

## CHAPTER- ONE

### INTRODUCTION

#### 1.1 General Background

It is an indisputable fact that the development of the industrial sector plays an important role in the economic upliftment of the nation. As long as this sector cannot be expanded on a promotional basis, proper development of the economy cannot be possible. The main objective of the industrial development is to mobilize properly the labor, capital and the natural resources, available in the country towards industrialization.

As development efforts have to embrace all the economic sectors of the country, it is essential that an atmosphere conducive to industrialization be created. If we fail to gradually diver our economic dependence from Agriculture to other fields of human endeavor, the outlook for economic development will be very dim indeed. Development of the industrial sector can make a remarkable contribution to creating employment opportunities for the growing population, solving the problems of Unemployment and Under-employment besetting the county, earning foreign exchange and balancing the payments position as well.

Industrialization plays a crucial role in acceleration the progress of a country. The progressive increase in the national income and living standards of the people is not possible without rapid industrialization. It has a necessary and ultimately a large role to play for the economic development of countries can be changed by establishing the industries. Hence, industrialization, regarded as a symbol of prosperity, is the key to economic progress. It is the basic ingredient of economic development.

Almost all countries are trying their best for the betterment of their economic development through industrialization. We have witnessed the history of U.S.A, U.K, U.S.S.R, Japan, China and most of the European countries are able to reach in highly developed position or in the age of high mass consumption through industrialization. Actually, it is one of the most important ingredients for the higher living standards of the people and to increase the pace of economic development of developing countries like Nepal. Realizing such importance of industrial development, pundit Jawaharlal

Nehru has said “The god which all the countries worship is the god of industrialization; the god of machine; the god of high production and utilization of natural power and resource for greater advantage”.

Some countries have attained industrialization mainly through large industries, other has mainly through medium and small scale industries attaining high economic growth rate. Now days industrialization has been considered traveled as most powerful instrument. Small scale industries have played vital role together with medium and lagged scale industries in promoting sound and speedy industrial growth. Appreciating or recommending small scale industries does not mean opposition to large scale industries. “The fact is that small industries have undeniably played an effective and important role in many countries in their industrial advancement including several developed countries like Germany, Switzerland and France. Particularly in south East Asian region, the experience and achievement in the field of the small industries are very significant in countries like Myanmar, Ceylon, India, Singapore, Hong-Kong, South Korea and Thailand. In some of these countries specially, comparatively, less developed and small countries have become pioneer and led the overall industrial development programme with remarkable success. Small industries can undoubtedly play significant role in meter using the aspiration of successful industrial revolution in developing countries especially in these countries of South East Asia whose economy are agriculture. Even in Japan one of the industrially developed countries of the world cottage industrial still occupy a predominated position in the national economy. Cottage and small scale industries are producing more than half of her total industrial product.

Nepal is characterized by rapidly growing population and labor force. A good suggestion can be given to transfer labour force from agriculture sector to industrial sector and to create more job opportunities to raise the national income and to attack poverty to mobilize idle resources and man power to fulfill the local demand of the consumer goods and creating sound base for industrialization there should be developed small and cottage industries in the countries effectively. Nepal being a landlocked country situated between China and India and backward nature of the country, the pace of development is too slow. Over three quarters of the total area of Nepal is mountainous and over 60 percent of the countries people live in the hilly or mountainous region. Due to the mostly hilly or mountainous topographical structure

of the country, development in this country is not achieved in satisfactory. Almost 85 percent of the population lives in villages and our peoples main source of income, employment and the main production is agriculture. In this way, agriculture has played an important role in the national economy. A major share of gross domestic product is contributed by agriculture and it is the chief source of export earning of the country. Besides it is also the main source for running many agro-based industries. Nevertheless agriculture sector is not so much dependable and saving of farmers is too low.

### **Meaning and Relevance of Cottage and Small Industries**

The sum of two words cottage and small give us the idea of small type manufacturing unit which is generally handled by household level in which family members work as full timer and use locally available raw materials. Cottage industries are producing goods required for daily consumption. Therefore, people are self-sufficient in respect to several consumption goods. Cottage industries are more or less household industries creation only a limited market. Small enterprises will be more or less manufacturing depending on resources coming from outside and more of them depending on a large scale industry for the supply of semi-finished products (Kharel-1992).

The words small-scale industry is itself different in various countries. In Japan, these are called small enterprises; in India, small industry. Some other countries call them rural or cottage industry. In Sweden and Germany, there is no official definition of small scale industry. These different expressions also indicate different meaning and scope of small-scale industries in different countries (Ojha-1987).

Different Economists have different concepts about cottage and small scale industry. It is different from country to country and from time to time. The western community thinks that labor intensive industries are cottage industries, whereas Far East Asian Community trends the traditional skill oriented or indigenous raw materials based or small units of industries are cottage industries. The concept of Indian community found that some specified or listed items are classified as cottage industries. So in India, the cottage industry could not be classified by either technology of product or by units of investment. But in Nepal, the definition of the

cottage industry is different before and after the industrial enterprise Act come into action. The concept has considered the indigenous raw materials based or handicraft based or handloom based industries are known as cottage industries.

For the purpose of industrial administration and facilities, Industrial Policy 1992 classified the industries:

1. Manufacturing Industries: industries which produce goods by utilizing or processing raw materials, semi-processed materials, by products or waste products.
2. Energy based industries: Industries generation energy from water resources, wind, solar, coal, natural oil and gas, bio-gas or any other sources.
3. Agro and Forest-Based Industries: Business mainly based on agriculture and forest such as integrated sericulture and silk production, horticulture and fruit processing, animal husbandry, poultry farming, fishery, tea gardening and processing, coffee farming and processing, herbiculture and herb processing, vegetable seed farming, floriculture, agro-forestry, community and private forestry etc.
4. Mineral Industries: Mineral excavation, processing
5. Tourism Industries:
6. Service Industries:
7. Workshops, printing press, consultancy services, ginning and baling businesses, cinematography, construction business, public transportation, photography, hospital and nursing home, educational institutions, laboratory, air service cold storage, etc.
8. Construction Industries: Road Bridge, tunnel, ropeway, flying bridge, railway, trolley bus and office, commercial and residential complex etc.

**Industrial promotion Board may add in the classification of industries in division of scale:**

1. Traditional Cottage Industries: The traditional industries mobilizing specific skill or local raw material and resources and labour intensive and related with national customs, arts and culture.
2. Small Industries: Industries other than traditional cottage industries with a fixed capital investment not exceeding Rs. 10 million.

3. Medium Industries: Industries with a fixed capital investment between Rs. 10 million and Rs.50 million.
4. Large Industries: Industries with a fixed capital investment more than Rs. 50 million.

### **Cottage and Small Industries in Nepal**

An ancient, people fulfilled their needs with the goods produced at home. Slowly and gradually, they learnt to weave cloths and make others require goods. They started to produce different articles to export their specialized goods to foreign country around 18<sup>th</sup> century. After the industrial revolution of Great Britain in 19<sup>th</sup> century, the world entered in to industrialization by establishing large-scale industries but the role of cottage and small-scale industries has not been decreased. Cottage and small-scale industries were developed being main part of large industries.

In Nepal, the evolution of craft and small scale industries is perhaps as old as the growths of the 'Kiratee civilization' Nepalese goods were exported to India and Tibet in 'Llchchhavi' and 'Malla' period. Kautilya praised Nepalese handicrafts in 14<sup>th</sup> century B.C. The Chinese travelers Henu Tasang had also describe the Nepalese crafts in 673 B.C. In 1793, Kirk Pratiak who came to visit Nepal was also appreciated the Nepalese handicraft (T.B Khatri, 2022, B.S, p. 24).

Great King Prithivi Narayan Shah who adopted the policy of using domestic goods, helped the growth of cottage industries in the country. He had also suggested keeping the record of such industries.

The history of united form of cottage industries started with the beginning of cotton textile handloom in 1925 A.D., during the period of P.M. Chandra Sumsher. In 1935 'Udyog Praised" was established. Similarly, a governmental office was established in 1939 named "Nepal Kapada and Gharelu Prachar Adda."

After a long period in 1947, some personnel were sent to India for cotton industry training. On 28 April 1954 Ford Foundation provided financial as well as technical assistance to Nepal for the development of cottage and small-scale industries in country. Village and cottage industry was also established in 1957.

Cottage and small industries have its tradition as per the worked, medieval period and recent period also significant for the division of cast system as nature of work or labor, which has been inherited as per their parents.

At present, there are lots of small and cottage industries in Nepal. Ministry of small and cottage industry is operation for the promotion of cottage and small industries. On the other hand, Department of industry and Small and Cottage Industry Committee also functioning to facilitate cottage and small industries. According to Department of industry, 76387 CSIs are registered till the fiscal year 065/066. They are of different types, such as tourism, restaurants, garments, handicrafts, metal industry, handloom, consultancies and so on.

In previous time it was difficult to define due to ever expanding and monopolistic trade with Tibet which was ended in the initiation of 20<sup>th</sup> century. The trade with Tibetan monopoly ended with the declaration of liberal trade route by company government. In course of time, Nepalese goods became unable to compete with Indian. So Nepalese craftsmanship ended and falls on the situation of disappearing gradually.

#### **Upto 2065 Ashad 30<sup>th</sup> registered Industries in Nepal**

Types of industry	Number
Private Firm	175481
Partnership Firm	11375
Private Limited	<u>12077</u>
<b>Total</b>	<b>198941</b>

#### **On the basis of Nature**

Types of industry	Number
Productive	34498
Energy	197
Agricultural and Forest based	2717
Construction	3439
Tourism	4467
Minerals	26
Service	38201
Construction	<u>3393</u>
<b>Total</b>	<b>83347</b>

#### **On the basis of Legalized**

Types of industry	Number
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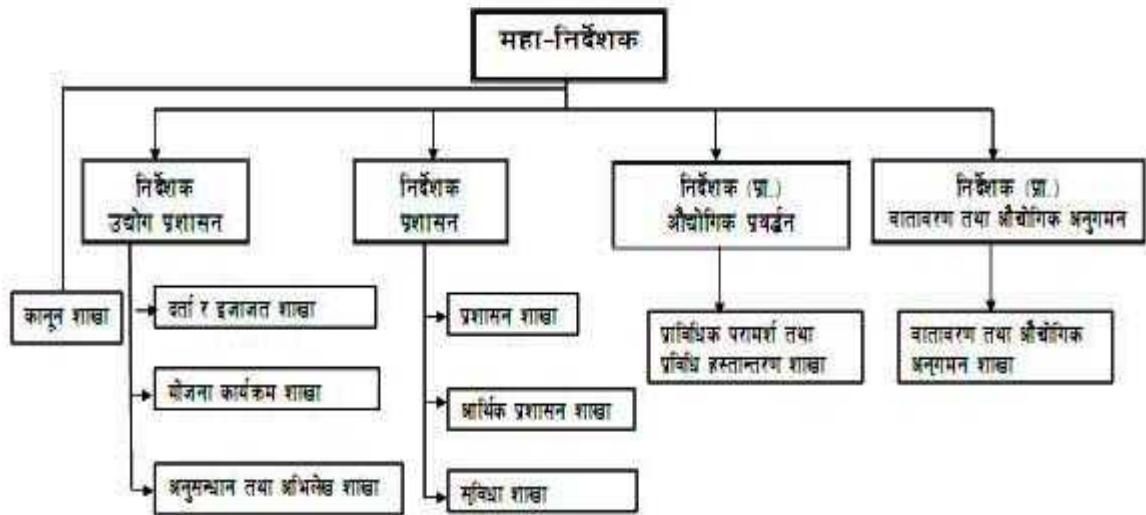
Private firm	73021
Partnership Firm	3847
Private Limited	<u>6479</u>
Total	83347

**On the basis of Level**

Types of cottage industry	Number
Cottage small	8569
Small	<u>74778</u>
Total	83347

Source: [http://www.dcsi.gov.np/industrial\\_scheme.php](http://www.dcsi.gov.np/industrial_scheme.php)

**घरेलु तथा साना उद्योग विभाग संगठन तालिका**



**Role of Cottage and Small Industries in Nepalese Economy**

Industrialization plays a vital role in economic development. Industrialization offers prospects of a growing availability of manufactured goods, increased employment, balance of payment and greater efficiency and modernization of the economy. But the geographical of our country is such that the feasibility of big industries is almost low. Most of the regions of the kingdom are remote and people do not have sufficient capital and technical knowledge to run big industries. In the Nepalese context, cottage and small scale industry has important role for the economic development of the country. Cottage and small industry plays significant role not only in preserving traditional skills, art, culture and the proper utilization of

raw material produced in rural and urban areas but also in upgrading the economic standard of the majority of people by generation employment opportunities and enhancing national productivity. As local raw material, skills and labor are extensively used in such industries, value added in these industries is higher.

Although more than 60 percent of the active population depends on the agriculture, the contribution of this sector to nation economy is rather decreasing every year. This phenomenon has resulted in ever growing problem of unemployment and underemployment. The present status of seasonal and regional unemployment is estimated to be 42 percent in the rural and 25 percent in urban areas. The bulk of the national labor force is now in search of business rather than agriculture. In this perspective, the industrialization is only alternative to solve the problem of unemployment. On the one hand there is the problem of decreasing national productivity and on the other hand however, establishing large industrial enterprises is not that much feasible in Nepal. Since the country is landlocked and has no direct access to the world market and the success of which largely depends on the good will of India. So from the development point of view, dependence of cottage and small industries could be, in reality response and way out for the industrial development in Nepal.

In context of Nepal, industrial development is a labour intensive, local raw material and local indigenous skill oriented enterprises, such enterprise, a part from helping accumulate the scattered capital resources in the rural area. In context of Nepal, we should encourage labour intensive technique of production due to existence of unemployment. Besides, it should be based on domestically available raw materials and skills. Enable rural people living under bare subsistence actively participate in the development countries industrial economy, the cottage and small industries can play a vital role to increase the export and by their help to maintain the balance of payment. Utilize the local resources through the use and expansion of indigenous local skill and technologies and make Nepalese traditional and cultural heritage renewed in the international field though the export of cottage and small industries products in the international market. So, it is the demand of time to shift the population heavily depended on agriculture to the cottage and small industries through series of well planned entrepreneurial activities.

## **Government Policy on Cottage and Small Industry Development**

Nepal started a Democratic political system only in 1951. Before that the country had experienced a feudalistic, autocratic and oligarchic regime for more than a century. At that time, the country had absolutely no infrastructure for the industrial development and it was only after the advent of democracy in 1951. The first five year plan was implemented in 1956 and since then ten Plan periodic plans have also been implemented and the 11<sup>th</sup> three year interim plan is in the process of completion this year. During the first four periodic plans, the government emphasized more on the creation of infrastructures for development. The government could not pay much attention towards the development of cottage and small industries in Nepal. It was only in the sixth plan period (1980-85). That government of Nepal shifted the emphasis from the infrastructural development to the production, employment and meeting the basic needs of the people through the exploitation of already created infrastructures. In that very period, the government of Nepal formulated industrial policy and implemented it. Supporting measures were taken to launch the plan all over effectively. The Cottage and small Industry Development Board was strengthened and carried out cottage and Small Industry Development Projects sponsored by World Bank and UNDP. In 1984, HMG, Department of Cottage and Small Industries got under its wing the Small Business Promotion Project and TRUGA (Training for Rural Gainful Activities) project. The formulation of industrial policy and the Industrial Enterprises Act and their implementation gave a favorable response to the national economy. It was for the first time in Nepal, the GDP growth showed a commendable increase of more than 4 percent despite the Government's failure to give the incentives and facilities promised to industrialist and to protect the cottage and small industries in terms of customs rates, tax and excise duties. Similarly, the seventh plan (1985-90) laid again the emphasis on the fulfillment of basic needs and followed the similar guidelines as regards to the development of cottage and small industries. The industrial promotion committee was constituted which suggested the government for meaningful amendment in the industrial policy and the Industrial Enterprise Act. At the outset of eight plans (1992-97), the amendment in the industrial policy was made which followed an amendment also in the Industrial Enterprise Act. Now it can also be expected that with the support of

government, there are some chances for small and cottage industries to go further achievement in the 'Three year interim plan'.

### **Overview: Cottage and Small-Scale Industries in Some Asian Countries**

The small and medium scale industries sector has steadily grown over the past decades in the Asian countries, playing a vital role in the economic structure of these countries by contributing significantly to their national industrial production and generating substantial employment (Bulletin, United Nations no 19, 1999).

#### **India:**

In India, during the last decade, the extent of small-scale industries has grown very rapidly now and occupies a position of vital important in the national economy of the country. Small scale and village industry taken together constitute about 49 % of total industrial production. According to revival act small scale industry is defined as "All units having investment in plant and machinery of up to Rs.6 million are small units, or for an ancillary units up to Rs.7.5 million investments in plant and equipment (Bulletin, United Nations no. 26).

#### **Philippines:**

In Philippines, the ministry of industry and financial institution has classified industries in to cottage, small, medium and large industries according to investment of assets as follows:

<b>Investment Range</b>	<b>Classification</b>
Less than Rs.0.1 Million	Cottage/home industry
Rs.0.1 million-to Rs.1.0 million	Small industry
Rs.1.0 million to Rs.4.0 million	Medium industry
Over Rs. 4.0 million	Large industry

#### **Bangladesh:**

Cottage and small scale industries play the vital role in the national economy of Bangladesh, which accounted for about 89% of total industrial employment and nearly 39% industrial value added. Cottage and small scale industry is defined in Bangladesh "Units with mechanical power employing between 10-19 employee and units with out mechanical power occupying less than 20 workers."

## **Nepal:**

In Nepal, when a new industrial enterprises act 1981 introduced then this act clearly classified the difference between small, medium and large scale industry according to their investment range on fixed capital.

### **Investment Range**

Less than 7 lakhs

Less than 3 million

3 million to 10 million

More than 10 million

### **Classification**

Cottage industry

Small industry

Medium industry

large industry

## **Overview of Accounting System in Small Scales Industries**

Whether the individuals or partnership business enterprises wish to increase their ability to acquire (hold) goods and services and in general they seek to maintain as high level of economic power as possible. Business firm are able to do this as long as they are able to use their beneficial financial resources. Thus, the primary motivating factors of the business enterprises behind our economy called profit motive. The desire for sustainable profit of each individual entrepreneur will bring technological and economic progress in our country.

It is assumed entrepreneurs try to optimize short as well as long run profit for enterprise. Accounting is a means of providing information to the manager to achieve these goals. Accounting is primarily concern with designing the system for recording, classifying and summarizing the recorded data and interpreting them for internal and external users.

Accounting is to justify their existence by pointing out to management what should have been done after enterprises has failed to optimize past profit. Accounting report can indicate the need for corrective action and help the manager to reach decision about when and how much turn the wheel, step on the gear or apply the breaks. But accounting reports however do not ensure that the firm is on the right road to profit optimization that is the function of management accounting. The relationship between revenue and expenses is tight rope upon which all managers must perform. Punctual accounting reports help to maintain necessary balance.

