		5,000

Dr. Suspense Account	Amount (₹)	Cr. Suspense Account	Amount (₹)
To Sales A/c	10,000	By Difference in trial balance	15,000
To P A/c	5,000		
Total	15,000	Total	15,000

The suspense account is closed, which proves that all errors have been located.

Effect of errors on profit

If the errors affect nominal accounts (expenses and incomes), they change the profit. For example, if rent ₹2,000 is omitted from expenses, profit is overstated by ₹2,000. After rectification, **corrected profit** is calculated by adding or subtracting the effect of each error from the profit reported.

Item	Effect on profit	Adjustment
Expense omitted or under-debited	Profit overstated	Subtract
Expense over-debited	Profit understated	Add
Income omitted or under-credited	Profit understated	Add
Income over-credited	Profit overstated	Subtract

Important questions: Module 3

- What is rectification of errors? Why is it necessary?
- Explain the types of errors with examples. Which errors are not disclosed by the trial balance?
- What is a suspense account? Explain its use.
- Pass rectifying entries for given errors and prepare the suspense account.
- Distinguish between errors of omission and errors of commission.

Module 4: Final Accounts of a Sole Trading Concern

Teaching hours: 15 | Units 4.1 to 4.4

4.1 Financial Statements

A **sole trading concern** is a business owned and run by one person. At the end of the accounting year the trader wants to know (a) the profit or loss made and (b) the financial position. For this the following **final accounts** (financial statements) are prepared from the trial balance:

- **Trading Account:** shows the gross profit or gross loss.
- **Profit and Loss Account:** shows the net profit or net loss.
- **Balance Sheet:** shows assets and liabilities on the closing date.

Trading account

Trading Account is prepared to find the **gross profit**, which is the excess of sales over the cost of goods sold. It contains **direct expenses** and **direct incomes** connected with buying and selling of goods.

Dr. Trading Account for the year ended ...	Cr.
To Opening Stock	By Sales (less Sales Returns)
To Purchases (less Purchase Returns)	By Closing Stock
To Direct expenses: Carriage inwards, Wages, Freight, Octroi, Import duty, Fuel and power, Factory expenses	By Gross Loss (transferred to P and L A/c)
To Gross Profit (transferred to P and L A/c)	

Gross profit = Net sales + Closing stock - Opening stock - Net purchases - Direct expenses.

Profit and loss account

It starts with the gross profit brought down from the Trading Account. All **indirect expenses** (office, selling and distribution, and financial expenses) and **indirect incomes** are entered. The balancing figure is **net profit or net loss**, which is transferred to the capital account.

Dr. Profit and Loss Account	Cr.
To Gross Loss b/d (if any)	By Gross Profit b/d
To Salaries, Rent, Rates and taxes, Insurance	By Interest received, Commission received
To Carriage outwards, Advertisement, Selling expenses	By Discount received
To Bad debts, Provision for doubtful debts, Depreciation	By Rent received, other incomes
To Interest paid, Bank charges, Discount allowed	By Net Loss (transferred to capital)
To Net Profit (transferred to capital)	

Trading expenses versus P and L expenses

Carriage **inwards** (on purchases) goes to the Trading Account; carriage **outwards** (on sales) goes to the Profit and Loss Account. Wages are direct expenses, whereas salaries are indirect.

Balance sheet

The Balance Sheet is **not an account**; it is a statement showing the assets, liabilities and capital of the business on a particular date. It is prepared after the Profit and Loss Account. Assets and liabilities can be arranged in two ways.