Most of the small-scale industries of developing countries like Nepal are only maintaining their accounts by using single entry book keeping system knowingly or unknowingly. They keep their records by using simple daybook and small ledger. But some organizations have adopted double entry book keeping system as well. They keep accounting records properly. In this phenomenon they generally used following process to maintain their accounts:

- Perform business transaction.
- Prepare the business document.
- Make journal & special journal.
- Posting in to general ledger.
- Prepare unadjusted trial balance.
- Prepare adjusting Entries.
- Prepare adjusting trial balance.
- Prepare financial statement (Trading, profit & loss A/C and balance sheet.)

For preparing such financial statement business enterprises may use journal entry, ledger, purchase book, sales book, invoice, cashbook, bankbook, Bank reconciliation, depreciation methods etc.

### **Small Enterprises Development Support in Nepal**

Each and every business unit cannot survive without analyzing feasibility study. Feasibility study included economic analysis, marketing analysis, technical analysis as well as support service organization analysis, which help to run business unit efficiently. However, business organization faces different problem while they start to run the unit such as poor access to capital and credit, scarcity of raw material, marketing problem, and lack of opportunity for competency development, lack of appropriate infrastructure and poor access to information, research, technology etc. To overcome such problem, entrepreneur require to institutional support. Institution can be government, NGOs, Co-operative, and INGOS, private sector. They played promotional, regulatory, and supportive as well as facilitative role.

Various government agencies, projects, private sector organization are involved to extend varieties of regulatory and promotional inputs with an objective to develop and promote small-scale industries development in Nepal. A brief introduction and major activities of these organizations is presented below:

## **1. Government Sector Institutions:**

Government agency refers to ministers, department and other agencies of the central or state government. They formulated and implemented policies related to entrepreneurial activities basically they provided following support to entrepreneur:

- i). Legitimacy
- ii) Regulation
- iii) Exhibition trade fair

There are different government's institutions in Nepal to support entrepreneur, which are as follows:

- a. Department of Cottage and Small Industries (DCSI)
- b. Cottage & Small Industries Development Board (CSDB)
- c. Industrial enterprises Development Institute (IEDI)
- d. National Productivity & Economic Development Center (NPEDC)
- e. Women Development Division (WDD)

All of these institutions perform following activities for welfare of small Industries:

1. Provide Technical Skill & entrepreneurship development program.
2. Provide provision of credit, scheme preparation and distribution program.
3. Recommendation and facilitation for loan incentive and other support service.
4. Provide license and registration to cottage and small-scale industries.
5. Provide technical counseling service.
6. Provide business creation, management, consultancy capacity building action research training and program.
7. They are doing feasibility study, industrial planning, and productivity awareness and promotion program with the help of Asian Productivity Organization (APO) etc.

## **2. Private Sector and Other Institutions:**

The Federation of Nepalese Chamber of Commerce and Industry (FNCCI) established in 1965 is an umbrella organization of Nepalese private sectors. It plays key role in protecting the interest of business communities and promoting industrial enterprises in the country. FNCCI provides business related information, advisory, consultative and representative service to business organization. FNCCI provides

various types of training and workshop and represents the major councils, boards, committees and advisory bodies of the government in business and industry sectors.

The Federation of Nepal Cottage and Small Industries (FNCSI) established in 1990 is another private sector organization with an aim of involving cottage and small scale industry promotion. It has been provided wide range of training and non-training services.

Other private sector, Nongovernmental sector, International non-governmental sector organizations and their major activities for business development sector are as follows:

- a. Women Entrepreneur association of Nepal (WEAN)
- b. Small & medium enterprises development project (SMEDP)
- c. Woman in Science & Technology (WST)
- d. Micro enterprises development project (MEDEP)
- e. Small industry promotion program (Swiss Contract)
- f. Fair Trade group (FTG) etc.

Major activities perform by these institutions are:

1. Information service to member of industry, trade, tourism, finance, taxation, technology, national and international market.
2. Establishing linkages with international agencies, and organization for promotion business.
3. Formulation of small enterprises.
4. Development program, policy implementation and their impact study.
5. Provision of micro credit.
6. Capacity building of business membership organization.
7. Technical and managerial support by providing management and services.

## **1.2 Statement of Problem**

Accounting is major part of the organization which helps to justify their existence, not only this but also it helps to studying, classifying and summarizing the data and interpreting even providing necessary information to management. To get accurate information, accounting system must be accurate. If accounting system is not

reliable it provides inaccurate information, which leads the organization towards diminishing way. There are different accounting tools, technique and system. But lack of awareness of concerning the accounting tools and techniques small-scale industries are always in backward position. This is a main problem faced by small-scale industries in developing countries like Nepal.

Some other problem faced by small scale organization in developing countries is lack of proper management technique, lack of intuitional support, lack of proper and adequate accounting training, financial limitations etc. The study is concentrated on problem faced by small-scale industries in specifies areas.

### **1.3 Objectives of Study**

Identify the accounting problems faced by small-scale services industries and to give appropriate accounting model for them is the basic objective of the study. Beside this, the main objectives of study are:

1. To examine the existing accounting system used by small-scale industries.
2. To identify major accounting problems faced by them in practice.
3. To evaluate the efficiency, adequacy and inadequacy of accounting system to present or display their transactions and able to provide the necessary information to the management for decision-making.
4. To identify, how supporting institutions have been providing the accounting training to small scale industries and also examine the effectiveness of such training.

### **1.4 Significance of the Study**

There is essential to make our industrialization process dynamic and consolidated by developing and expanding cottage and small-scale industries in keeping with our limited markets, level of technical know-how, position of transportation, technological structure and geographical structure of the country.

Small-scale industries are backbone for developing countries like Nepal. To develop and strengthen the small-scale industries the financial aspect also should be strong. An entrepreneur is adequately required to make the several types of decisions. It is impossible to make the right decision with out appropriate information. The main source of internal information is accounting system. But the management of the

Nepalese companies enforced to make decision on the basis of incorrect data. So they are loosing their objectives. Thus it is necessary to examine their accounting system.

This study helps to examine the existing accounting system used by small-scale industries and identify accounting problem faced by small-scale industries. A part this study also contributes to identify how their supporting intuitions have been providing the accounting knowledge or training for small scale industries.

Similarly, it helps to identify the appropriate accounting system which will be sufficient to provide the information to management for decision making and appropriate in term of cost, simplicity, applicability, effectiveness for display or present the entire transaction of business organization.

### **1.6 Limitations of the Study**

1. Study is based on primary data so its result would exist on its limitation.
2. There is limited study on accounting system concerning to small-scale industries so the study lacks review of previous related studies in this context.
3. Time frame and resources also constrained this study.
4. This study has taken only fifty small-scale services industries as sample population and conclusion has been based on this population, it may fail to represent the total population so the conclusion drawn are suggestive rather than prescriptive.
5. This study focuses only accounting system of small scale services industries.

### **1.7 Organization of the Study**

The project study is divided in to following five chapters:

#### **Chapter One:**

It entitles “Introduction chapter;” the reading materials in this chapter are general background of study, a brief introduction of service firm and their background, statement of problem, objective of study, significance of study, limitation of study and organization of study.

#### **Chapter Two:**

This chapter concerned with the literature review, the reading materials in this chapter are conceptual review and review of related studies

**Chapter Three:**

This chapter consists of research methodology adopted for the study and includes research design, data collection and data analysis methods and tools.

**Chapter Four:**

This chapter comprises data presentation and analysis.

**Chapter Five:**

This chapter is concerned with the output of study in the form of summary, conclusion and recommendation.

At the end of the chapters bibliography and appendices have been incorporated.

## **CHAPTER- TWO**

### **REVIEW OF LITERATURE**

Review of literature is an essential part of the studies. It is way to discover what other research in the area of the problem has uncovered, which is also a way to avoid investigating problems that have already been definitely answered.

Literature review is basically a “stock taking” of available literature in one’s field of research, which provides the student with the knowledge of the status of their field of research. The purpose of reviewing the literature is to develop some expertise in once area, to see what new contributions can be made and to receive ideas for developing a research design.

This chapter explains about review of related literature of the study which covers published, unpublished literature e.g. books, journals, newspaper, different thesis, dissertations, business reports and government publications. The literature review helps to find out what research studies have been conducted in once chosen field of study, and what remaining to be done, which provide the foundation for developing a comprehensive theoretical frame work from which hypothesis can be developed for testing.

#### **2.1 Conceptual Review**

##### **2.1.1 Meaning and Definition of Accounting**

Businessman or management of Business organization wants to know different fact about the economic activities of the firm. Generally, they want to know following information to conduct the business activities:

- Amount of capital.
- Amount of profit and loss made.
- Financial position.
- Assets type and their value.
- Amount of liabilities.
- Liquidity position of the organization.
- Trend of expenditure.
- Source of cash and its applications etc.

For information on this fact each and every transaction and events relating to economic activities of the business must be recorded systematically and scientifically. The act of keeping records in a regular and systematic manner is called Book keeping, which is elementary stage of accounting. Accounting means process of analyzing financial result of operations, which shows a path of to go ahead also called an administrative tools a means to an end.

Accounting is an information generating system designed to measure and report upon economic aspect of entities that are relevant for decision-making. It is the process of providing quantitative information about economic entities to aid users in making decision concerning the allocation of economic resources. It is regarded as a cyclical process starting from the collection and recording the financial transactions and ending with reporting the performance to various interested stakeholders. Accounting is an art of recording, classifying and summarizing transaction of financial character in term of money and finally interpreting the result thereof, which is a systematic means of collecting information recording and communicating it by way of some what standardized report format.

It is argued that Accounting means the process of identifying, measuring, recording and communicating the economic events an organization to interested events of the information which includes the design of accounting system, preparation of financial statements (e.g. Trial balance, P&L Account, Cash Flow, Balance Sheet), audits, cost studies, development of forecast, income tax work and the analysis and interpretation as an aid to making business decision. Even accounting has been subject to numerous studies yet. Some definition concerning the term “Accounting” has been presented below.

According to K.Fred. And Harold W. Steve- “Accounting is service activities designed to accumulate, measure, communicate financial information about organization for decision making purpose.”

Similarly H.M. Surana has defined “accounting is considerable as one of the most effective tools of management for measuring efficiency.”

A committee of American accounting Association (AAA) defined the accounting as “Process of identifying, measuring and communicating economic information to permit informed judgment and decision by user of the information.”

As of the above definition, it is unambiguous that accounting means the collection and processing of financial data of an entity to report the decision makers. In general terms there are three aspects of accounting functions, which it adopts to suit business requirements either business may be profit motive or service motive. The aspect is in respect of system it lays down for recording the business event. Another aspect deals with the method of controlling the transaction. The third aspect is related to managerial or service aspect, which analyze business environment for appraising the past and deciding the best achievement to be followed in the future.

### **2.1.2 Evolution of Accounting**

Recording of economic events i.e. monetary transaction is a very old activity of human being. Record keeping relates to about 3600 B.C, which was practiced in India around twenty-three centuries ago. It has been proved from the book written by Kautilya named “Arthashastra.” The written records of accounting have been traced back as far as 5000 BC to the Egypt & Babylonian Empire, who recorded on clay tables such transaction as the payment of wages and taxes.

During the Roman period detailed tax record were maintained. In England under Hanry I investigation of financial records similar to contemporary audit was conducted. (K.Fred,Skousen, HaroldQ, Langenderful, W.Steve Albrecht,1967,p471)

But accounting is done in descriptive way even in business firm until the origin of double entry book keeping system. However, the modern system of accounting as well as known it, owes its origin to an Italian Franciscan monk, Luca Pacioli whom first described the principle of double entry system on his book named “Accounting of Veenice” which was published in 1494 at Venice in Italy. He is still known as father of modern accounting system, which was originated, by him still in use all over the world. He has explained basically three kinds of accounts, they were:

- I. Goral or Journal
- II. Me morale or Ledger account
- III. Quarderno or Final account

In the 17<sup>th</sup> and 18<sup>th</sup> centuries the industrial revolution in England provided the impetus for developing new approaches in accounting and focused on the accumulation of data about the cost of manufacturing each product (Daniel G. Short and Glem A welsh, sixth edition).

“During the late 1930’s and 1940’s attempts were made to formalize the framework under laying the rules for recording and reporting financial matters. The works of Sanders, Hat field and More (1938), Gilman (1939), Patton and Littleton (1940) and others attempted to rationalize existing practices and to set frame work with in which alternatives ideas and procedures might be evaluated”.

Early accounting practice was to record transactions and accumulates such records; it was a latter development to consider the usefulness of the balance sheet and profit & loss account. Early accounting practice can be justified if the transactions records provided cost effective information’s for operating a business and for the purpose of control and accountability (John Samuels, Colin Rickwood, Andrew Piper, 1989, p.18).

The advent of Industrial Revolution has resulted in large-scale production, cutthroat competition and widening market. Today there is a grater need for coordination and control. Accounting to day cannot be the same as it used to be about half century ago. It has become very dynamic subject. At present some of the important specialized branches of accounting which are developed are: cost accounting, Management Accounting, Responsibility Accounting, social Accounting, or Macro Accounting, government Accounting, Inflation Accounting, Mechanized Accounting, Human resource Accounting etc. needless to mention that some of the techniques devised are standard costing, Managerial costing, Budgetary control statistical and quantitative techniques, Ratio accounting, fund and Cash flow, Profit & loss Account, Balance sheet etc.

### **21..3 Scope of Accounting**

The scope of accounting is very wide. Accounting required both the trading and non-trading organization either Governmental or Quasi governmental organization. The word “Accounting” covered the wide range of economic activities. It provides the knowledge to professionals and individuals, which help to decision-making and forecast future goal. As a result we can conclude the scope of accounting include following area:

1. Public Accounting, which includes:

- (a) Auditing
- (b) Tax service

- (c) Management advisory services etc.
2. Management accounting includes:
    - (a) Designing and operating of accounting system
    - (b) Budgeting
    - (c) Cost accounting
    - (d) Internal auditing
    - (e) Tax accounting etc.
  3. Governmental, Quasi Governmental and Business organization, which includes;
    - (a) Government bodies
    - (b) Non-profit organization.
    - (c) Business enterprises: sole Trading, Partnership, company and corporation
    - (d) Social Accounting
    - (e) Inflation Accounting
    - (f) Human resource accounting etc.

#### **21..4 Essence of Accounting in Small-Scale Industries**

Whether the profit motive or service motive business enterprises should keep the record of financial transaction which is necessary for decision makers as well as satisfaction of each stakeholder Generally, Accounting information essence for every business industries either it is small scale or large because of following reason:

1. To design the suitable accounting system.
2. To make planning or budgeting if the whole organization.
3. To valuate and revaluate the organization's assets
4. To make healthy relation to stakeholders (e.g. customer, supplier, stockholder bankers etc.) to enlarge goodwill of the organization.
5. To provide the evidence either organization maintained its account as international acceptance accounting principle and government law or not, to governmental bodies.
6. Accounting helps to management level to manage organizational resources, production process, inventory, human resources, etc for increasing strength of the organization avoiding weakness.

7. Analysis of accounting entries facilitates a good and proper control over expenses incurred so as to maximize the profit.
8. Amendment of business law, provision of license, assessment of tax etc are based on accounting system.
9. Accounting treat as controlling tools (e.g. Production control, inventory control, sales control, credit control).

Apart from the above, the position of cash and goods can be known, errors and frauds can be detected and the requirement of the business at any time can be known. At last we conclude that accounting include area of planning, communication, recording, controlling, evidenced, valuation of tools, business position, decision-making, goodwill, and profitability etc.

### **21..5 Origin of Accounting in Nepal**

The history of account keeping in Nepal by government is very old. Mandev 1<sup>st</sup>, the king of Nepal in Lichchhavi Kal had circulated first coin called “Mananka” during the period 464-491 AD. Similarly, King Mahendra Malla had circulated the coin name “Mahendra malli” in Malla period. This seems to be main step to record the national transactions in an accounting manner. It is said that a few number of financial transactions used to be formed in Lichchhavi and Malla periods, which there was certain form of transaction. (Auditor General’s office, 1962, Page 31)

Written records of accounting have been traced back after 18<sup>th</sup> centuries in Nepal. After the unification of the nation in 1768 (1825BS) by the great king Prithivi Narayan shah, the chief of the drastic level solders use to keep the accounts of the government offices. (T.P. Giri, 2050, p155)

In 1814(1871 BS), a Book called “Lal Dhadda” was created for recording the revenue and administrative expenses. Similarly, in 1832(1889 BS) for recording things about land management Called Kitab Byabastha, anotherbook called “Mothdhadda” was used. These two records are important steps in the history of accounting development in Nepal. After the long period 1868 (1925 BS) an office called “Kitab Khana” was formed for recording the salaries paid to government employees. In the process of development of accounting in 1879 (1936BS) Kharadar gunbat, a senior official person propounded Syaha Shrestha Pranali which was an

advance form of accounting includes the books of account named Syaha, Awarji and Dhapot. After around 30 year another accounting system developed named Wasil Waki Srestha Pranali. During 1911 (1968 BS) Faram Sresta pranali has been developed for revenue accounting especially to use Terai regions.

After advent of democracy, first budget system was in progress in Nepal in 1951(21st Magh 2008 BS). The auditor general's office was established in1959 instead of Kumari chocwk to perform auditing jobs. For improvement of economic administration Nepal government formulated work schedule for payment of government revenue policy, which is supported to Bhuktani Srestha Pranali based on financial procedural rules of B.S 2016.

In 1960 (20<sup>th</sup> Magh 2019), accounts committee was formed to study and analysis the problems of accounting in Nepal. After detailed study of 288 days the committee made a report to introduce a New Accounting System, which is granted royal seal from King Mahendra in 1961 (2<sup>nd</sup> Chaitra 2018).

After over thrown the Panchayat regime, a new constitution of kingdom of Nepal, was 2047 begun. *Under article 100 (4)* of this constitution and other legal provisions, all Government organizations are required to maintain accounts on forms prescribed by Auditor General, in accordance with rules and procedures of Nepal government. One of the finance sector committee financial Comptroller General Office is to enforce Government accounting as prescribed by Auditor General in prescribed forms and to make necessary arrangement for proper account keeping operation in all the government units.

At present following accounting system are in vogue in Nepal Government Offices.

1. New accounting system.
2. Public works accounting system.
3. Revenue accounting system.
4. Property accounting system.