Order	Liabilities side	Assets side
Liquidity order	Most urgent liabilities first (bank overdraft, creditors) and capital last	Most liquid first (cash, bank, debtors, stock) and fixed assets last
Permanence order	Capital first, then long term loans, then current liabilities	Fixed assets first (land, building, machinery) and cash last

Classification

Group	Items
Fixed assets	Land, building, plant and machinery, furniture, vehicles, goodwill
Current assets	Closing stock, debtors, bills receivable, cash in hand, cash at bank, prepaid expenses, accrued income
Capital	Opening capital plus net profit and interest on capital less drawings and net loss
Long term liabilities	Bank loan, loan from others
Current liabilities	Creditors, bills payable, bank overdraft, outstanding expenses, income received in advance

Closing entries (transfers)

- Trading A/c Dr. To Opening Stock, Purchases, Direct expenses.
- Sales, Closing stock and Purchase Returns are transferred to the credit of Trading A/c.
- Gross profit is transferred to the credit of Profit and Loss A/c; indirect expenses are debited and indirect incomes credited.
- Net profit is transferred to Capital A/c; Drawings A/c is also closed to Capital A/c.

4.2 Preparation of Trading and Profit and Loss Account and Balance Sheet

The steps are: (1) read the trial balance carefully; (2) take **adjustments** into account; (3) prepare the Trading Account; (4) prepare the Profit and Loss Account; (5) prepare the Balance Sheet. **Every adjustment must have a double effect**: once in the Trading or Profit and Loss Account and once in the Balance Sheet (unless it is a pure transfer).

4.3 Adjustments: Meaning and Treatment

Adjustments are items that are not recorded in the books at the time of the trial balance but must be taken into account to show the true profit and position. They are given **outside the trial balance** in the question.

Adjustment	Treatment in Trading / P and L Account	Treatment in Balance Sheet
Closing stock	Credit side of Trading A/c	Current asset
Outstanding expense	Add to the expense (debit side)	Current liability
Prepaid expense	Deduct from the expense	Current asset
Accrued income	Add to the income (credit side)	Current asset

Adjustment	Treatment in Trading / P and L Account	Treatment in Balance Sheet
Income received in advance	Deduct from the income	Current liability
Depreciation	Debit side of P and L A/c	Deduct from the asset
Bad debts (further)	Debit side of P and L A/c	Deduct from debtors
Provision for doubtful debts	Debit new provision, or only the increase over old provision (decrease is credited)	Deduct from debtors
Provision for discount on debtors	Debit side of P and L A/c, calculated on debtors after bad debts and provision	Deduct from debtors
Interest on capital	Debit side of P and L A/c	Added to capital
Interest on drawings	Credit side of P and L A/c (income)	Deducted from capital
Drawings of goods	Deduct from purchases in Trading A/c	Deduct from capital
Goods lost by fire or theft	Deduct from purchases (credit Trading A/c); loss not covered by insurance goes to P and L A/c	Claim receivable from insurer is a current asset
Manager's commission	Debit side of P and L A/c	Current liability if unpaid

Ready reckoner for outstanding and prepaid items

Expense charged to the account for the year = Amount paid + Outstanding at end - Outstanding at start - Prepaid at end + Prepaid at start. For incomes the signs are reversed for accrued and advance items.

Calculating provision for doubtful debts

Provision is made for debts which may not be recovered. Charge to Profit and Loss Account = **New provision + Bad debts (all) - Old provision**. If the old provision is more than the new provision plus the additional bad debts, the excess is credited. Debtors are shown in the Balance Sheet at the amount **less** the total provision.

4.4 Numerical Problem on Final Accounts

Problem. From the following Trial Balance of Mr. Ramesh as on 31 March 2026 prepare the Trading and Profit and Loss Account and the Balance Sheet after taking the adjustments into account.

Debit balances	₹	Credit balances	₹
Opening stock	20,000	Sales	2,50,000
Purchases	1,50,000	Creditors	35,000
Wages	15,000	Capital	1,20,000
Carriage inwards	3,000	Provision for doubtful debts	1,000
Salaries	24,000		
Rent	12,000		
Insurance	3,600		
Sundry expenses	4,400		
Furniture	30,000		
Machinery	60,000		
Debtors	40,000		

Debit balances	₹	Credit balances	₹
Cash in hand	5,000		
Cash at bank	25,000		
Drawings	12,000		
Bad debts	2,000		
Total	4,06,000	Total	4,06,000

Adjustments:

- Closing stock was valued at ₹30,000.
- Salaries outstanding ₹2,000.
- Insurance prepaid ₹600.
- Depreciate machinery at 10% and furniture at 5%.
- Maintain provision for doubtful debts at 5% on debtors.
- Allow interest on capital at 5% on opening capital.