### **21..6 Accounting Concepts and Principles**

Various stakeholders are interested to know about the affairs and performance of the business enterprises. Performance and financial position of the business can be coved to interested parties through financial statements (e.g. Income statement,

Balance sheet, Cash Flow statement etc.). Financial statements are to be prepared on the basis of principles and concept of accounting, which may be regarded as fundamental of accounting. The fundamental of principles and concepts are term as generally accepted accounting principle (GAAP). GAAP may be described as board rules adopted by the accounting professional as guide in measuring, recording and reporting the financial affairs and activities of business which consist following concept and principles;

<b>Concepts</b>	<b>Principles</b>
1. Money Measurement Concept	1. Cost Principle
2. Business Entity Concept	2. Matching Principle
3. Going Concern Concept	3. Realization Principle
4. Dual Aspect Concept	4. Objectivity Principle
5. Accounting Period Concept	5. Consistency Principle

## **A. Concepts:**

### **1. Money Measurement Concept:**

Only those transactions, which can be expressed in monetary terms, are recorded in accounting though their quantitative records may also be kept. All business transactions should be expressed only in money. Thus transactions, which cannot be expressed in money, will not be recorded in accounting books. Thus, it has some limitation, which are, this concept do not recorded labor managements, sales policy, labor unrest effectiveness of competition etc. Another limitation of this concept makes the assumption that the money value is constant.

### **2. Business Entity Concept:**

This concept implies that a business unit is separate and distinct from the entrepreneur. This concept is important and implies that a business is separate and distinct from the person who supplied capital to the firm. All the transactions of business are recorded in the books of the firm. If business affairs and private affairs are mixed, the true picture of the business will not be available. The proprietor is treated as a creditor to the extent of his capital. Capital is thus a liability to the firm and the proprietor is creditor of the business. An entity is defined as an organizational

unit for which accounting records are maintained. There are three major types of business entities.

- a.) Proprietorship
- b.) Partnership
- c.) Corporation

### **3. Going Concern Concept:**

This concept relates with the sustainability of the business. A business is intended to continue for an indefinite period. In this concept, continuity of activity is assumed, thus accounting reports are fashioned as a going concern, just as against liquidation. The current disposal value is irrelevant for a continuing business. Thus, under this assumption fixed assets are recorded at original cost and are depreciated in a proper manner. In balance sheet market price of fixed assets are not considered.

### **4. Dual Aspect Concept:**

This concept signifies that every business transaction involved a two-fold aspect one is yielding of benefit and another is giving of the benefit. Each and every transaction should have two side effects so technically speaking, “for every debit, there is a credit”. Therefore, we can say that every debit must have a corresponding credit and vice versa. This concept has resulted in accounting equation, which states at any point of time the assets of any entity must be equal to the total of owner’s equity and outsider’s liabilities. This may express in the form of equation.

$$\textit{Total Assets} = \textit{Total Liabilities}$$

$$\textit{Total assets} = \textit{Capital} + \textit{Outsider's liabilities}$$

$$\textit{Capital} = \textit{Total Assets} - \textit{Outsider's liabilities}$$

### **5. Accounting Period Concept:**

To ascertain the true and fair financial position of a business entity on a particular date is reasonable to divide the life of the business into accounting periods. So, it is able to know the profit & loss and financial position at the end of such period. An entity is divided into distinct and equal periods in order to report financial information to each and every stakeholder as required. Generally, business firms are indicating accounting period as monthly, quarterly, or annual basis.

## **B. Principles**

### **1. Cost Principle:**

This principle requires that all transactions should be recorded at their monetary cost of acquisition. Assets and liabilities are recorded in the book of account at the cost of acquisition. And they are carried from year to year irrespective of subsequent increase or decrease in their market value. This principle is also called Historical Cost Principle.

### **2. Matching Principle:**

According to this principle, it is necessary to match the expenses incurred during the accounting period with the revenues recognized during the same period. It means that expenses should be recognized with same period as associate revenues. Since profit is an excess of revenue over expenses, it becomes necessary to bring tighter all revenues and expenses pertaining to a particular period. Again, only such expenses as incurred in generating revenues during the period should be deducted form those revenues for deriving the amount of income or profit during the period. The main objective of this principle is that accounting record be made in such a manner that cost may be compared with revenue.

### **3. Realization Principle:**

According to this principle, revenue is measured by the amount charged for goods sold or services rendered to customers. It is state that revenue should be recognized in the period when the sale is made, and specified that revenue should be measured as the cash received and the cash equivalent of other received. This concept is also known as “revenue recognition concept”.

### **4. Objectivity Principle:**

This principle implies that all the accounting transaction should be evidential and supported by business document i.e. bills, vouchers etc which should free from bias of accountant or others. The principle of objectivity requires the accounting verifiable and bias less data.

## **5. Consistency Principle:**

This principle holds the accounting process, of all concepts, principles and measurement approaches which should be applied to assure in a similar or consistent from on period to next.

## **21..7 Accounting Methods**

Accounting methods refer to the way of keeping the account using different alternatives accounting weapons. Generally, there are mainly two recognized methods of accounting, which are presented below:

### **1. Cash Method of Accounting (Cash Basis of Accounting)**

Under this method, all incomes are considered to be earned only when they are actually received in cash. Similarly, expenses are deemed to be incurred only when they are actually paid in cash. This method ignores the non-cash item such as outstanding, prepaid expenses; Accrued Income or Income received in advance etc. In other words, this is the method of recording transaction under which revenues and costs, assets and liabilities are reflected in accounts in the period in which actual receipt or actual payments are made. This method is adopted in those concerns where only cash transactions take place. Generally, individuals like, Doctors, Lawyers, Auditors, Engineers follow this system, and Brokers etc followed this system. The provision of this system of accounting is that it is very simple because it requires no adjustments at the end of closing date. But, the con is that it fails to reveal profit and loss accurately in the absence of adjustment.

### **2. Accrual Basis of accounting (Mercantile Basis Accounting)**

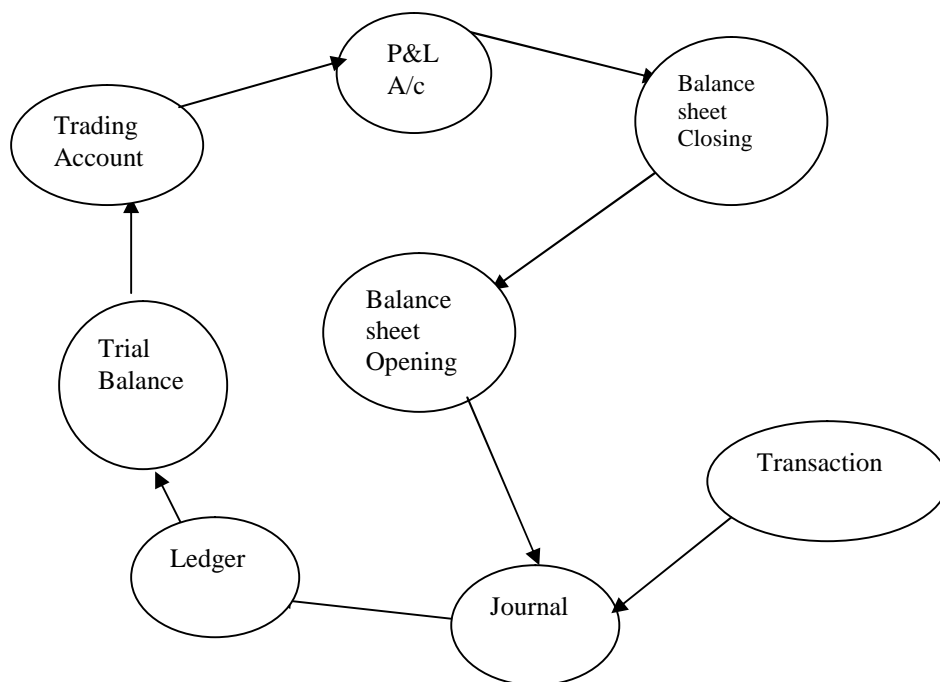
This is the method of recording transactions by which revenues and costs, assets and liabilities are reflected in accounts in the period, which they incur. Or in this method incomes are recorded or credited to the period in which they are earned irrespective of the fact that whether the same has actually been received or not. Similarly, expenses are charged to the period in which they relate irrespective of the fact that they have actually been paid or not. This method of accounting is considered all cash as well as non-cash transactions such as pre paid expenses, accrued income etc.

### 2.1.8 Accounting Cycle

Accounting cycle is the process of keeping accounting record in scientific and systematic way, which runs like human life cycle. It helps for recording, summarizing, classifying, analyzing and reporting of the data.

The accounting cycle makes possible to analysis by recording, classifying and summarizing an entity's transactions and preparing reports which present the summary results (K. Fred Harold W. Steve, p 54).

Each and every business organization wants to perform their transaction in scientific way. For this, business transaction is recorded in a set of ruled books such as journal, ledger, cashbook etc. Unless this transaction is recorded properly, he will not be in a position to know where exactly he stands. Therefore, any business record keeping is the most important. To present the business economic event in systematic way, the record should summarize, classify, analyze and report in scientific manner, which is known as accounting cycle.



Source: C.Mohan Juneja, R.C.Chawala, K.K.Saksena

Accounting cycle refers to complete sequence of accounting procedure, which is required to be repeated in same order during each accounting period, which include following items.

- I. Journal: A book, which presents the record of opening balance sheet and day-to-day business transactions of the accounting year.

- II. Ledger: A ruled book where journal's transactions are transferred periodically.
- III. Trial Balance: At the end of the every accounting year trial balance is prepared after balancing the ledgers accounts.
- IV. Then the final accounts such as trading and profit & loss accounts are prepared
- V. Finally a balance sheet prepared which gives the complete financial position of the business enterprises at the end of the accounting period.

### **21..9 Accounting for Information**

Accounting is a system of generating and communicating financial information to make decision for building the strong capacity of organization reducing its weaknesses. Accounting information is presented mostly in the form of financial statements like income statement (P&L A/C), position statement (Balance Sheet) etc.

Accounting provides the information internal as well as external users groups. In other words, both external as well as internal users use the information for decision-making. The internal users of accounting information are the manager at different level of organization, employees, owners etc. And external users of information are creditors, government, consumer, bankers etc. They use the information provided by accounting systems for performance evaluation and decision making purpose. Major users of accounting information are:

- Customers
- Suppliers
- Government
- Owners
- Lenders
- Employees and Trade union
- Investment analyst
- Community representative
- Management etc.

Financial statement of the business organization provides very important and useful information to the parties interested in the activity of the business enterprises.

So the information disseminated by the financial statement should bear the following characterizes.

- ) Useful
- ) Understandable
- ) Relevant and Reliable
- ) Neutral Verifiable
- ) Timelessness
- ) Completeness

### **21..10 Accounting System**

There are mainly two systems of accounting, which are as follows:

- 1) Single Entry System
- 2) Double Entry System

#### **A. Single Entry System**

Under this Single Entry System of book keeping, both aspect of every transaction are not recorded in the books of accounts. In this system, businessmen do not follow any uniform systems or scientific principles and records so their maintained are mostly seemed incomplete. It is more appreciate to call it an incomplete system of records transactions. The double effect of every transaction is ignored. Generally, under this system personal accounts of debtors and creditors are maintained. The usual subsidiary books maintained under the double entry system of book keeping are also maintained under the single entry system, but the posting are made form these subsidiary books of those entries which affect personal accounts. Real and Nominal account are not maintained under this system so this system known as single entry system.

Single entry system of bookkeeping is not a scientific and systematic system of accounting, which is incomplete and disjointed form of accounting system. According to Kohlar- “Single entry system is a system of book keeping in which only records of cash and personal accounts are maintained, it is always incomplete double entry system, varying with circumstances.” The degree of incompleteness of records varies from business to business according to its nature and complexity.

There are different types of single entry system of book keeping which can be classified in to following categories:

a. Pure single Entry System: -

Under this system only personal accounts are kept. And no records are kept for real or nominal accounts, which ignore dual aspect of each transaction.

b. Quasi Single Entry System: -

Under this system some subsidiary books (cash book, personal account etc.) are maintained but only those entries are posted which affect personal accounts. Quasi single entry system is a term covers the numerous system of book keeping which are different from one to another's in details. It is also known as incomplete of double entry system.

Quasi single entry system may consist of:

1. Double entry for certain transactions such as cash received from debtors or cash paid to creditors.
2. Single entry in respect of some transactions such as purchase of fixed assets, payment of expenses etc.
3. No entry in respect of some transactions such as bad debts, depreciation, loss of stock by fire etc.

Single entry book keeping system is very useful for the organization in the sense it is very economical, simple, suitable for small firm, secrecy but it has also some demerits, which are:

- ) Incomplete and unscientific.
- ) Ascertainment of profit or loss is difficult.
- ) Financial position of business can't be ascertained.
- ) Possibility of committing frauds, errors and manipulations.
- ) Control of assets is very poor.
- ) Tax authority suspect on the reliability.

**i. Ascertaining profit under the single entry system**

Under the single entry system of book keeping, it is not possible to prepare a regular trading and profit & loss account, because no record is kept of the nominal accounts, therefore, the exact profit or loss for a particular period cannot be

ascertained. The net profit for a particular period can be ascertained in a rough manner by comparing the financial position of the business at the commencement of the period with financial position at the end of the period. This requires either the preparation of two statements of affairs, one in the beginning and the other at the end or conversion of single entry into double entry will reveal either profit or loss.

## ii. Ascertaining the profit by using Statement of affairs Method

Statement of affairs is a summarized statement of financial position, i.e., a statement of assets and liabilities at the particular date of business. It is prepared to show the financial position of a business under single entry system of book keeping. A statement of affairs for this purpose is a document in the form of a balance sheet, showing on right-hand side the estimated amounts of various assets and on the left-hand side the estimated amounts of liabilities. The difference of the two sides represents capital of the owner.

The following is the procedure to be adopted and through which the profit or loss can be ascertained from the books.

Step 1. A statement of affairs at the beginning of the period to find out the amount of capital invested in the beginning, which is prepared as follows.

### Statement of Affairs at.....

Liabilities	Amount	Assets	Amount
Sundry creditors	xxxxx	Cash balance	xxxxx
Long & short term loan	xxxxx	Bank balance	xxxxx
Bank overdraft	xxxxx	All fixed assets	xxxxx
Bills payable	xxxxx	Advance expenses	xxxxx
Other liabilities	xxxxx	Outstanding income	xxxxx
Capital- (Bal. Figure) (Excess of assets over liabilities)	<b>xxxxx</b>	Other assets	xxxxx
Total	xxxxxxx	Total	xxxxx

Step 2. In the same manner, a statement of affairs at the closing period is prepared to ascertain the capital.

Step 3. The capital derived at step 2 may be adjusted by adding back the drawings, if any by the proprietor.

Step 4. In additions to the initial capital, it is possible that a trader might have invested fresh amount of capital in the business during the course of the period. The closing capital would have been less, in the absence of additional capital.

Step 5. The beginning capital should be deducted from closing capital's is added to the amount of draws then form this amount of additional capital is deducted. In other words, Adjusted capital= Closing Capital+ Drawings- Additional Capital.

The comparison of the capital at the end and capital at the beginning reveal some differences, which is either gain or loss. If the adjusted capital at the close is more than the capital in the beginning, trader has made a profit to the extent of excess and vice versa.

#### Statement of Profit and Loss Account

Particular	Amount
Ending Capital	XXXX
Add: Drawing during the period	XXXX
Less: Additional capital	XXXX
Adjusted Capital	XXXX
Less: Beginning Capital	XXXX
Profit /Loss	XXXXX

#### **iii. Ascertaining the profit by using Conversion Method**

The statement of affairs/net worth method explained above doesn't provide a clear operational result of a firm. It doesn't provide the essential information for the improvement of the business. Moreover, the available figures from the existing books may not be enough to have a meaningful analysis to know the soundness of the business. In the absence of complete records, the correct profit and the financial position cannot be known. Therefore, a trader may wish to convert single entry system into double entry so that, he can prepare final accounts, which reveal the exact financial position of the business apart from knowing the correct profit.

The conversion of single entry system into double entry system may be done in the following two ways:

- a. Conversion from certain date.

- b. Conversion of whole set of books.

### **Conversion from Certain Date**

Converting the books maintained from single entry system into double entry system in a definite time, the following steps should be followed:

1. Preparation of statement of affairs on the date on which conversion is to be done.
2. Pass the opening journal entry for the item of statement of affairs debiting all assets accounts and crediting all liabilities accounts and capital account.
3. Post of the opening entry into ledger, except debtors, creditors and any other accounts as already appear in ledger.
4. Then prepare other necessary subsidiary books.

These processes complete the double entry in the ledger in an accurate

### **Conversion of the Whole Set of Books**

The following procedures may be followed for conversion of the whole set of books.

1. Preparation of opening statement of affairs.
2. Prepare opening entries in the journal and post to ledger all the assets and liabilities except those as already appeared in ledger.
3. Post the total of subsidiary books in the respective ledger.
4. Prepare cash account for finding out the missing figures of cash or bank balance in the beginning or at the end. Then cash book should be prepared by showing cash collection, cash sales, income from investment, sales proceeds of assets etc on debit side and total payment to creditors, wage, salary and other expenses paid payment for purchase of assets, drawing by proprietor etc on credit side.
5. Posting should be made respective accounts from debit side and credit side of the cashbook.
6. If no records are kept in respect of certain transactions, recording and posting should be made for such transactions.
7. Balance off the accounts and prepare the Trial Balance in the usual manner.
8. Form the Trial Balance and allied information; prepare trading, profit and loss accounts and balance sheet.

These above steps complete the conversion of whole set of books.

## **B. Double Entry System**

The double entry system is simply a recording system, which records the dual effect of each business transaction. The dual effect of business transaction is recorded by means of the double entry book keeping system. An Italian monk named Paciolo first propounded the concept and principles of double entry system of bookkeeping in 1494. The double entry rules states that when recording each transaction the total amount of the debit entries must be equal to the total amount of the credit entries for that transaction. The golden rule for double entries that every debit should have a credit and every credit should have a debit. Double entry bookkeeping is the concept that every transaction involves the giving of a benefit and the receiving of the benefits. A double entry has to be used to transfer an amount from one account to another. The double entry system of bookkeeping uses the left-hand side of account for debits and the right-hand side of the account for credit. It is a feature of double entry system that each transaction is posted twice and on the opposite sides of different accounts, reflecting different aspects of each transaction.