Solution

Dr. Trading Account for the year ended 31 March 2026	₹	Cr.	₹
To Opening Stock	20,000	By Sales	2,50,000
To Purchases	1,50,000	By Closing Stock	30,000
To Wages	15,000		
To Carriage Inwards	3,000		
To Gross Profit c/d	92,000		
Total	2,80,000	Total	2,80,000

Dr. Profit and Loss Account	₹	Cr.	₹
To Salaries 24,000 + Outstanding 2,000	26,000	By Gross Profit b/d	92,000
To Rent	12,000		
To Insurance 3,600 - Prepaid 600	3,000		
To Sundry Expenses	4,400		
To Bad Debts	2,000		
To Provision for Doubtful Debts (2,000 new - 1,000 old)	1,000		
To Depreciation: Machinery 6,000	6,000		
To Depreciation: Furniture 1,500	1,500		
To Interest on Capital (5% of 1,20,000)	6,000		
To Net Profit (transferred to Capital)	30,100		
Total	92,000	Total	92,000

Balance Sheet as at 31 March 2026: Liabilities	₹	Assets	₹
Capital (opening)	1,20,000	Furniture 30,000 - 1,500	28,500
Add: Net profit	30,100	Machinery 60,000 - 6,000	54,000
Add: Interest on capital	6,000	Closing stock	30,000
Less: Drawings	(12,000)	Debtors 40,000 - Provision 2,000	38,000
Capital at end	1,44,100	Prepaid insurance	600
Creditors	35,000	Cash in hand	5,000
Outstanding salaries	2,000	Cash at bank	25,000
Total	1,81,100	Total	1,81,100

Checks: gross profit = $(2,50,000 + 30,000) - (20,000 + 1,50,000 + 15,000 + 3,000) = ₹92,000$. Total of Balance Sheet agrees on both sides at ₹1,81,100, which confirms that the work is correct.

Points to remember while solving

- Items that appear **inside the trial balance** appear only once; items given in adjustments appear **twice** (in the account and in the Balance Sheet).
- Interest on capital is an expense for the business but an income for the proprietor, so it is **added to capital**.
- Bad debts already in the trial balance are shown in P and L; **further** bad debts in adjustments are deducted from debtors and also charged to P and L.
- Depreciation is deducted from the asset in the Balance Sheet, not shown on the liabilities side.
- Do not forget the date in the heading: Account **for the year ended**, Balance Sheet **as at**.

Important questions: Module 4

- What are final accounts? Explain their importance for a trader.
- Distinguish between Trading Account and Profit and Loss Account.
- Explain any six adjustments and their treatment in final accounts.
- Prepare Trading and Profit and Loss Account and Balance Sheet from a trial balance with adjustments.
- Distinguish between capital and revenue items; fixed and current assets.

Module 5: Consignment Accounts

Teaching hours: 15 | Units 5.1 to 5.4

5.1 Meaning: Consignment, Consignor and Consignee

A manufacturer or wholesaler may want to sell goods in a distant market but does not have an office there. He therefore sends goods to an agent who sells them on his behalf for a commission. This arrangement is called **consignment**.

- **Consignment:** dispatch of goods by one person to another for sale on behalf of the sender, the ownership of the goods remaining with the sender.
- **Consignor:** the person who sends the goods (principal).
- **Consignee:** the person who receives the goods and sells them on commission (agent).
- **Consignment account:** a nominal account in the consignor's books prepared for each consignment, which shows the profit or loss.
- **Account sales:** a statement sent by the consignee to the consignor, showing goods received, sales, expenses, commission and the amount due.
- **Proforma invoice:** a statement sent by the consignor with details of goods sent; it is not a sale invoice.

Features of consignment

- Relation between consignor and consignee is that of **principal and agent**.
- Goods remain the **property of the consignor** until sold, so unsold stock is the consignor's asset.
- Consignee earns **commission**; risk of loss, other than due to his negligence, is on the consignor.
- Consignee sends **account sales** and remits the amount due.
- Profit or loss on each consignment is found separately.

Consignment and sale compared

Basis	Consignment	Sale
Relationship	Principal and agent	Seller and buyer
Ownership	Stays with consignor	Passes to buyer
Risk	Borne by consignor	Borne by buyer
Return of goods	Unsold goods can be returned	Cannot be returned unless agreed
Document	Proforma invoice	Invoice
Profit	Consignor gets profit; consignee gets commission	Buyer makes profit on resale
Account sales	Required	Not required

Commission to the consignee

Type	Meaning
Ordinary commission	A fixed percentage on the sales made by the consignee, usually on gross sales
Del credere commission	Extra commission paid to the consignee for taking the risk of bad debts on credit sales; if the customer does not pay, the loss is borne by the consignee
Overriding commission	Extra commission on sales above a fixed target price or quantity, to encourage the consignee to sell at higher prices

Note: When del credere commission is allowed, the consignee is liable to pay for the credit sales even if the buyers default. Without it, bad debts are a loss of the consignor, debited to Consignment Account.

5.2 Goods Consigned at Cost Price and Invoice Price

Journal entries in the books of the consignor

Particulars	Dr. (₹)	Cr. (₹)
1. Goods sent: Consignment A/c Dr.	xxx	
To Goods Sent on Consignment A/c		xxx
2. Expenses paid by consignor (freight, insurance, cartage): Consignment A/c Dr.	xxx	
To Cash / Bank A/c		xxx
3. Advance or remittance from consignee: Cash / Bank A/c Dr.	xxx	
To Consignee A/c		xxx
4. Expenses incurred by consignee: Consignment A/c Dr.	xxx	
To Consignee A/c		xxx
5. Commission earned by consignee: Consignment A/c Dr.	xxx	
To Consignee A/c		xxx
6. Sales made by consignee: Consignee A/c Dr.	xxx	
To Consignment A/c		xxx
7. Closing stock on consignment: Stock on Consignment A/c Dr.	xxx	
To Consignment A/c		xxx
8. Profit on consignment: Consignment A/c Dr.	xxx	
To General Profit and Loss A/c		xxx
9. Goods sent transferred: Goods Sent on Consignment A/c Dr.	xxx	
To Purchases / Trading A/c		xxx

If there is a **loss** on consignment, the entry in step 8 is reversed: General Profit and Loss A/c Dr. To Consignment A/c.

Valuation of closing stock

Stock lying unsold with the consignee is valued at **cost or net realisable value, whichever is lower**. Cost includes the cost of goods plus the **proportionate non-recurring expenses** incurred up to the point of reaching the consignee's godown (freight, insurance, cartage and similar items). Selling expenses of the consignee (rent, salesmen's wages, advertisement) are **recurring** and are **not** included in stock valuation.

Formula

Value of closing stock = Cost of unsold goods + (Non-recurring expenses x Unsold quantity / Quantity sent)

Goods sent at invoice price

Sometimes the consignor sends goods at a price higher than cost, called the **invoice price** (cost plus a loading). The purpose is to keep the actual profit margin secret from the consignee. The difference between invoice price and cost is the **loading**. Loading may be expressed as a percentage on cost (for example 25% on cost) or on invoice price (20% on invoice price is the same as 25% on cost).

Loading stated as	Loading amount	Cost
25% on cost	Invoice price x 25/125	Invoice price x 100/125
20% on invoice price	Invoice price x 20/100	Invoice price x 80/100

Because the loading is only an internal profit, it must be eliminated so that the consignment account shows the true result.