Double entry system of bookkeeping is a scientific system of bookkeeping as record keeping under this system is made cause and effect. This system of book keeping follows rules for recording the economic events. As such there are certain features of the system and they are:

- Twofold effect
- Equal effect
- Change in ownership etc

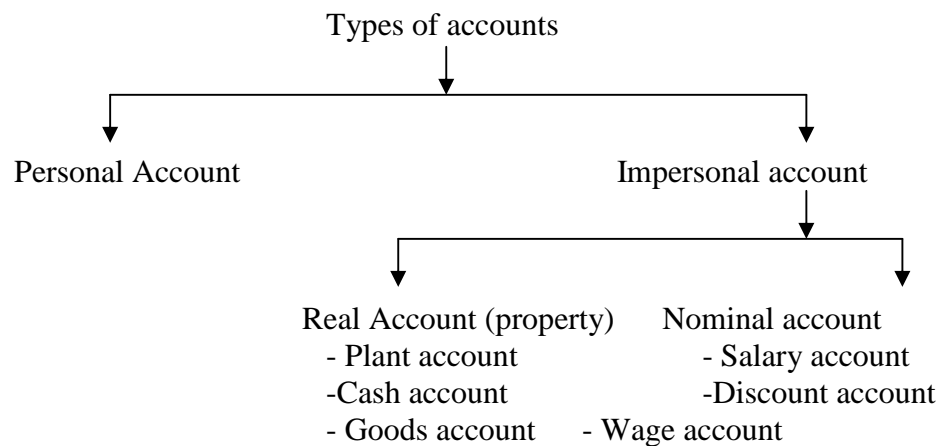
### **21..11 Rules for Debit and Credit**

The process if recording a transaction in a journal is called journalizing the transaction. And the journalizing the transaction is based on rules for debit and credit. Debiting the one side and crediting other side of transaction is requiring in journal. There are some rules for debiting and crediting the transaction in different basis; some of them are as follows:

#### **A. Rules for debit and credit on the basis of the account**

Before indicating the rules, first of all we have to know about types of account. There are different types of account according to account nature, which are

showing in following figure:



### **1 Personal Account: -**

Accounts recording transactions relating to individual or firms or company are known as personal accounts. Personal accounts may further be classified as:

- I. Natural person's personal accounts: The accounts recording transactions relating to individual human being e.g. Ram's A/C.
- II. Artificial person's personal account: The accounts recording transactions relating to Limited companies, Bank, Firm, etc.
- III. Representative personal account: The accounts recording transactions relating to the expenses and incomes are classified as nominal accounts. But in certain case using matching concept, the amount one particular date, is payable to individual or recoverable from individuals. Such amount is classified as representative personal account e.g. pre- paid insurance account, wages outstanding account etc.

### **2 Real Accounts: -**

The accounts recording transactions relates to tangible things such as goods, cash, building, machinery etc. are classified as tangible real account. Whereas the accounts recording transactions relating to intangible thing such as goodwill, patent, copyright, trademark etc. are classified as intangible real account.

### **3 Nominal Accounts: -**

The accounts recording transaction relating to the losses, gains, expenses and income are classified as nominal accounts e.g. rent, salaries, wage, commission, interest etc.

### **Rules for debit and credit**

Personal Account:	Debit the receiver. Credit the giver.
Real Account:	What comes in Debit What goes out in Credit.
Nominal account:	All losses and expenditure are Debit All income and profit are Credit.

### **B. Rules for debit and credit on the basis of Dual aspect (Nature of transaction)**

Dual aspect concept of accounting implicitly implies that every accounting transaction would be expressed by a debit amount and equal and opposite credit amount. Thus, the rule that for each transaction debit amount must equal with the credit amount. The equality of debit and credit may be expressed in the form of an equation:

$$\text{Debit} = \text{Credit}$$

In other words accounting equation made  $A-L = P$   
i.e., Assets – Liabilities = Proprietor's fund or capital

If each account is to be considered in isolation it would make no difference whether increase were recorded on the debit side or on the credit side but since the accounts are inter- dependent, therefore a system of recording increase and decrease on the two side had to be fixed. It gives rise to the following rules:

- 
1. Increases in assets amounts are debit, decrease are credit.
  2. Increases in liability amounts are credit, decrease are debit.
  3. Increase of owner's equity are credit, decrease are debit.
  4. Increase in expenses/ losses amount are debit, decrease are credit.
  5. Increase in revenue/ profit account are credit, decrease are debit.
- 

### **21..12 Journal**

Journal is the "day-by-day" book of the business wherein both the aspect of all business transactions is recorded in chronological order. The journal is, thus, a book of prime entry. It is also known as original entry because transactions are first written in the journal or the information about each business transaction is initially recorded in journal. These entries are than posted from the journal in to ledger. The journal merely helps the posting of entries from journal in to ledger. Hence, journal is known

as subsidiary record or subsidiary book. Journalizing is an act of recording the debit and credit aspect of business transaction in journal, together with explanation of transaction known as narration.

Journal of each transaction includes the date of transaction, the debit and credit change in specific ledger account and behalf of explanation of transaction and the debit and credit amount recorded in the journal are posted to accountancy in the ledger. So in brief, we can say a journal is a chronological record of accounting transaction showing the names of accounts that are to debited or credited, the amounts of debit and credit, any useful supplementary information about transaction.

### **A. Rules of journal**

For each transaction, a separate entry is recorded. While journalizing the transaction following process should be followed:

1. The date of transaction is written in the date column.
2. The name of the account to be debited is written first in the particular column. And the amount of the debit is entered on the same line in the debit money column.
3. The name of account to be credited is written in the second line below than debit line. It is intended, i.e., place few spaces from the left margin of the debit line entry. The amount credited is entered on the same line in credit money column.
4. A brief explanation of the transaction begins on the line immediately below the credit line entry.
5. The number of ledger account (page No.) should be posted while transfer or posted the amount of showing journal debit and credit column.

### **i. Procedure of journalizing**

Following procedures should be followed while making journal entry for business transactions or while passing journal entry:

- First, find out the two-sides/ fold effect of the transaction.
- Then, determine the affecting accounts.
- Recall the debiting and crediting rules of affecting.

- Then, determine the debit entry and credit entry.
- Finally, record the transaction in general journal.

### **21.13 Ledger**

Ledger is the principle book. It is most important book in accounting system. It contains all the accounts (assets, liabilities, capital revenue, expenses) to which the transactions recorded in the books of original entry are transferred. Ledger is ultimate destinations. It is also called book of “final entry”. In the ledger the information is classified by nature and relevance.

Ledger is the main book of accounting system. A ledger is a collection of all the account debited or credited in general journal and various special journals. It is the destination of the entries made in journal and special journal.

Ledger is a means of accumulating in one place all the information about changes in a specific asset, liabilities or owner’s equity. It may be define as a summary statement of all transaction relating to persons, assets expenses, and income, which have taken place during the given period of time and shows their effect. Basically ledger gives answer to the following questions:

- How much sales organization have affected during the period?
- How much a particular customer owes in particular period?
- What is the amount payable to different suppliers?
- What is the amount of goods purchased during specific period?
- What has been organization expenditure and income during period?

#### **A. Advantage (necessity) of Ledger**

There are different types of ledger such as debtor or customer or sales ledger, creditor or supplier ledger and general or impersonal ledger. Maintaining the ledger is a must in every accounting system. It is necessary as will be clear from its advantages:

- a.) Transaction relating to a particular person, item or heading of expenditure or Incomes are grouped in the concerned account at one place.
- b) Ledger reflects the net position of account when each account is periodically balanced.

- c.) It is the stepping-stone for preparing Trial balance.
- d) Since the entries recorded in the journal are referenced into ledger the  
Possibilities of errors or deflections are reduced to minimum.
- e) It is destination of all entries.
- f) Ledger is the store house of all information which subsequently is used for  
preparing final accounts and financial statements.

### **B. Ruling of Ledger**

The ledger account is ruled either in 'T' form or in running balance form. Running balanced ledger account shows the balance after each posting as such it is also called balance shaped ledger account.

Ledger account contained the following information:

1. In date column, the date of transaction took place is recorded.
2. In particulars column, particular relating transaction is recorded.
3. In folio column, a reference is made to the page number of the book of original entry.
4. In amount column, the amount involved in the transaction is entered.

### **C. Posting the Journal Entries in to Ledger Account & its Balancing**

Posting means updating the ledger accounts for the effect of the transactions recorded in journal. It is simply the process of transferring the journal entries in to ledger accounts for simple and quick reference of the account concerned. In addition, posting involves recording the date of transaction in the ledger and a cross reference between the entries and related journal. The complete posting and balancing process included the following steps for each account titled in the journal entry.

1. Locate the corresponding account to be debited or credited as entered in the journal in the ledger.
2. Enter the date of transaction in the date column.
3. Write the name of account through which it has been debited in the journal on debit side of particular column. That is, each debit entry in journal is posted to the debit side of the respective account.

4. In the same way, write the name of account through which it has been credited in the journal on credit side of the particular column. That is, each credit entry in journal is posted to the credit side of the respective account.
5. Enter the page number of the journal in the ledger folio number.
6. Enter in the corresponding column the amount being debited or credited to the ledger account.
7. Take the total of the two sides of the concerned account.
8. Ascertain the differences between total of two sides.
9. Enter the difference in the amount column of the side showing less total, writing against difference in the particular column. To balance c/d (carried down) on the debit side of the account and by balance c/d credit side of the account. In this way the total of the sides will equal.
10. The balance is brought forward at the beginning of next period if to balance c/d is written on debit side before balancing, it is brought forward on credit side and by balance b/d (brought down) is written against the balance in particular column and vice versa.

#### **21..14 Cash Book**

Cash book is an important to maintained properly or manage the cash. The cash book only records transactions connected with cash. The object of the cashbook is to keep a daily record of transactions relating to receipt and payment of cash. When business is large, the numbers of transactions relating to cash are also usually large. Since cash transactions form the major portion of the transaction of a business, it is necessary to keep a separate book for cash transactions. If every transaction is entered in journal, it will be tremendous job. Thus it becomes necessary to have a cashbook to record only the cash transactions.

Maintaining of cashbook removes the necessity of having cash and bank accounts in ledger. This book enables us to know the balance of cash in hand and at the bank at any point of time. Cashbook consists of cash and bank accounts taken out of ledger and maintained separately; thus it also is a book of original entry because cash and bank transactions are not recorded in any other subsidiary book. To

maintained cash book we should have knowledge as well as its features which are significant to know clearly about the concept of cash book.

- ❖ Only cash and bank transactions are recorded.
- ❖ It performs the role of both journal and ledger.
- ❖ Receipts are recorded on the debit side and payment on the credit side.
- ❖ Transactions are recorded in chronological order.
- ❖ Cash column must have debit balance (if any) whereas bank column may have debit or credit balance depending upon whether bank balance positive or overdraft etc.

### **A. Types of Cash Book**

On the basis of cash book's nature and requirement types of cash book are given below:

1. Single column cashbook
  - Simple cashbook
  - Simple bankbook
2. Double column cashbook
  - Cash book with cash and discount column.
  - Cash book with bank and discount column.
  - Cash book with cash and bank column.
3. Triple column cashbook
  - Cash book with cash, bank and discount column.
4. Analytical cash receipt and cash payment books
5. Analytical Petty cash book

Generally, each business will use any one of the above types of cashbook along with petty cash book, which is maintained on memorandum.

#### **i. Single Column Cashbook**

Single column cashbook which contains only one column of amount is called single column cash book. Receipt of cash and cheque will be entered on the debit side and payment of cash and endorsement of cheque received on the credit side of cashbook. There are two types of single column cashbook:

## **I. Simple cashbook: -**

This type of cashbook makes a record of all the receipt and payment of cash. A simple cashbook is a ruled exactly a ledger. When cash received, it is entered on the debit side of the book, and similarly cash payment is entered on the credit side. When cash received by cashier, daily a cash receipt is issued against the cash; the cash receipt possesses a number R. No. (receipt number), which is written in the debit side, in column R. No. Similarly, cash is paid against the voucher and the number on it is entered on credit side, in column V. No (voucher number). The difference between the total receipt including opening balance (Dr. Side) and total payment (Cr. side) represents the balance i.e. the amount of cash in hand. The cashbook should always show a debit balance because total cash paid will never exceed opening balance plus received.

## **II. Simple Bankbook: -**

Single column cashbook with bank column only is termed simple bankbook. Most organization now a day maintained bankbook instead of cashbook for recording the cash transactions. Such organizations make cash transactions through bank only. Cash will be received through bank and payment through cheque. The bankbook also contain only one column for amount i.e. bank column. The recording process in bankbook is same as that of in the bank account. But the bankbook sometime may show credit balance if overdraft arrangement has already been made with the bank.

Generally, bankbook also shows debit balance as that of the cashbook it means, debit total of bankbook exceed the credit total in the absence of overdraft. But, if there is an overdraft arrangement with the bakers, credit total of bankbooks may exceed the debit total. Overdraft is an arranged loan in which bank charges interest. If debit total of bankbook is heavier to credit total, then difference will be written on credit side with words by balance C/D in particular column and amount in the bank column and vice versa.

### **iii. Double Column Cashbook**

As the phenomenon of offering and accepting cash discount is intimately associated with the act of receipt and payment if cash, therefore, the utility, of cashbook increases if the columns of discount are also provided in it. Cashbook

having additional columns of discount is known as double column cashbook which is following three types:

### **I. Cashbook with Cash and Discount Column: -**

Sometimes cashbook is provided with an additional column of 'discount' on each side. This type of cashbook is known as Cashbook with Cash and Discount Column. Cashbook may contain a column for discount. Cash discount arises at the time of cash received and cash payment. It may be received and allowed. Cash discount is allowed to the customers at the time of cash received from them and it is received at the time of cash payment to the supplier. The supplier of goods for encouraging prompt payment from debtors makes provision of cash discount. Discount allowed is an expense and so required to be debited and received in a convenient to add a column for discount on each side of the cashbook for recording discount expense and income. The cashbook containing discount column is termed as double column cashbook.

Posting of cash column is similar to simple cashbook. After posting, the cash columns are balanced like other ledger accounts but discount columns are totaled but not balanced. That is, on balancing the cashbook, the discount columns are added up. The total of discount allowed (Dr.) column is posted to debit of discount/discount-allowed account and the total of discount received (Cr.) column is posted to the credit of discount/discount-received account in ledger. This discount column in the cashbook is only the memorandum column and doesn't stand for discount account.

### **II. Cashbook with Bank and Discount Column: -**

In big firm transactions are not done in cash. All cash receipts are deposited with the bank and payments are made only through cheque. This type of cashbook is similar to above cash book i.e. cash book with discount and cash column but the only difference is that bank is there instead of cash. Procedure of closing the cashbook is similar to the above cashbook.

When cash or cheque is received through the bank from the customers, it is entered in the debit side of bank column of cashbook. And similarly, when a cheque is issued to the party, the bank column of cashbook is credited. The discount columns of debit side of the cashbook represent the discount allowed to the customers. The customers pay less than what is due from them. So it represents a loss sustained by the

merchant. The discount column on the credit side represents discount allowed to the merchant by his creditors. And it represents gain.

### **III. Cashbook with Cash and Bank Column: -**

Some firms may maintain cashbook with cash and bank column ignoring discount column. Such cashbook combined the cash account and bank account. And the procedure of recording in such cashbook is the same as to recording in single column cashbook and bankbook.

#### **Contra Entry:**

Cash received from the customers and drawn from the bank are shown on the debit side of the cash column and payment deposited into the bank, on credit side of cash column. Amount paid into the bank and withdrawn from bank for official use affect both side of cashbook. Such transactions affect debit side of cash column and credit side of bank column. If cash is deposited into bank, it affects credit side of cashbook on cash column and debit side of cashbook on bank column. Likewise, if cash is withdrawn from bank for office use, then it affect debit side of cashbook on cash column and credit side, on bank column. Such entries are called “Contra Entries”. Contra entries are those entries, which affect the both side of cashbook. To distinguish contra entries from the rest of the entries in cashbook “C” is written against in the “L/F Column”.

#### **Treatment of Cheque Received:**

Often a cheque received from customers is paid into bank on the same day or next day. Hence it is entered in the debit side of cashbook directly in the bank column.

Balancing of the cashbook is done to find out the amount of cash remained in hand and at bank. For balancing the totals of cash and bank column on either side of cash book and finds out the difference. And the amount of difference in cash column will be debit balance and recorded on credit side with “By balance C/D”. The difference in bank column sometimes will be credit balance and recorded in debit side with “To balance c/d”.

### **iv. Triple Column Cashbook (Cashbook with cash, bank and discount column)**

Nowadays, it is difficult to carry on any business without having dealing with the bank. Bulk of its funds is normally kept by the business at the bank in a current

account where frequent withdrawals and deposits are permitted. Bank transactions, i.e. payment in to and out of bank are more numerous than cash transactions. Therefore, it is appropriate as well as convenient that cash book should have one additional column on each side to record moneys deposited in bank and payments out if the bank. The additional advantage of having this type of cashbook is that bank account is not required to be maintained in ledger. For preparing this type of cashbook should consider about contra entries cheque treatment like as cashbook with bank and cash column.

The cash columns are balanced exactly in the same manner as explained in case of single column cashbook. Discount columns are totaled but not balanced. Bank column are also balanced just like cash columns. Since the banks allow overdraft therefore it is possible for, the business to withdraw more than amount deposited. In such a case the totals of the bank column on the credit side will be bigger than one on the debit side. The difference is written on the debit side as “To Balance c/d”.

#### **v. Analytical Cash Receipt and Cash Payment Book**

A businessman may like to get more information from the cashbook, such as receipts from different heads of income and payments on different accounts. In this case book may be split in to two parts, one for receipts- cash receipt books and another for payments- cash payments book. Generally, this type of cash book useful for insurance business they can modify suitably the format depending upon their requirements.

#### **vi. Analytical Petty Cash Book**

Petty means small. In big business firms all payments are made by cheque and all receipts are banked. There are numerous small payments on account of expenses like stationery, cartage, coolie hire, refreshments to guests etc. This cannot be paid through cheque. Moreover, the main Cashier will be overburdened if he makes these small as well as frequent payments. To avoid this inconvenience, such items of expenditure of frequent occurrence are removed to a separate book, known as petty cash book, which is maintained by Petty Cashier. Petty cashier is a person, who maintains the petty cashbook. Petty cash is maintained in a columnar form. A petty cashier makes a detail analysis of petty payments and records under suitable head of expenditure. Petty cash book is similar to cashbook. The amount received by petty cashier from the main cashier is debited in petty cashbook and all petty payments are

credited. Periodic total of each column is posted to respective nominal account in the ledger. The book may be considered as a book of original entry or memorandum book. If treated as a part of double entry, then no separate petty account is needed. When the petty cashier needs further cash, he makes up the petty cash book and presents it to the chief cashier, who verifies the accounts and gives further amount.

**Imprest System of Petty Cash Book:** Under this system, a round sum of money estimated as necessary for the possible needs of the business to meet petty expenses for the week or fortnight is handed over to petty cashier. At the end of fixed period or earlier, when petty cashier needs further cash, he submits the petty cash book along with voucher. The chief cashier examines the cashbook with the vouchers. Then chief cashier gives the money/cheque for exact amount, which he actually spent during the period. Thus he starts for next period with the same sum as held previously. That is, the petty cashier will have again the fixed sum in the beginning of the next period. This system is known as Imprest system of Petty Cash book.

There are different advantages of Imprest of Petty Cash Book System. Some of them are:

1. Commission of fraud is reduced.
2. The total expenditure under each column can easily be ascertained.
3. It reduces burden of chief cashier etc.