Particulars	Dr. (₹)	Cr. (₹)
(i) Goods sent at invoice price: Consignment A/c Dr.	xxx	
To Goods Sent on Consignment A/c		xxx
(ii) Loading on goods sent: Goods Sent on Consignment A/c Dr.	xxx	
To Consignment A/c		xxx
(iii) Balance of Goods Sent on Consignment A/c (at cost) is transferred: Goods Sent on Consignment A/c Dr.	xxx	
To Purchases / Trading A/c		xxx

After step (ii), the Consignment Account is at **cost**, so closing stock and abnormal loss are also taken at cost (invoice price less loading plus proportionate expenses).

5.3 Normal and Abnormal Loss, Valuation of Stock, Stock Reserve

Normal loss

Loss which is **unavoidable** in the ordinary course of business, such as evaporation, leakage, breakage in transit, or loss in weight of bulk goods. Normal loss is **not separately recorded in money**; its cost is spread over the remaining units, which increases the per-unit cost of closing stock. No special entry is passed.

Per unit cost of stock = (Total cost of goods and non-recurring expenses) / (Units sent - Units of normal loss).

Abnormal loss

Loss arising from **unusual events** such as theft, fire, accident, or goods lost in transit. It is valued at cost, including a **proportionate share of non-recurring expenses** up to the point of loss, but not selling expenses. It is credited to the Consignment Account and shown separately, so the loss does not reduce the profit of the consignment.

Particulars	Dr. (₹)	Cr. (₹)
Abnormal Loss A/c Dr.	xxx	
To Consignment A/c		xxx
If insurance company admits a claim: Insurance Claim A/c (or Cash) Dr.	xxx	
To Abnormal Loss A/c		xxx
Balance of loss written off: General Profit and Loss A/c Dr.	xxx	

Particulars	Dr. (₹)	Cr. (₹)
To Abnormal Loss A/c		xxx

Basis	Normal loss	Abnormal loss
Nature	Inevitable, expected	Avoidable, unexpected
Examples	Evaporation, breakage, leakage	Fire, theft, accident, flood
Treatment	Charged to Consignment A/c; spread over remaining units	Credited to Consignment A/c and debited to Abnormal Loss A/c
Effect on profit	Reduces consignment profit	Charged to general Profit and Loss A/c after claim

Creation of stock reserve

When the consignor sends goods at invoice price, the closing stock lying with the consignee contains an **unrealised profit** (the loading on unsold goods). Profit should not be taken before it is earned. Therefore a **stock reserve** is created for the loading on closing stock. It is deducted from the stock on consignment in the balance sheet.

- **Stock reserve = Loading on closing stock = (Invoice price of unsold stock) x (Loading percentage).**
- Entry for stock reserve: Consignment A/c Dr. To Stock Reserve A/c (where closing stock is credited to Consignment A/c at invoice price).
- Next year the reserve is reversed: Stock Reserve A/c Dr. To Consignment A/c (opening stock reserve).
- Stock reserve is shown in the Balance Sheet as a deduction from Stock on Consignment, so the stock appears at cost.

Illustration. Goods sent at 125% of cost. Unsold stock at invoice price is ₹10,000. Loading = $10,000 \times 25/125$ = ₹2,000 stock reserve. Stock on consignment appears at ₹8,000 net.

Account sales (specimen)

Particulars	₹
Gross sales proceeds	xxx
Less: Expenses paid by consignee (godown rent, advertisement, etc.)	(xxx)
Less: Commission (ordinary + del credere + overriding)	(xxx)
Less: Advance already paid	(xxx)
Balance remitted by consignee	xxx

Entries in the books of the consignee

- The consignee does **not record goods received** because they are not his property. He keeps a memorandum.
- Expenses paid on behalf of consignor: Consignor A/c Dr. To Cash.
- Sale of goods: Cash/Debtors Dr. To Consignor A/c.
- Commission earned: Consignor A/c Dr. To Commission A/c.
- Remittance to consignor: Consignor A/c Dr. To Cash/Bank A/c.