### **21..15 Subsidiary Books**

Many businesses may perform different repetitive transactions. Repetitive transactions are also called routine transaction, which are most frequently occurred and as such involved. Most of the business transactions are repetitive in nature and can be easily recorded in special journals. Special journal are meant for recording all the transactions of a similar nature. Under special journal system separate books are kept for each particular class of transactions of similar nature. And each separate book is meant to record transaction of particular class in the book of original entry. Such book of original entry is also known as special journal or sub journal or sub division of journal or daybook or subsidiary books. There is various types of subsidiary book include the following:

1. Purchase Book.
2. Purchase Return Book.

3. Sales Book.
4. Sales Return Book.
5. Bills Receivable Book.
6. Bills Payable Books.

#### **A. Purchase Book**

The purchase book is also known as Purchase Journal, Bought Book, and Purchase day book or Invoice Book. This book is recorded with credit purchase of goods, meant for resale. Cash purchases are not recorded in this book. Cash purchases are entered in the cashbook. At the same time, credit purchase of assets, meant for the firm, are entered in journal. Usual purchase book should have column for date, invoice number, particulars, ledger folio, details and amount.

#### **Invoice:**

When we purchase goods on credit, we receive a statement from the supplier giving the particular of the goods supplied. It also states the discounts allowable (trade and cash) and the conditions under which payment is expected.

The supplied upon the receivers of order for goods takes following to actions:

1. Shipped the goods to the customer.
2. Sent to the customer and invoice.

Invoice act as a contract paper regarding purchase and sales of goods agreed by the seller and purchaser of goods. It can be produced as a valid document in the court if necessary. Invoice are prepared in five copies of different colors and dispatched as follows:

First copy of an invoice is sent to the purchaser through mail. And upon the received of an invoice, purchaser prepares the purchase book or purchase journal.

Second copy of an invoice, is kept by the seller itself for recording in the sales journal which is known as sales daybooks copy.

Third copy of an invoice has handed over to the transporter i.e., shipping company that took responsibility for deliver of goods to the purchaser. So the third copy of an invoice is also called the delivery copy.

Fourth copy of an invoice is sent along with goods shipped to the customer. It is an advice note to the purchaser regarding freight charges and quality and quantity of goods shipped.

Fifth copy of an invoice is sent to the sales representative if the order of goods is received through the sales agent.

### **Methods of Preparation of Invoice:**

While preparing an invoice following factors should be included:

- I. Address of the business enterprises.
- II. Fax, e-mail, telephone of the enterprises.
- III. Invoice date.
- IV. Purchaser's name and address
- V. Credit terms, quantity discount and settlement discount
- VI. Distribution of goods being sold
- VII. Method of shipment and freight paid or to be paid.

### **B. Sales Book**

This book is also called sales journal or sales book or sales daybook. Only credit Sales are recorded in this book. The ruling is similar to that of purchase book. If there are cash sales they are recorded in cashbook and sale of assets are recorded in journal proper. The entries in the sales book are made from the copies of the invoices, which have been sent to the customer along with the goods. Such copies of invoice may be termed as "outward invoice". Each such outward invoice should be numbered consecutively and the reference be given in sales book.

### **Value added Tax (VAT):**

At present the purchased daybook and sales daybook are necessary to keep in such a way which clearly shows the value added tax on supplies of goods and services that are subject to value added tax. VAT is tax imposed on the supplies of goods and services. As such, VAT is also known as goods and service tax (GST).

### **C. Purchase Return Book:**

This book is also known as return outwards book or purchase return journal. It records all the return of the goods. Goods purchased may have to be return to the supplier for various reasons such as not up to sample or not ordered or damaged

during the transit etc. The purpose of this book is to record only the transactions relating to return goods. The ruling of the return book is identical with the ruling of purchase book.

**Debit Note:**

While returning the goods to the suppliers a letter is sent to them for their information and stating therein that we have debit your account by this amount on account of goods being returned here with for the reasons stated. Generally such “information’s letters” are printed with counterfoils. Debit notes are sent to the parties concerned. The counterfoils providing the base for writing up the purchase return book. The debit note contains the name and address of the supplier, the detailed description of the goods returned and reason for return. Debit note is the source document for recording entries in the purchase return book.

**D. Sales Return Book:**

This book is also called return inward books or sales return journal, which records all returns of goods sold. Goods sold may be return by our customers for various reasons such as goods sent being of wrong description or inferior quality or damaged.

**Credit Note:**

Our costumer may return good to us. On receipt of the goods returned by the customer, a credit note is sent to them, by us, intimating the credit given to their account. This statement is called credit note. When a debit note is received along with the goods returned form the customer, it is a claim on us. If claim is accepted then credit note will usually printed in red ink, with full details required credit.

**E. Bills Receivable Book:**

All receipts of the bills are entered in a c\book called bills receivable book. Whenever a bill of exchange is received its particulars are entered in the appropriate columns of the bills receivable book.

Posting from bills receivable book- The periodical total of the bills receivable book is posted to the debit of bills receivable account in the ledger. Each entry in the book is posted to the credit of individual account from whom the bill is received.

## **F. Bills Payable Book:**

The details of the bills accepted by a trader are recorded in the book known as bills payable book.

Posting of the bills payable book- the periodical total of the bills payable book is posted to the credit of the bills payable account in the ledger. Each entry in the book is posted to the debit of the individual account to whom the bills is granted.

## **21..16 Journal Proper**

After the subsidiary journals are created, the question of cash transactions and purchase, sales, purchase returns and sales returns transactions being entered in the journal does not arise. In other words, the journal will have only for residual transactions, i.e., transaction other than of cash and goods in trade account. The journal then called the journal proper.

Proper journal is a special book in which transactions of special nature, which occasionally happened, are recorded. The transactions, which are not recorded in the respective primary books of accounts, are recorded in journal proper.

Proper journal is used for recording following transactions:

1. Credit purchase and credit sales of assets
2. Transfer entries
3. Opening entries
4. Closing entries
5. Adjusting entries
6. Rectification entries.

### **A. Credit purchase and credit sales of assets**

The entry in case of purchase of assets on credit is to debit the assets account (what comes in) and to credit the supplier's account (the giver) likewise, in case of a sale, the entry is to debit the purchaser's account (the receiver) and to credit the assets account (what goes out). For example,

- In case of plant purchase from Sagun and Company, the entry will be

Plant A/C Dr

To, Sagun & Company Cr.

## **B. Transfer entry**

If any, amount is to be transferred from one ledger to another ledger than it is done by means of journal proper. Transfer entry will be

-If transfer the profit to reserve fund

Profit & Loss A/C Dr.

To, Reserve fund A/C

## **C. Opening entry**

Opening entry is requiring transferring the assets and liabilities of the previous year to the current year. For example amount of cash, stock, furniture, debtors and creditors of previous year transferred this year the journal will be as

Cash A/C Dr.

Stock A/C Dr.

Furniture A/C Dr.

Debtors A/c Dr.

To, Creditors A/C

To, Capital a/C (balancing figure)

## **D. Closing entry**

For ascertaining the profit or loss for the year, all the accounts relating to incomes and expenditure are transferred to either trading account or profit & loss account from which gross profit and net profit arrived at. This is done with the help of journal proper is called closing entry.

## **E. Adjustment entry**

Since accounting follows “accrual concept” therefore adjustment has to be done at the end of the year regarding:

- a) Expenses incurred but not paid.
- b) Expenses paid but not benefit to be available in the next period.
- c) Income becoming due but not received.
- d) Income received in advance.
- e) Charging depreciation on fixed assets etc.

## **F. Rectification of error**

Rectification of errors refers to the correcting of the errors already committed. If an error is seen immediately after it is committed, it can be corrected by crossing out the wrong entry and by making the correct one and initialing the correction. But if errors are detected afterwards, these are always corrected in account book by suitable additional entries or by giving proper explanation. For the view point of the rectification errors may be classified as:

- 1.) One-side errors: - errors affecting one account.
- 2.) Two side errors: - errors affecting two or more account.

Such errors would have to be rectified either:

- a.) Within the accounting period (Before preparation of final account)
- b.) After the accounting period (After preparation of final account)

## **21..17 Bank Reconciliation Statement**

The passbook medicates the amount paid in to the bank and the amount withdrawn there from. The passbook balance on any given date must be the same as the balance shown by the bank column of the cashbook on the same date. But in actual practice the bank passbook balance seldom agrees with the balance shown by the bank column of cashbook. This happens when some of the transactions appear in the cashbook but not in the passbook or in the passbook but not in the cashbook. The differences between the two balances are due to the following reasons.

### **Reason for disagreement between cashbook balance and pass book balance**

- Cheque paid but not yet cleared.
- Cheque issued bit not presented for payment.
- Interest allowed by the bank.
- Interest and bank charges debited by the bank.
- Interest, dividend etc. collected by bank.
- Direct payment by the bank.
- Direct payment to the bank by the customer.
- Dishonor of bill discounted with the bank.
- Any error committed by the bank.

In conclusion, we can say the statement, which is prepared for verifying and reconciling the bank balances, shown by the cash book and the pass book on certain date and incorporates the reason of disagreement between them is called a Bank Reconciliation Statement. There are some procedures should be followed in sequential order for finding out the causes of difference in the cash book and pass book balance.

1. Compare the debit of the passbook against the credit side of the cashbook and tick in the both books those entries that appearing each.
2. Compare the credit of the passbook against the debit side of the cashbook and tick in both the book those entries that appear in each.
3. Pick up the amount from the debit side of passbook of the untick entries.
4. Pick up the amount of the untick entries from the credit side of passbook.
5. Pick up the amount of the untick entries from the debit side of cashbook.
6. Pick up the amount of the untick entries from the credit side of cashbook.

After listing the unticked entries along with the amount, the bank reconciliation is prepared starting from either (a) Balance as per bank pass book or (b) Balance as per cashbook.

Above items that causes difference in the balance will be added to and deducted from the cashbook balance, if it is started from Cashbook balance. Treatment of the above items will be revised if the starting point in as per passbook, i.e., items to be added will be deducted and vice versa, items to be deducted will be added.

### **Treatment of Overdraft in Bank Reconciliation Statement**

When there is overdraft the situation will be just opposite to that when there is a favorable balance. Hence, revised step would, of course, be taken while preparing Bank Reconciliation statement. When there is an overdraft, the bank passbook shows a debit balance and the bank account in the cash book shows a credit balance. For the discrepancies mentioned earlier are the same, under overdraft, but in opposite direction.

Treatment on above item will be revised if the starting point is overdrafts per pass book, i.e., items to be added will be deducted and vice versa. Item to be deducted will be added.

## 21..18 Depreciation

Assets are necessary to run a business. Assets are purchased either for immediate use or for prolonged use. Assets acquired for immediate use, they are known as current assets. When assets are acquired for prolonged use, they are known as fixed assets; for example Plant, Machinery, and Building etc. These fixed assets, not meant for resale, having long life, are kept in the business. When the value of fixed assets gets diminished due to one reason or other, the assets are said to have depreciated in value. As the value of assets in terms of its purchase price gets reduced every year, the business incurs losses by way of depreciation.

Depreciation means decrease or decline in value of assets. Fixed assets are liable to loss of their value once they begin to be used in productive process. Depreciation is the gradual permanent reduction in value of assets. Depreciation is the part of the cost of the assets, which is not recoverable when the asset is finally put out of use. Depreciation, therefore, refers to permanent, continuing and gradual shrinkage in the book value of assets. Since the assets shrink in the value from year to year, it is also necessary that the book value will also be written down; otherwise the balance sheet will not reveal the correct position.

In conclusion, depreciation is an expense or loss involved in using machinery, motor vehicles, tools and other fixed assets in the process of production and has to be provided for; this is done by estimating the amount to be written off the value of a particular asset each year and setting this amount against the profit for that year. There are different causes of depreciation in account some of them are wear and tear, lapse of time, obsolescence, exhaustion, non use, maintenance, market trend etc.

The treatment of the depreciation in account begins with the purchase of fixed assets and ends with transferring profit and loss account which can be clarified from following entries:

1. For purchase of fixed assets

Fixed assets A/C Dr

To, Cash A/C

2. For providing depreciation at the end of the year

Depreciation A/C Dr.

To, Assets account

3. For transferring depreciation to and loss account

Profit and loss A/C Dr

To, Depreciation A/C

### **A. Methods of Depreciation**

There are various methods for providing depreciation. It is to be written off during economic life of an asset. The various fixed differ from each other in their nature and therefore no single method of providing depreciation can be applied to all type of assets. The following are the various method of providing depreciation.

1. Uniform installment method:

- a.) Fixed installment method
- b.) Depletion method
- c.) Machine hour rate method

2. Declining charge or accelerated depreciation

- a.) Diminishing balance method
- b.) Sum of year digit method
- c.) Double decline method

3. Other methods

- a.) Annuity method
- b.) Depreciation fund method
- c.) Insurance policy method
- d.) Inventory system of depreciation method
- e.) Group depreciation method

#### **1. Uniform Charge Method**

Under this method, year after year, depreciation is charged on uniform basis. These methods are considered suitable for those assets only, which are uniformly productive. Following method falls under this category.

I. Fixed installment / straight line/ original cost Method

In this method, a fixed or equal amount of depreciation is written off as depreciation at the end of each year, during the life time of assets. Thus the book value of the assets will become zero or its residual value.

The calculation of annual depreciation charge is done with the help of following symbolic expression.

- a. When the assets has no residual value

$$\text{Each year depreciation} = \frac{\text{Original cost of assets}}{\text{Estimated life of assets}}$$

- b. When assets has residual value

$$\text{Each year depreciation} = \frac{\text{Original cost of assets} - \text{Estimated scrap value}}{\text{estimated life of assets}}$$

Or

$$D = \frac{C - ZS}{N}$$

The depreciation to be charged each year can also be expressed as percentage of cost.

This percentage can be calculated as follows:

$$R = D/C * 1000$$

Where,

R = Rate of depreciation

D= Annual amount of depreciation

C= Cost of assets.

## II. Depletion Method

This method is also called productive output method. According to this method the charge for depreciation in respect of the use of an asset will be based upon following factors.

- Total amount paid.
- Total estimated quantities of output available.
- Actual quantity taken out during the accounting year.

This method is suitable in case of mines and queries etc. where it is possible to make an estimate of the total out put likely to be available. Depreciation is calculated per unit of output. The amount of depreciation to be charged in a particular years in computed by multiplying the units of output with the rate of depreciation per unit of output.

The periodic depletion is better not calculated in terms or year. It is always better to calculate cost per unit and the multiply the cost of unit produced in that particular year. Depletion for each unit is calculated as follows-

$$\text{Depletion per unit} = \frac{\text{Acquisition cost } - \text{Residual value}}{\text{Estimated life in terms of production units}}$$

### III. Machine hour rate Method

This method is also known as service hour method. This method takes in to account the total number of working hours of a machine during the whole of its effective life and then cost of machine is divided by the expected number of hours of useful life, this gives the rate per hour. The annual depreciation is calculating by multiplying this rate by the number of hours. The machine actually runs in a year. Or we can calculate the depreciation per hour by using:

$$\text{Depreciation per hour} = \frac{\text{Cost of machine } - \text{Scrap value}}{\text{Life of machine in hour}}$$

### 2. Declining Charge Depreciation Method

In these methods the amount charged for depreciation declines over assets expected life. These methods are suitable in the following cases-

- a. Where the receipts are expected to decline as the assets gets older.
- b. It believed that allocation of depreciation should be related to the pattern of assets expected receipts.

Following methods fall under this category:

#### I. Diminishing Balance Method

Under this method, the amount of depreciation is calculated as a fixed percentage of the reducing or diminishing value of the assets standing in the books at the beginning of the year, so as to bring down the book value of the assets to its residual value. The amount of depreciation goes on decreasing every year. That is, the amount of depreciation charged in each period is not fixed but it is gradually decreasing sum. This method is similar to the fixed installment method with the exception that depreciation is changed every year at a fixed percentage and not on the

original cost of assets but on the reduced opening balance of the assets as brought forward from previous year. Therefore, the system called reducing balance method.

This method is suitable in case of those assets whose repair charges increase as they become old. This method is also simple in calculating the amount of depreciation. Under this method assets can never be reduced to zero. This method is suitable for assets like Plant, Machinery, and Buildings etc. In this method the rate of depreciation can be obtained by using following formula:

$$r = 1 - \frac{s}{c} \div n$$

Where,

n = Expected useful life in year

s = Residual value

c = Acquisition cost

r = rate of depreciation to be applied

## II. Sum of Year Digit Method

This method of depreciation accelerates depreciation expenses, so that the amount recognized in the earlier years of an assets useful life are greater than those recognized in the later periods. The sum of year digit is found by estimating an assets useful life in years then assigning consecutive number to each year, and the totaling these numbers for n years.

$$SYD = 1 + 2 + 3 + 4 + 5 + \dots + n$$

Determining the sum of the year digit factor by simple addition can be summing what laborious for long lived assets for such assets the formula will be:

$$\text{Annual depreciation} = (\text{Original cost} - \text{scrap value}) \times \frac{\text{Remaining useful life}}{SYD}$$

## III. Double Declining Method

This method derives its name from the fact that a constant percentage factor is determined and applies each year to the declining balance of the asset's book value. The act provided that an accelerated rate up to twice the straight-line rate is permissible for new assets. The straight-line rate is simply the number of years in asset's useful life divided in to 100%. In our example, this would be  $100\% / 5 = 20\%$  Double the straight-line rate is than 40%. In equation form,

$$\text{Double Declining Balance Rate} = \frac{100\%}{\text{Years of useful life}} * 2$$

The simple rule for determining the annual double declining balance is to multiply the asset's book value at the beginning of the period by the constant rate (r) percentage.

### **3. Others Method**

#### **I. Annuity Method**

Under this method, it is assumed that the amount spent in the purchase of the asset is an investment, which should yield interest. The amount spent in acquiring an asset assumed as an investment and interest is charged at a certain rate on the diminishing balance of the assets and is debited to assets account and credited to interest account, which is transferred to profit and loss account. The assets are credited every year with a fixed amount of depreciation. The amount of depreciation to be charged every year is such that in spite of assets being debited with interest every year, the asset is reduced to zero or its residual value. The amount of depreciation is calculated from the ready annuity tables. The amount of depreciation will be different according to the rate of interest and the lifetime of the assets.

The net burden on the profit and loss account goes on increasing year after year. This is because depreciation that debited to profit and loss account is constant and the interest being credited goes on decreasing year after year. When additions are made to the assets account, calculations have to be revised. This method is used in the case of leases having large amounts spread over a number of years.

#### **II. Depreciation Fund Method**

This method is also known as sinking fund or amortization fund method. Under method, a fixed amount is charged as depreciation every year. It endeavors to provide the required lump sum cash at the retirement of a long-lived asset by annually setting a side an investing a fixed sum in readily realizable securities. These securities earn interest at a fixed rate and same being reinvested along with successive fixed installments of depreciation, allowed to accumulate at compound interest. The sinking fund method thus takes into account of this probable income from interest while fixing the annual depreciation and investing the same, which together with compound interest accumulated to the asset's depreciable cost by the end of its useful life.

Obviously, the fixed installment of annual depreciation is here smaller as compared to straight-line method. This method of depreciation is suitable for costly but wasting assets. The depreciation, under this method, can be calculated with the help of a sinking fund table for a particular period at a given rate of interest.

### **III. Insurance Policy Method**

In this method, instead of purchasing securities as depreciation fund method is purchased for an amount equal to the cost of replacement of assets. The insurance company agrees to pay a lump sum in return for a sum known as premium to be paid at the beginning of every year. Under this method, it is not only provides funds for the replacement but also provides security to the assets. When the policy is taken, the asset is secured against any loss. The system is applicable to costly wasting assets. The assets account remaining at its original cost.

The advantage of this method is that a define amount is received on maturity. Under depreciation fund investment, there may be loss when the investments are sold and this risk is avoided here.

### **IV. Inventory system of depreciation or Revaluation Method**

This method is adopted in case of those assets, which are of small values such as loose tools or where the life of assets can no be ascertained with certainty. In case of these assets the depreciation is charged on following basis:

Cost of the assets in use at the beginning or the year	XXX
Add: Cost of assets purchase during the year	<u>XXX</u>
	XXX
Less: Cost of assets in working condition at the end of	
Accounting year	<u>XXX</u>
Depreciation for the year charged	<u>XXX</u>

### **VI. Group Depreciation Method**

Under this method whole of the similar assets, having similar average life expectancy are put into one group. One summary account is established for each group and original cost of all assets in the group is charged to this account. Depreciation is charged for the group in total and not in individual items. The essential features of this method are:

1. Only a summary account is maintained for homogenous assets.
2. Depreciation is calculated for the group in total at a rate based upon expected average useful life and scrap values of the assets in the group.
3. The purchase of an asset in a group is debited to that group.
4. In case asset is sold the amount received on account of sale of the asset account. The difference between cost of asset and sale value is transferred to accumulated depreciation account.

### **21.19 Accounting for Non Trading Institutions**

Non-trading institution such as clubs, hospitals, libraries, temples, and professional bodies' etc. aim may not be profit making, yet it can't avoid account keeping. It must maintain proper accounts of its receipt, payment, incomes and expenses; because those who have donate money to such institution must know that their money is being used properly and fruitfully. So profit or no profit accounting is a must.

Certainly, proper accounting is essential for non-trading institutions. These concerns maintain, generally, a cashbook and ledger they prepare a summary of cash transaction appearing in the cashbook. This summary takes the form of an account known as receipt and payment account.

Such concern also prepared income and expenditure account (which is more or less on the line of profit and loss account) and the balance sheet. The day-to-day accounting consists of maintaining cashbook for recording receipt and payments and ledger for classification of transactions under proper heads. Whatever may be the accounting system such organizations prepare, at the end of year, the following key statements: -

1. Receipt and payments account
2. Income and expenditure account
3. Balance sheet.

#### **A. Receipt and Payment Account**

It is a real account. It is a consolidated summary of cashbook. It is prepared at the end of the accounting year. All cash receipts are recorded on the debit side and all

cash payments are recorded on the credit side. Cashbook consisting of entries of receipts and payments is a summary of total cash receipt and cash payments. It starts with opening balance of cash and bank and ends with closing balance of cash and bank. It does not take into account outstanding amount of receipt and payments. Receipt and payment may be of capital or revenue nature; they may relate to the current or previous year or subsequent year; so long as they are actually received or paid, they must appear in this account.

### **B. Income and Expenditure Account**

It is a nominal account. It is in the form of profit and loss account. It is concerned with only revenue item- expenses and income. It records all losses and expenses on its debit side and all incomes and gains on its credit side. The income and expenses of revenue nature is only the portion pertaining to the current years shown in income and expenditure account. In other words, incomes and expenses have to be adjusted for both outstanding and pre payments. All non-cash item, depreciation, bad etc, provision for doubtful debt are taken in to account. The different between the debit side and credit side is either surplus or deficit for the year concerned and difference will be transferred to the capital funds appearing balance sheet.

### **C. Balance sheet**

Balance sheet of non-trading concern is prepared in the usual manner and consists of all liabilities and assets on the date on which it is prepared. The excess asset over liabilities is termed capital fund or general fund. Again, the capital funds are accumulated with capital receipts, receipt that are capitalized and further increase by surplus or decrease by deficit during the year. At the inception of a non-trading concern, there will be no formal capital fund and in such case, the surplus, if any, earned during the year constitute the capital fund at the end of the year.

### **21..20 Reserve and Provision**

In actual practice the two words “Reserve” and “Provision” are used to mean the same thing no distinction is made between them. For example, very often we see the use of the terms- reserve for doubtful debts, instead of provision for doubtful debts, etc. but in fact there is a sharp distinct between these two.

## **A. Reserve**

The meanings of the words “reserve” have been considerably clarified by the companies act. It lays down- the term reserve shall not be included any amount written off or retained by way of providing for depreciation, renewals or diminution in the value of assets or retained by way of providing for known liability. It is negative definition. Reserve is an amount set aside out of profits and other surpluses, which are not designed to meet any liability, contingency, commitment or diminution in the value of assets known to exist at the date of balance sheet. The amount of reserve is an appropriation of profits. Hence profits retained in the business without having any of the attributes of a provision are to be treated as reserves. These are meant to strength the financial position of a business to meet contingencies, which are indeterminate at the time of making the reserves. The excess provision, after meeting the specific liability, is also treated as reserve and hence the excess provision is written back and credited to profit and loss appropriation account. Reserve helps the business in strengthening its financial position. It also helps to tide over the unexpected losses, without any reduction in proprietor’s capital. Reserves constitute a source of cost free capital of the business because it consists of ploughing back of profit.

## **B. Provision**

Provision means providing for possible loss or liability, the amount of which cannot be determined exactly e.g. provision of doubtful debts. Since it is not possible to determine exactly the portion of current year’s debts that will turn bad next year. It is necessary to make provision therefore. If it is possible to determine it exactly, there would have been no necessity for creating provision- the amount would be straight a way written off as loss. Provision usually means an amount written off or retained by way of providing depreciation, renewals or diminutions in the values of assets or retained by way of providing any known liability of which the amount cannot be determined with substantial accuracy. It is very clear that the sum set aside to meet unknown liability of which the amount cannot be ascertained with substantial accuracy should be treated as “accruals” or “accrued liabilities” and not the provisions.

### **2.1.21 Trial Balance**

The concept of dual aspect is one of the fundamentals to the accounting theory. The dual aspect concept lies down that every transaction has two sided effects to the extent of the same amount. For every debit entry in an account in the ledger, there is a corresponding credit entry in another account. This is the necessary rule of double entry. If, therefore at the end of certain period says a month, a statement is prepared with totals of debit and credit sides of all the accounts in the ledger these totals should tally. Such statement is called trial balance.

It is an abstract or list of the ledger accounts at a specified date, showing debit and credit totals for all the accounts. It has two money columns- one for debit amount and the other for credit amount. It is prepared periodically usually at the end of each month. Further it should be noted that a trial balance could be prepared only when the posting to the ledger is complete. Trial balance may be prepared according to either total method or balances method. In total method, total of debit sides of all the accounts in the ledger is placed in one column of the list and similarly total of credit sides of all the accounts in the ledger is placed in another column of the list then this list of total (trial balance) will be known to have been prepared. In balance method, trial balance is prepared on the basis of balances of accounts, which is based on the mathematical maxim that equals are taken away from equals, result are equal. There are different futures of trial balance and different objectives of preparing trial balance, which are present below:

#### **Feature of trial balance:**

1. This statement prepared after recording all transactions.
2. This statement prepared after finding out the differences of debit and credit side of all the ledger accounts.
3. Prepared on particular date.
4. If the debit and credit amount columns are equal; we assume that ledger accounts are arithmetically accurate.
5. Total of debit and credit amount column of trial balance must tally.
6. Difference in debit and credit columns pint out that some mistakes have been Committed.

7. Tallying of trial balance is not a conclusive proof of accuracy etc.

### **Objectives of trial balance**

- a.) To ascertain the arithmetical accuracy of ledger account.
- b.) Completion of double entry.
- c.) To help preparation of final accounts and balance sheet.
- d.) To consolidate statements of balances of accounts etc.

## **21..22 Trading and Profit and Loss Account**

### **A. Trading Account**

Trading account is the summary of those accounts, which affects the profit, or loss of a business concern. There are various accounts of revenue and expenses in the trial balance. All these accounts either increase the profit or increase losses or vice versa. In order to know the overall situation of the effect of these accounts, they are grouped at one place. The revenue items are put on the credit side, whereas, the items of expenses and losses are put on the debit side. Trading accounts includes sales, opening stock and other direct expenses as expenses or sales as income, which results gross profit. The net profit of the company is determined in two stages. In the first stage the profit or loss from core activity of the business i.e. buying, manufacturing and selling is determine. This is termed as gross profit/ loss. The word gross is used because the other incomes and expenses not directly related to the production process, which is describe by trading account. Trading account is to know in the first place, whether core activity is efficient in earning or not. Trading account simply tells about the gross profit or loss made by a business on purchasing and selling goods. It does not take in to account the other operating expenses incurred during the course of running the business.

### **B. Profit and Loss Account**

After the preparation of trading account, the next step is to prepare profit and loss account with a view to ascertain net profit or net loss during an accounting period. The profit and loss account can be defined as report that summarizes the revenues and expenses of an accounting period to reflect changes in various critical areas of firm's operations.

Trading account simply tells about the gross profit or loss, made by a business on purchasing and selling the goods. It does not take into account the other operating expenses incurred by him during the course of running the business. The balancing figure of trading account- gross profit or gross loss is transferred to profit and loss account, which is starting point of the preparation of profit and loss account. That is why trading account is treated as sub section of the profit and loss account. Profit and loss account shows the profit and loss on ordinary activities of the business. It is also contains profit or loss on sale of assets, other abnormal losses and gains but excludes the payment of tax transfer to reserve and distribution of profit. Profit and loss account also considers other income expenses related the income head and gives the net profit made or net loss suffered by a business during a particular period.

After transferring all the nominal accounts from trial balance to the profit and loss account, it is necessary to balance the profit and loss account. If credit side is more than debit side, it indicates net profit for the period. Conversely, if the debit side is more than credit side, it indicates net loss for the period. Profit and loss account contains office and administrative expenses, selling and distribution expenses, financial expenses, maintenance expenses and abnormal losses on its debit side and it contains gross profit, other income, non-trading income and abnormal gains on its credit side.

### **21..23 Balance Sheet**

A balance sheet is an accounting statement which is prepared from accounting balances in given time. It shows the financial position of a business which deals with the sources of funds and the utilization of the funds. A balance sheet shows the assets and liabilities grouped, properly classified and arranged in a specific manner.

It has already been stated that after the preparation of trial balance, some accounts are closed by transferring them to the trading account and some accounts are closed by transferring to profit and loss account. These accounts are in the nature of expenses and revenue. With the remaining accounts laying in the trial balance, which mainly represent assets and liabilities, a balance sheet is prepared to ascertain the financial position on given date. In this connection, one should remember that accounts appearing in the trial balance are to be shown either in trading account or in profit and loss account or the balance. Balance sheet contains fixed assets, current

assets, fictitious assets, long-term liabilities, current liabilities, capital fund etc. A balance sheet has two sides- the left hand side and right hand side. These two sides, however, are not comparable with the debit side and credit side of the ledger account because balance sheet is not an account. The left hand side is liabilities side and contains credit balance of all real and personal account and on right hand side which is assets side, are listed the debit balances of real and personal accounts.

## **2.2 Review of Related Studies**

An attempt is made here to review some of the researches, which have been submitted in profit planning and control as well as management accounting practice in the context of Nepal are following one by one respectively.

Bhattarai (2004) had conducted a research on the topic “Budgeting in Public Enterprises: A Case Study of Nepal Telecom”. The main objectives of her study is to examine the application of profit planning in NTC. The necessary data and other information were collected from secondary as well as primary source of data. The time period covered of the research was five years from FY 2055/56 to FY 2060/2061. In her research she had pointed out various objectives and findings. Some remarkable objectives were as follows:

- ) To examine the practice and effectiveness of profit planning in NTC.
- ) To observe the NTC’s profit planning system on the basis of budgeting system.
- ) To provide suggestion for improvement of efficient planning or budgeting of NTC’s in near future based on findings.

Some major findings are as follows:

- ) Budgets are prepared just to fulfill the formalities which are not used effectively for profit planning process.
- ) Long terms and short-term budgets are prepared but long-term budget is confined only able to the top level.
- ) The corporation is not able to maintain to proper co-ordination between various directories in regard in the goal and objectives of the corporation.
- ) The corporation fails to analyze its strength and weakness in depth because of the absences of the competitors.
- ) Lacked of skill planners and experts.

) Gaps between actual production and sales.

Tripathi (2005) had conducted a research on the topic “Profit Planning in Manufacturing Enterprises of Nepal: A Case Study of Harrishiddhi Brick and Tiles Factory”. He had focused his study in the application of profit planning in manufacturing enterprises. The time period covered by the study was 12 years from FY 2047/48 to FY 2058/59. In his research, he had pointed out various objectives and findings. Some remarkable objectives are as follows:

- ) To analyze the absolute profit and losses of HBTF.
- ) To examine and analyze the various functional budgets those are prepared by HBTF.
- ) To evaluate the variance between target and actual sales of HBTF.
- ) To assess financial performance of HBTF in terms of various financial ratios and cost structure.
- ) To examine relationship between the financial performance of the factory and the market price of the share of the factor.

Some major findings were as follows:

- ) HBTF Ltd. Prepared functional budgets like sales budget, production budget, expenses budget on annual basis. But the short-term product wise production and sales budget on monthly basis. But they are find to be far from real life situation.
- ) Marketing manager is responsible for sales forecasting in HBTF. Forecasting is said to be done keeping in view different situations and past records but it is not supported by necessary marketing strategy for promotion.
- ) The sales target set with forecasting is ambitions. Actual sales are less than that of targeted sales. There is significance difference between targeted sales and actual sales. This shows lack of promotional activities to increase sales.
- ) Although, straight line trend shows the positive sales figure for the future, it is for below the volume of sales to operate at BEP level.
- ) The poor financial performance of the factory has also lead to decline in its market price of share.

K.C (2006) had conducted research on the topic “Management Accounting Practice In The public Enterprises”. He had focused his study to examine the practice of

management accounting tools in public enterprises. Mr. K.C.'s research was based on only primary source of data. In his research, he had pointed out objectives and findings. Some of remarkable objectives are as follows:

- ) To study and examine the present practice of management accounting tools in public enterprises in Nepal.
- ) To identify the areas where management accounting tools can be applied to strength the public enterprises.
- ) To identify difficulties in applying management accounting tools in Nepalese public enterprises.
- ) To make recommendation to overcome the difficulties in applying management accounting tools in Nepalese public enterprises.

Some major findings were as follows:

- ) Different types of management accounting tools, which are tough in the colleges, are not found applied by public enterprises.
- ) Management accounting is help to managers to formulate organizational strategies as .
- ) well as policy. PE's as practicing management accounting tools such as Capital Budgeting, Annual Budgeting, Cash flow and Ratio Analysis. And not practicing management accounting tools such as Zero Based Budgeting, Activity Based Budgeting, Activity Based Costing, Target Costing and Value Engineering.
- ) In PE's hiring outside experts for carrying out different activities are almost nil because of high cost.
- ) PE's are with concept that management accounting is similar to financial accountings.
- ) Lack of information and cognizance about management accounting tools are the main factors causing problems in the application of such tools.

Karki (2006) had conducted a research study in “management accounting Practice in joint venture banks of Nepal”. He had focused his study to examine the practice of management accounting tools in joint venture banks of Nepal. Mr. Karki's research study was based on only primary source of data collection. In his research, he had

pointed out various objectives and findings. Some remarkable objectives were as follows :

- ) To study and analysis the present practice of management accounting tools in joint venture banks of Nepal.
- ) To identify the areas where management accounting tools can be applied to strengthen the banks in commercial activities.
- ) To make recommendation to overcome the difficulties in applying management accounting tools in Joint Venture Banks Of Nepal.

Some major findings were as follows:

- ) Different types of management accounting tools, which are though in the colleagues are not found applied by the joint venture banks of Nepal. So it is shows gaps between the theory and practice.
- ) Management accounting helps to managers to formulate organizational strategies as well policy for decision making.
- ) In NJB's practice of hiring outside expert almost nil. Thus it can be concluded that NJB's are in infant stage in practicing of management accounting tools. Now, here in the banks can't find management accounting experts.
- ) In NJB'S practicing the management accounting tools such as capital budgeting, Annual Budget, Ratio Analysis, and Cashflow. And not practicing management accounting tools such as zero Based Budgeting, ABC, Target Costing and Value Engineering.
- ) They are with concept that TIA is similar to financial accounting.
- ) Lack of information and cognizance about management accounting tools are the main factors causing problems in the application of such tools.

Acharaya (2006) has conducted research study on topic "Management Accounting Practice in Nepalese Public Enterprises." He had focused his study to examine the practice of management tools in NPE's. Mr. Acharaya's research study was based on only primary source of data collection. In his study, he had pointed out various objectives and findings. Some of the remarkable objectives are as follows:

- ) To study and examine the extent of practice of management accounting tools and techniques made in Nepalese PE's.

- J To identify the major difficulties for applying the management accounting tools in Nepalese companies.
- J To identify the business sectors, where management accounting tools can be applied to strengthen the PE's.
- J To make recommendations to overcome the difficulties in applying management accounting tools and techniques in Nepalese PE's and other business companies.

Some major findings were as follows:

- J Different types of management accounting tools, while are though in the colleges aren't found applied by the NPE's so, it shows the gap between the theory and practice. Managerial accounting is new discipline and still in developing stage in the context of modern business organization.
- J In NPE's not practicing management accounting tools such as Standard Costing, Cost Segregation and Allocation, ABC. The use of overall master budget was very low. ABB and ZBB were not proper practicing to prepare the budget.
- J The price strategy was completely based on cost of production and government decisions.
- J The traditional inventory valuation technique FIFO was widely practiced.
- J NPE's overall performance are fully measured by profit and loss account.
- J In NPE's past trend was most used technique to forecast the future cost and revenues.
- J Government policy was affecting to more than half of NPE's for making the account related decisions.
- J Role of management accounting tools and techniques were found negligible for making management accounting related decisions.