5.4 Numerical Accounting Problems on Consignment

Problem 1: goods sent at cost

Rahul of Latur consigned 500 units to Suresh of Nanded at a cost of ₹100 per unit. Rahul paid freight and insurance ₹5,000. Suresh sold 400 units at ₹140 per unit and incurred godown rent of ₹2,000. Suresh is entitled to 5% commission on sales. Suresh remitted the balance due. Prepare Consignment Account and Suresh's Account in the books of Rahul.

Working. Sales = $400 \times 140 = ₹56,000$. Commission = 5% of 56,000 = ₹2,800. Closing stock: 100 units $\times$ ₹100 = 10,000, plus freight $5,000 \times 100/500 = 1,000$, total **₹11,000**. Godown rent is a selling expense and is not included in stock value.

Dr. Consignment A/c	₹	Cr.	₹
To Goods sent on Consignment (500 x 100)	50,000	By Suresh (sales)	56,000
To Freight and insurance	5,000	By Stock on Consignment	11,000
To Suresh: godown rent	2,000		
To Suresh: commission	2,800		
To Profit transferred to P and L A/c	7,200		
Total	67,000	Total	67,000

Dr. Suresh A/c	₹	Cr.	₹
To Consignment (sales)	56,000	By Consignment (godown rent)	2,000
		By Consignment (commission)	2,800
		By Cash (remittance)	51,200
Total	56,000	Total	56,000

Problem 2: invoice price, abnormal loss and insurance claim

Avinash sent 200 units to Bhushan at an invoice price of ₹150 each (cost ₹120 each). Avinash paid freight ₹4,000. In transit, 20 units were lost due to fire. The insurance company admitted a claim of ₹2,000. Bhushan sold 150 units at ₹180 each, and 30 units are unsold. Bhushan is entitled to 10% commission on sales and paid selling expenses of ₹1,500. Prepare Consignment Account in the books of Avinash.

Working. Invoice value of goods sent = $200 \times 150 = ₹30,000$. Loading = $200 \times 30 = ₹6,000$, so cost = ₹24,000. Abnormal loss = $20 \times 120 = 2,400$ plus freight $4,000 \times 20/200 = 400$, total **₹2,800**. Sales = $150 \times 180 = ₹27,000$; commission = ₹2,700. Closing stock: $30 \times 120 = 3,600$ plus freight $4,000 \times 30/200 = 600$, total **₹4,200**.

Dr. Consignment A/c	₹	Cr.	₹
To Goods sent (invoice price)	30,000	By Goods sent (loading)	6,000
To Freight paid	4,000	By Bhushan (sales)	27,000
To Bhushan: selling expenses	1,500	By Abnormal Loss	2,800
To Bhushan: commission	2,700	By Stock on Consignment	4,200
To Profit transferred to P and L A/c	1,800		
Total	40,000	Total	40,000

Dr. Abnormal Loss A/c	₹	Cr.	₹
To Consignment A/c	2,800	By Insurance Claim A/c	2,000
		By General P and L A/c (loss)	800
Total	2,800	Total	2,800

Check: profit on 150 units sold = 27,000 - 18,000 (cost) - 3,000 (freight share) - 1,500 - 2,700 = ₹1,800.

Common mistakes to avoid

- Including the consignee's **selling expenses** in stock valuation (only non-recurring expenses up to the godown are included).
- Forgetting to **eliminate loading** when goods are sent at invoice price.
- Treating **abnormal loss** as a charge on consignment profit.
- Calculating commission on cost instead of **sales**.
- Not creating **stock reserve** when stock is shown at invoice price.

Important questions: Module 5

- Define consignment. Distinguish between consignment and sale.
- Explain types of commission: ordinary, del credere and overriding.
- Distinguish between normal loss and abnormal loss. Explain their accounting treatment.
- How is closing stock valued in consignment accounts? What is stock reserve?
- Prepare Consignment Account and Consignee's Account (numerical problems at cost price and at invoice price).