Shrestha (2008) has conducted a research on the topic "Management Accounting Practice In The Public Trade Companies". He had focused his study to examine the practice of management accounting tools in the public trade companies in Nepal. Mr. Shrestha's research was only based on only primary source of data. In this thesis he had pointed out various objectives and findings. Some remarkable objectives were as follows;

- J To find out the MA tools and techniques use in PTC's in Nepal.
- J To identify the process of planning, controlling, and decision making process of PTC's in Nepal.
- J To identify the management policy towards the MA tools and techniques.
- J To identify the major difficulties in using MA tools techniques in PTC's Nepal.
- J To make suggestions to overcome the difficulties in practicing MA tools and techniques in PTC's in Nepal.

Some major findings were as follows:

- J Management accounting is help to managers to formulate organizational strategies as well as policy. PE's as practicing MA tools such as Capital Budgeting, Annual Budgeting, Cash-flow and Ratio Analysis.
- J Management Accounting is help to managers to formulate organizational strategies as well as policy for decision making.
- J Lack of information and cognizance about MA tools are the main factors causing problem in the application of such tools.
- J Nepalese public trade companies were prepared budget by committee, planning department and chief of finance division mostly. It also recommended to take outside expert service for budget prepared.
- J Nepalese public trade companies should use not only profit and loss account but also use/practice standard costing, budgetary control, ratio analysis, cash flow analysis and activity based costing for evaluation of overall performance of companies at the end of the accounting year.

Dallakoti (2008) had conducted a research on topic "A study on Management Accounting Practice In civil Aviation Authority Of Nepal". He had focused his study to examine the management accounting tools practiced in CAAN. Mr. Dallakoti's research was based on primary and secondary data collection. In his research, he had pointed out various objectives and findings. Some remarkable objectives were as follows:

- J To study and examine the management accounting tools not in use.
- J To identify the difficulties in applying management accounting tools in CAAN.

- J To recommended the areas where management accounting tools can be applied to strengthen the organization.
- J To make recommendation to over come difficulties in applying MA tools in CAAN.

Some major findings were as follows:

- J CAAN was facing challenge in collecting of the overdue/outstanding revenues from airlines and other clients. A substantial proportion of due was with Nepal Airlines Corporation, NECON airs and Cosmic air etc.
- J It is the ground reality that the transportation service throughout the nation is quite difficult due to its geographical structure. So that in most part of the country the only access of transportation is possible through air services. The construction of aerodromes and its regular operation is very much expensive than others. Even in huge loss, CAAN was operating large number of airports for its public responsibilities as a service provider but due to that government was not providing any subsidies to CAAN.
- J In some cases, the aerodromes were constructed on the interest of political leaders and parties even the future perspective is very poor. Such airports were made on grants or loan from different sectors and transferred all the responsibilities to CAAN.
- J Civil aviation academy was functioning as sole institution to train manpower required for CAAN in various discipline like air traffic services, rescue and fire fighting services, radio maintenance, aviation safety, computer etc. There was no such faculty on the academy to provides trainings concentrating managerial and accounting discipline. For these trainings, huge amount was paying to outside training controls.
- J A study on management accounting practice in civil aviation authority of Nepal

Thebe (2009) had conducted a research on the topic “The Balanced Scored: measuring total business unit performance (A comparative Study of Commercial Banks).” The main objectives of her study is comparison of Nepal Investment Bank Limited and Kumari Bank Limited by using balance scored card a tool of strategic management accounting. The necessary data and other information were collected

from secondary as well as primary source of data. In her research she had pointed out various objectives and findings. Some remarkable objectives were as follows:

- ) To assess the total business performance of each company from financial, customer, internal business process and learning and growth perspectives.
- ) To compare the two companies on the basis of above four perspectives and identify the one company stronger than other on various factors.
- ) To determine the relationship between financial indicators with non-financial indicators.

Some major findings were as follows:

- ) With the help of rank correlation, it has found that the weight given by both banks on financial customer internal business process and learning and growth perspectives are highly associated.
- ) After the test of cause effect model out of nine objectives, five objectives developed by KBL have zero correlation while only one objects with NIBL has zero correlation.

Among four perspectives three perspectives favor NIBL. It shows the better performance of NIBL through BSC approach.

### **Research Gap**

Previous research conducted on accounting on profit planning and control were only on the budgeting practices in manufacturing companies. Specially in public enterprises and their findings were based mostly on secondary data. Previous researches conducted on management accounting practices were not sufficient and they were concerned specially on small and cottage industries. This study concerned with the present practice of management accounting tools in small and cottage industries in Nepal and disclosed the reason about the management accounting tools which were not practiced for planning, controlling and decision making process.

## **CHAPTER - THREE**

### **RESEARCH METHODOLOGY**

Research methodology refers to the various sequential steps to be adopted by a researcher in studying a problem with certain objects in a view. Research methodology and instruments used for each research methods are different, according to their applicability. Generally, three methods and instruments applicable to each type of research, i) purposed and data inputs ii) data requirements & analysis and iii) research out put. The basic objective of the study is to identify the accounting problem faced by small scale industries and to give an appropriate accounting model for them. To obtain the stated objective following research methodology has been used.

#### **3.1 Research Design**

Research design is the overall plan of the proposed activity, which refers where research begins and where the research ends. The research designing implies procedures, technique and tasks, which guide to evaluate the objective of the study and propounds way for research viability. It is the overall plan of purposed study to specify the appropriate research methods and procedures for obtaining specific findings, validity objectively, accurately and economically as possible. The research design followed exploratory as well as conclusive research design. Basically, this study based on descriptive survey.

#### **3.2 Population and Sampling**

The total numbers of registered small scale industries in Nepal are considered as population of this study. It is assumed that 198941 industries are in operation at the end of fiscal year 2065 in Nepal. It is very difficult to study the whole population in the present study, so this study will be based on the sample of 50 (fifty) industries.

#### **3.3 Sampling Method**

A sample is collection of items or elements from a population or universe. Hence, a sample is only a portion or subset of the universe. It comprises some observations selected from the population.

Sampling is the simply the process of learning about population on the basis of sample drawn from it. Under this method a small group of the universe is taken as the

representative of whole mass and the result are drawn. Different types of sampling techniques can be used for drawing the sample plan. Out of them, the stratified sampling method has been chosen in this study.

Stratified sampling assumes that the composition of the total population is known. Generally, in this sampling the population is divided in to sub-groups or strata and a simple random sample is taken from each such sub group. This units thus picked up from the sub groups together constitute a stratified sample. Generally when population is heterogeneous with respect to variable or characteristics under study then the technique of stratified sampling is used to obtain more sufficient and accurate result. When the characteristics of elements with in the population are diverse of heterogeneous, simple random or systematic random sampling may not give representative sample so stratified random sampling used for this study.

### **3.4 Sample Selection**

#### **34..1 Selection of Sample District**

In accordance with detailed methodology mentioned in the proposal 'Kathmandu' district had to be selected for the study.

#### **3.4.2 Selection of sample Industries**

Altogether fifty (50) industrial units were selected for the purpose of the study, which are divided into ten (10) different groups on the basis of similarities and five (5) samples from each of the following group are chosen:

- ❖ Furniture's
- ❖ Photo Studio
- ❖ Advertising Firm
- ❖ Printing Press
- ❖ Computer Sellers
- ❖ Communication Services
- ❖ Legal services
- ❖ Clinics
- ❖ Art Centers
- ❖ Garment industry

### **3.5 Data Collection Method**

Basically, this study uses primary source of information which is collected through personal contact, interview, field survey, questionnaires, observation etc but wherever necessary secondary source of information may be collected by using published as well as unpublished data sources.

The set of questionnaires had been prepared (See Appendix 1) and distributed to the entrepreneurs to collect the information. The distributed questionnaires were personally collected by the researcher frequently visiting the entire fifty services forms unless it were filled and returned. Close observation of the firm were also made while visiting them.

### **3.6 Data Analysis Tools**

The data obtained from questionnaires and observations were carefully edited and than coded in the standard code sheet. The data is presented in tabulation form as per requirement. For the purpose of data analysis and interpretation mostly percentage method had been used. In addition various statistical tools, such as (standard deviation), <sup>2</sup> (non-parametric) test etc has also been used to test the hypothesis.

### **3.7 Formulation and Test of Hypothesis**

To obtain the good result from the research some hypothesis should be tested. There are some general procedures of testing hypothesis which has been applied in this study are as follows:

#### **37..1 Formulation of hypothesis**

##### **I. Null Hypothesis:**

In this hypothesis testing a general way to start the process is 'to set the hypothesis and present it into standard way'. A statistical hypothesis, which is stated for the purpose of possible acceptance or there is no different between the sample mean and the population mean. And, this is called the Null Hypothesis and is denoted as  $H_0$ . The null hypotheses formulated in this study are:

- I. a  $H_0$  : Account keeping system is independence of academic background of the accountant.
- I. b  $H_0$  : There is no significance difference of accounting pattern between account trainees and non trainees.

##### **II. Alternative Hypothesis:**

During the process of the sample evidence may lead to accept or reject the hypothesis. If the hypothesis is accepted, that mean the hypnotized value is really true. If the hypothesis is rejected, the sample mean is different from population mean, and it is called Alternative Hypothesis and denoted as  $H_1$ . The alternative hypotheses formulated in this study are:

- II. a  $H_1$  : Account keeping system is dependent of academic background of accountant.
- II. b  $H_1$  : There is significance difference of accounting pattern between accounts Trainees and non trainees.

### 37..2 Test of Statistic

For computing an appropriate test of statistic, which is based on an appropriate probability distribution for testing, whether null hypothesis accepted or rejected.

Basically, the  $\chi^2$  statistic is tested to find significant different between actual (observed frequency) and expected frequency based on null hypothesis. It is applicable for test of goodness of fit as well as independence of fit. It is expressed as,

$$\chi^2 = \frac{(O - E)^2}{E}$$

Where, O is observed frequency or actual frequency and E is the expected frequency obtained, if the null hypothesis  $H_0$  is true.

To calculate expected frequencies denoted by E following equation can be used.

$$E = \frac{RT * CT}{N}$$

Where, RT= Row total for the row containing cell

CT= Column total for the column containing cell

N= Total number of observations

### 37..3 Decision rule

Compare the actual value of  $\chi^2$  with tabulate value of  $\chi^2$ . If calculate value of  $\chi^2$  less than or equal to tabulated value of  $\chi^2$  ( $\text{Cal } \chi^2 \leq \text{Tab } \chi^2$ )  $H_0$  is accepted. Other wise, the null hypothesis  $H_0$  is rejected.

## CHAPTER - FOUR

### DATA PRESENTATION AND ANALYSIS

#### 4.1 Introduction

Basically, this chapter has been dealt with two parts; one is presentation of data and analysis of data. The presentation of data is the basic organization and classification of the data for analysis, which make some sense to the researcher. After presenting data should be organizing & processing, require some technical methods. The activities in data processing include editing, coding and classification of information and analysis them. This chapter deals with the accounting practices, problems, inquiry about accounts training, evaluation of accounts training provided by supporting institutions. Data are presented and analysis by using table, charts etc. The researcher is trying to draw the conclusions with the help of this information. Therefore this chapter is related to processing of input (raw) data to obtain output of the study.

Various table are prepared on the basis of questionnaire used, represents the following.

#### 4.2 The Legal Status of the Enterprises

**Table No 4.1**

##### **Legal Status of Enterprises**

Classification	Number of Firms	%
1.Private Firm	21	42
2.Partnership Firm	19	38
3.Private Limited	10	20
Total	50	100

The table no 4.1 shows the legal status of the enterprises. Out of 50 number of enterprises 21(42%) were private firm, 19(38%) were partnership and 10(20%) were private limited. In comparison of them majority percentage of firm were private firm.

### 4.3 Academic Background of Enterprises

**Table No 4.2**

#### **The academic background of enterprises**

Level of Education	Number of Firms	%
1.No Normal Education	-	-
2.Up to secondary education	5	10
3.Up to S.L.C	8	16
4.Up to Intermediate	20	40
5.Up to Bachelor	12	24
6. Masters & above	5	10
Total	50	100

Above data shows the academic background of entrepreneurs. The number of entrepreneur having intermediate academic back ground is in large 20(40%) and Master degree and above is 5 (10%), where as up to Bachelor, S.L.C and Secondary level are 12(24%), 8 (16%) and 5 (10%). This shows Nepalese entrepreneurs are literature.

### 4.4 Human Resources of Book Keeping

**Table No 4.3**

#### **Book keeping personnel**

Classification	Number of Firms	%
1.Owner/Partner	24	48
2.One Accountant	12	24
3.Saperate Account department	-	-
4.More than one accountant	2	4
5.NoBook Keeping	12	24
Total	50	100

Above table shows the personnel of keeping the account records of sample small scale industry. Out of 50 sample firms 24 (48%) industries accounts are kept by the owner or partner themselves. Besides this 12 (24%) firms have hired one accountant. Similarly, 2 (4%) firms hired more than one accountant However, 12 (24%) firms have found that they are not maintaining any accounts. There is no firm which has a separate account department. Thus, majority of entrepreneurs have kept

accounts by themselves. Only few firms have hired accountants form out side for maintaining accounting transactions.

#### 4.5 Maintaining the Accounting Records

**Table No 4.4**

##### **Maintenance of accounting records**

Response	Number of Firms	%
1.Yes	40	80
2. No	10	20
Total	50	100

Above figure covers the number of firms that maintain systematic and non systematic records as well as single and double entry bookkeeping system. It is found that 40(80%) firms have maintained the books of account however 10 (20%) firms have not introduced the systematic accounting records. These firms have not maintaining the account properly.

#### 4.6 Basis of Accounting

**Table No 4.5**

##### **Basis of Maintaining the Accounts**

Basis	Number of Firms	%
1.Accural	33	66
2.Cash	6	12
3.Not Idea	11	22
Total	50	100

Above table reveals the basis of account keeping. It is found that 33 (66%) firms are keeping account under the accrual basis where as 6 (12%) firms are keeping account under cash basis. It is also observed that 11(22%) firms have not been maintaining account of their transaction. These firms replied that they have no ides how to maintain the account of their business transactions.

#### 4.7 Types or Mode of Maintaining the Accounting Records

**Table No 4.6**

##### **Types or Mode of Maintaining the Accounting Records**

Types	Number of Firms	%
1. Manual	27	54
2. Computerised	11	22
3. None	12	24
Total	50	100

From the table no 4.6, it is observed that majority of firms 27 (54%) use manual system of accounting. Beside this 11 (22%) firms use computerized accounting system where as 12 (24%) firms maintain no accounting records.

#### 4.8 System of Maintaining the Account

**Table No 4.7**

##### **Accounting System Used by Firms**

Systems	Number of Firms	%
1. Single entry	23	46
2. Double entry	15	30
3. No maintained	12	24
Total	50	100

Above table denotes that majority of firms have adopted single entry system and few have adopted the double entry system. It is observed that 23(46%) firms keep their accounts under single entry system. 15(30%) have followed double entry system however 12 (24%) firms have not maintained any accounting records. The reasons for not adopting the accounting systems are as follows:

1. Very small scale business transactions.
2. Owners themselves don't feel need of maintaining account.
3. Lack of accounting knowledge and its importance.
4. Hiring of an accountant is costly.
5. All transactions in cash only.
6. Maintaining the systematic account is a costly job.

#### 7. Problem of income tax etc.

Firms which have one or more accountants have followed the double entry of accounting system. However, most of these firms do not prepare balance sheet. The problems observed in this regard were the adjustments of the entries. Owners basically use single entry system where separate register or pages for different types of transactions are recorded. Most of the firms keep accounts only to identify the credit transactions with an objective of knowing the accounts receivable and accounts payable only.

#### 4.9 Cosign Period of Accounting

**Table No 4.8**

**Account closing period**

Closing Period	Number of Firms	%
1.Monthly	6	12
2.Quartly	-	-
3.Sami-annually	4	8
4.Annually	28	56
5.No proper account	12	24
Total	50	100

It is observed that, out of 50 firms, 28 (56%) firm close their account annually whereas 6 (12%) firm close their account monthly and 4 (8%) firms close semi annually. But, the 12 (24%) firms don't close as they maintain no proper books of accounting. Similarly, no firms were found who close their accounts quarterly. It is concluded that most of the firms close their account annually.

#### 4.10 Mode of Operating Financial Transactions

**Table No 4.9**

**Mode of operating financial transactions**

Options	Number of Firms	%
1. In Cash	22	44
2.Through Bank	8	16
3.Through Bank & Cash	20	40
4.Any other system	-	-
Total	50	100

The majority of the small scale firms operate their financial transaction in cash. Most of the firms feel so difficulty to perform the financial transaction through bank. It is observed that only 8 (16%) firm perform the transaction through bank where as 20 (40%) firms operate through bank as well as cash. Generally, small scale firm deal with bank for the purpose of depositing and withdrawing the huge amount of money and taking the loan through bank.

#### 4.11 Methods of Charging Depreciation

**Table No 4.10**

##### **Method of Charging Depreciation**

Methods	Number of Firms	%
1.Fixed installment method	6	12
2.Diminishing balance method	4	8
3.Depreciation prescribed by Income Tax	2	4
4. Others	-	-
5. No Depreciation	38	76
Total	50	100

It is observed that 38 (76%) firms do not charged depreciation .Only 6 (12%), 4(8%) and 2 (4%) firms were found charging depreciation under fixed installment, diminishing balance method and as prescribed by income tax law respectively. It indicates majority of firm are careless or not interested to charge the depreciation. Besides them some firms were found that they charged depreciation only to large plant and machinery excluding furniture and fixture. Thus total 12 (24%) firms are tried to adopt depreciation methods, whereas most of the firms don't have accounting records regarding depreciation on fixed assets. The main reason for not adopting the depreciation methods are:

1. Lack of knowledge & qualified manpower.
2. Unable to estimate the life of fixed assets.
3. Lack of knowledge of usefulness of accounting records regarding depreciation.
4. Negligence of record keeping regarding depreciation.

5. Lack of income tax act.

#### 4.12 Audits of Accounts

**Table No 4.11**

##### **Audits of Account**

Audits of accounts	Number of Firms	%
1. Yes	22	44
2. No	28	56
Total	50	100

Out of total observed 50 firms, only 22 (44%) firms' transactions were audited. But the majority of firms 28 (56%) are not audited. It found that all proprietorship firms are not audited and very few partnership firms are audited but all of the limited companies are found audited. It is also found that some firms are interested to go for audited after improving their accounting system.

#### 4.13 Satisfaction of Entrepreneurs with Existing Accounting System

**Table No 4.12**

##### **Satisfaction of entrepreneurs with existing accounting system**

Satisfaction	Number of Firms	%
1. Yes	8	16
2. No	26	52
3. Partly	16	32
Total	50	100

It is pragmatic that the majority of firms don't satisfy their existing accounting system. The number of satisfied, dissatisfied and partly satisfied firms are 8(16%), 26 (52%) and 16 (32%) respectively. This shows most of the entrepreneurs desire to improved to change their present accounting keeping system.

#### 4.14 Availability of Management Information System

**Table No 4.13**

##### **Information to management**

Provided to information to management	Number of Firms	%
1.Yes	15	30
2.No	20	40
3. Partly	15	30
Total	50	100

From table no 4.13, it is found that existing accounting system of 20 (40%) firms were not able to provided necessary information to management for decision making, whereas 15 (30%) firms were able to provide the necessary information to management. Similarly, existing accounting system of 15 (30%) firms do not provide complete information. They provide only partly information to management for decision making.

#### 4.15 Final Output of Existing Accounting System

**Table No 4.14**

##### **Final output of existing accounting system**

Final output	Number of Firms	%
1.Periodic trial balance P&L A/c and Balance sheet	10	20
2. Receipt &Payment A/C, income & expenditure A/C and Balance sheet.	13	26
3. Single entry system (i.e. separate register or pages in one register for different type of transaction.	15	30
4. No proper account.	12	24
Total	50	100

The final output of majority 15 (30%) firms were single entry system with separate register or separate pages in one register for different type of transactions whereas 10 (20%) firms were produced their periodic trial balance, profit & loss account and balance sheet. Similarly, 13 (26%) firms provide balance sheet with the

help of receipt and payment & income and expenditure account. It is found that the final out put of books maintain of those firms, which have kept their accounting transaction under double entry book keeping system, is receipt & payment account, income and expenditure account, trial balance and balance sheet whereas the firms who kept their accounting records under single entry system is separate register or separate pages in one register for different type of transaction. Likewise, the firms who don't have practice the accounting system don't have any final output.

#### **4.16 Effectiveness of Existing Accounting System**

**Table No 4.15**

##### **Effectiveness of existing accounting system**

Effectiveness	Number of Firms	%
1. Yes	14	28
2. No	18	36
3. Partly	18	36
Total	50	100

It is concluded that the existing accounting system of 14(28%) firms were display their transaction effectively and efficiency whereas existing 18 (36%) firms can not provide true information to management for decision making. However, 18 (36%) firms can partly display their transactions. It is found that majority of the firms have not perform their financial truncations effectively.

#### **4.17 Purpose of Accounting**

**Table No 4.16**

##### **Purpose of Accounting**

Purpose	Number of Firms	%
1.To know the result of operation	17	34
2. To manage the cash	8	16
3.To expansion of existing capacity	4	8
4.To make important future decision	5	10
5.To identify credit transaction	4	8
6. No clear objective	12	24
Total	50	100

Out of observed 50 firms, it is found that 17 (34%) firms were used their accounting records to know the result of operation. (i.e. P&L for the period). These firms were using their accounting information for decision making purpose. Similarly, 8 (16%) firms were used the accounting records to manage the cash position of the firm. Whereas 4 (8%) & 5 (10%) firms were kept their records to develop expansion policy and forecast the future decision respectively. In total 4 (8%) firms were used the accounting records only to know credit balance or their liabilities. Some of the firm kept their account for multipurpose use as well.

#### 4.18 How the Account Record Keep

**Table No 4.17**

##### **How the Account Record Keep**

Options	Number of Firms	%
1.As prescribed in accounting training	10	20
2.As per own requirement	16	32
3.As prescribe by income tax	2	4
4.As prescribe by GAAP	10	20
5.Not Keeping	12	24
Total	50	100

Out of observed 50 enterprises in Kathmandu valley, it found that 10 (20%) firms are maintained their accounting transaction on the basis of their accounts training. The majority of the small firms kept their accounts as per their own requirement. Like wise, 2 (4%), 10 (20%) of the firms maintained their accounts as per income tax and under the rules and regulation of GAAP respectively,

#### 4.19 Training Approach

**Table No 4.18**

##### **Training Approach**

Approaches of Training by firms	Number of Firms	%
1. Yes	28	56
2. No	22	44
Total	50	100

Above figure denotes that 28 (56%) firms have one or more supporting institutions to provided accounting training or they have positive approaches about

training. It means majority of firms have been consulting with supporting institutions about accounts training where as some firms have not any approaches regarding accounts training. It is investigated that numbers of the firms have taken accounts training from private institutions, such as training centers, computer training institutions etc. And some of them have been taking training from governmental institutions but some of them were not able to take training.

#### 4.20 Desire for Account Training

**Table No 4.19**

##### **Desire for Account Training**

Training Desire	Number of Firms	%
1. Yes	28	56
2.No	22	44
Total	50	100

It is found that 28 (56%) firms are interested in account training. Majority of the firms desire to participate in account training program. Where as, 22 (44%) firms were not interested to go to the account training. There are different reasons for not interested to participate the training presenting as below:

1. Lack of education.
2. Small transactions.
3. Lack of awareness.
4. Lack of trained man power.

#### 4.21 Duration of Training

**Table No 4.20**

##### **Duration of Training**

Duration	Number of Trainees	%
1.One Week	19	50
2.Fourteen Days	8	21
3.One Month	7	18.4
4. Above than one Month	4	10.6
Total	38	100

Out of observe 38 participants, 19 (50%) participants have taken one week training. Whereas another 8 (21%), 7 (18.4%) and 4 (10.6%) participants have taken fourteen days, one month and more than one month training respectively. This shows majority of participant have taken only short period of training program ranging in one week.

#### 4.22 Methods of Training

**Table No 4.21**

##### **Training Methods**

Methods	Number of Trainees	%
1. On the job training	8	21
2. Off the job training	20	52.6
3.Both	10	26.4
Total	38	100

Majority of participants 20 (52.6%) are trained under off the job training whereas only 8 (21%) are trained under on the job training in an organization. Total of 10 (26.4%) participant trained under both off the job training as well as on the job training methods. It is concluded that majority of the participants were trained under off the job training program.

#### 4.23 Knowledge of Accounting Before Training

**Table No 4.22**

##### **Accounting Knowledge before Training**

Knowledge	Number of Trainees	%
1. Yes	-	-
2. No	16	42
3. Partly	22	58
Total	38	100

Study found that all the participants don't have perfect knowledge regarding accounting systems and methods before training. Table no 4.22 shows 16 (42%) participant don't have any knowledge about system and methods of accounting whereas 22 (58%) participants have little knowledge about accounting system.

#### 4.24 Change in Accounting Pattern after Training

**Table No 4.23**

##### **Change in Accounting Pattern after Training**

Changed	Number of Trainees	%
1. Yes	32	84.2
2. No	6	15.8
Total	38	100

It is concluded that majority of participants (Trainee) 32 (84.2%) have changed their accounting methods and pattern after training means they have perfect knowledge after training. whereas only 6 (15.8%) trainees have not changed their behavior to keep their accounting records.

#### 4.25 Evaluation of Training

**Table No 4.24**

##### **Evaluation of Training**

Classification	Number of Trainees	%
1. Very useful	12	31.6
2. Useful	20	52.6
3. Less useful	6	15.8
Total	38	100

With regards from table no. 4.24, It is found that 12 (31.6%) trainees have felt their training were very useful whereas 20 (52.6%) and 6 (15.8%) participants perceived their training programs were useful and less useful respectively. It is concluded that the evaluation shows majority of trainees were satisfied with training program.

#### 4.26 Trainees' Educational Background and Evaluation of Accounting System

Table No 4.25

##### Trainees' Educational Background and Evaluation of Accounting System

Existing accounting system \ Educational Background	Good	Moderate	Poor	Total
1.S.L.C	-	3	4	7
2.Intermediate	2	4	3	9
3.Bachelor (Graduate)	6	8	-	14
4. Master ( Post Graduate)	8	-	-	8
Total	16	15	7	38

On the basis of education, rating of accounting system is quite regarded. Above table denotes that accountants of small scale industries, who have higher educational background and accounts training have found that they have been keeping good accounting system than others and vice versa.

#### 4.27 Justification of Data with the Test of Hypothesis

Table No 4.26

##### Test of Hypothesis on Existing Accounting System and Educational Background

Existing accounting system \ Educational Background	Good	Moderate	Poor	Total
1.S.L.C	-	3	4	7
2.Intermediate	2	4	3	9
3.Bachelor (Graduate)	6	8	-	14
4. Master ( Post Graduate)	8	-	-	8
Total	16	15	7	38

1. a  $H_0$ : Account keeping system is independence of academic background of the accountants.

1. b  $H_1$ : Account keeping system is dependent of academic background of accountants.

Here, data have found with 3 by 4 contingency table and degree of freedom (d f) = (number of row-1) (number of column-1), which denotes (r-1) (c-1) so in this problem d f = (r-1)(c-1)= (4-1) (3-1)= 6

(For Calculation see Appendix 2)

$$\chi^2 = \frac{(O - E)^2}{E} = 25.34$$

The tabulated value of  $\chi^2$  at 0.05 level of significance for 6 d.f. is 12.59

**Decision:** Since the calculated value of  $\chi^2$  (25.34) is greater than tabulated value of  $\chi^2$  (12.59) means ( $\chi^2_{\text{tab}} < \chi^2_{\text{cal}}$ ), Null hypothesis is rejected. Alternative hypothesis is accepted. i.e. Account keeping system is dependent of academic background of accountants.

2. b  $H_0$  : There is no significance difference of accounting pattern between account trainees and non trainees.

2. b  $H_1$  : There is significance difference of accounting pattern between accounts trainees and non trainees.

**Table No 4.27**

**Accounting Pattern between Account Trainees and Non-Trainees**

Accounting pattern Types	Good	Moderate	Poor	Total
1. Training	25	8	-	33
2. Non Training	-	5	12	17
Total	25	13	12	50

Here, data have found with 2 by 3 contingency table and degree of freedom (d f) = (number of row-1) (number of column-1), which denotes (r-1) (c-1) so in this problem.

$$d f = (r-1)(c-1) = (2-1) (3-1) = 2$$

(For Calculation see Appendix 3)

$$\chi^2 = \frac{(O - E)^2}{E} = 36.29$$

The tabulated value of  $\chi^2$  at 0.05 level of significance for 2 d.f. is 5.99

**Decision:** Since the calculated value of  $F_2$  (36.29) is greater than tabulated value of  $F_2$  (5.99) means ( $F_2 \text{ tab} < F_2 \text{ cal}$ ), Null hypothesis is rejected. Alternative hypothesis is accepted. i.e. there is significance difference of accounting pattern between accounts trainees and non trainees.

#### 4.28 Finding of the Study

The analysis and the review of literature co-operate to researcher that some of the major findings which marked in this paper are given below.

1. It is found that majority of small Scale industries of the research area have not followed the proper accounting records to make future decision. But, they were merely maintained their account to know their own investment and liabilities.
2. Researcher explained and displayed an outcome of the research is that most of small scale industries owner have no knowledge about the well being accounting system. The cause of the problems of an accounting system:
  - A. Primary problem regarding the systematic record keeping are:
    - i. Lack of enhancement of qualified, competent, experiences, energetic, practical Manpower
    - ii. Owner has additional cost for keeping systematic accounting system.
    - iii. Recording of major transactions only problem is depreciation.
    - iv. Dubiousness in recording the various transactions like contra entry etc.

In the other hand, implication of computer and computerized problems vehemently keep the poor accounting system, Software problems, insecure of data in the context of our country.

3. Entrepreneurs were interested to keep the account themselves instead of educated accountants.
4. Not, all but few entrepreneurs have systematically audited of their accounts.
5. All Entrepreneurs are literate however they have not scientific knowledge about accounting system of small scale industries.
6. Generally, entrepreneurs were closed their account annually but most of them followed manual record and they were maintained their account in accrual basis

rather than cash basis. But, in practical they were kept their financial transactions in cash.

7. Majority of the firms are dissatisfied with their existing account keeping system.
8. Most of the small scale industries were not set their standard targets and no Planning and objectives were made for the improvement of their business firms.
9. Basically, majority of the firms were applied an autocratic style of leadership. They were not interested to improve their style of leadership and communication system.
10. According to the double entry system of book keeping users, the following feature should be obtained.
  - Twofold effects
  - Equal effect
  - Change in ownership.
11. Some of the entrepreneurs were reflected their views in favor of double entry systems which are as follows:
  - Double entry system helps to keep the records of personal as well as impersonal monetary transaction of business.
  - It helps to know the exact amount of debtors and creditors.
  - It helps to prepare trial balance for checking arithmetic accuracy of the records of transaction and to reveal the errors.
  - Double entry book keeping helps to prevent the errors as well as discover the fraud and manipulations.
  - It helps to find accurate operating position and result of the firms.
  - It helps to provide the management information for decision making.
12. Regarding the single entry book keeping system feature, system users said that system is suitable for the small scale industries like sole trading where the operation transactions were directly control by owners. Small scale industries were maintained personal account rather than real account. So this system does not have uniformity because naturally it is flexible.

13. The user of the single entry system said that it is economic, simple account keeping system. It is also suitable for small scale firms who wants to keep their transactions in secrete.
14. Some of the entrepreneurs also suggest the draw backs regarding single entry system which are:
- Incomplete and unscientific
  - Financial position of firm can not be ascertained.
  - Arithmetical accuracy can not be tasted.
  - Possibility of committing frauds, errors and manipulations
  - Control on assets is very poor.

## **CHAPTER - FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Summary**

This study is intended to focus on accounting system used by Small Scale services industries attempt to identify the accounting problems faced by small scale firms to give accurate accounting model to them. The study of small scale firms is in shadow because there is no earlier study about the accounting system of small scale industries. Therefore, the study lacks the review of previous related studies in this scope.

The study primarily based on the sample of 50 different services firms, which have been selected using the stratified sampling method. Mostly, percentage method has used for analyzing the data and Chi-Square Test (Non-Parametric Test) is applied to test the hypothesis.

It is investigated that the levels of accounting system practice in small scale industries have lack of some good quality. They have been suffering from various accounting problems. Government of country also has no lunched any extensive, qualitative and liberal orientation program for reforming accounting system in small firms. Numbers of ancillary intuitions have been providing accounting training for entrepreneurs, which becomes auxiliary to increase the scientific, practical knowledge of accountant of entrepreneurs but most of them comment about the lack of follow up system. Most of the firms are intrusively running. Majority of the firms are interested to undergo account training program to change their existing accounting system in to systematic system so, as to use accounting information in decision making process. Major supporting institutions are Industrial Enterprises Development Institutions (IEDI), Federation of Cottage and Small Industries (FNCSI), Women Entrepreneurs Association of Nepal (WEAN), Training for Employment, and private training intuitions etc. but these intuitional supporting training also can not be successful to give the sense of quality system as per the demand and essentiality of contemporary period. So, various firms are dissatisfied with their existent system. Among the studied institutions few firms only sufficiently, effectively display their existing accounting transactions. It is known that, majority of firms prefer transaction in cash. They feel hard to perform all financial transaction through bank. Many small business

firms primarily use single entry book keeping system instead of double entry of journal and ledgers. Majority of entrepreneurs keep account themselves. Only a few firms have hired accountants for maintaining and keeping systematic accounting records. Those firm, which have one or more hiring accountant have maintained systematic records based on double entry system. Majority of firms are careless on charging depreciation, it is found that all proprietorship firms are not audited and vary few partnership firms are audited. Only the limited companies are found audited. It is found that most of the entrepreneurs are unknown about the income tax act but few of them have little bit knowledge about the income tax act even though they have not implement the act. It is crystal clear that they have no interest and careless about the act. Numbers of reason are there behind the failure of small scale industries. Competent, qualified and educated people's role is omniscient for the smooth running of the small industries but in the context of our country, there is lack of so-called people therefore the cottage and small scale industries are not extended in proper way.

## **5.2 Conclusion**

As per the analysis and interpretation of data following conclusion have been drawn:

1. Most of the small scale business are using single entry book keeping system in stead of double entry book keeping system.
2. Most of the small business firms have maintained their transactions on cash basis. It means they have kept the record of cash transaction only.
3. Most of small firms are lacking fundamental concept of accounting.
4. Numbers of small business firms have not preferred to prepare financial records in details.
5. No profit & loss account and balance sheet are prepared because of incomplete and unqualified information.
6. Government has no scheme in lunching the extensive training program to reform the accounting system of small firms.
7. Extensive training and vocational education are essential to keep accounting record scientifically.
8. Most of the entrepreneurs have faced the problems of accounting principle, so it is necessary to provide short term accounting training.

9. Volumes of firms are interested to undergo account training program to change their attitude as well as existing accounting system using by them.

### **5.3 Recommendations**

Due to lack of sufficient fund or to save the cost most of the small scale industries were kept their account by using single entry system which gives poor information for decision making. Generally, they could not follow complete accounting cycle so all of them are unable to get more information regarding financial position of the organization which hampers to give final output. Considering all of those weaknesses a new approach of accounting system is recommended with their controlling mechanism.

#### **1. Recommendation for Sole Proprietorship Small Business**

Most of the small business firms prefer fewer records, to save the cost and time of double entry system. The complete book keeping cycle is not been used. Considering this view a new approach of accounting system has been recommended for small scale service industries which include journal, ledger, profit & loss account and balance sheet as given below:

#### **Recommendation to prepare journal, ledger, profit & loss account and balance sheet:**

It is recommended that every small scale firm should initially record their accounting transaction by using journal entry which is also called original entry. For this, firm can use a book of original entry instead of using several journal papers. It saves time, energy, labor and cost. In journal entry, they have to record their transaction in a chronological order denoting the names of accounts that are to be debited and credited, along with the amount of debit and credit. Supplementary information about transaction, if any, should also be recorded. It is also recommended that no entry can be made in a ledger account unless it has been recorded in the book of original entry. In brief to prepare the journal entry of transaction, firms can follow the following rules:

- i) If assets and expenses are increased it should be posted in Dr side of journal.
- ii) If capital, liabilities and income are increased it should be posted in Cr side of journal and vice versa.

General format of books of journal as follows:

### Original Books of Journal Entry

Date	Particular	L/F	Dr.(Amt)	Cr. (Amt)

Following rules should be followed for journaling the transaction:

- i. The date of transactions is written in the date column.
- ii. The name of account to be debited is written first in particular column and amount of debit is entered in the same line of the debit column. Then the name of account to be credited is written in second line and the amount credited entered on same line in credit column.
- iii. A brief explanation of the transaction begins on the line immediately below the credit line of entry.
- iv. The ledger folio number column just to the left side of the debit money column is left blank at the time of making journal entry. When the debits and credits are later transferred or posted to ledger accounts, the number of ledger accounts (page number of ledger) will be listed in this column.

When journals are being prepared, it is ready for posting into ledger accounts. Ledger is a collection of all the account debited or credited in the general journal or various special journals. At the time of posting the journal in to ledger following steps are recommended.

- i. Locate the corresponding account debited or credited as entered in journal in the ledger.
- ii. Enter the date of transactions in date column.
- iii. Each debit entry in journal is posted to the debit side and each credit entry in journal is posted to the credit side of respective account.
- iv. Enter the page number of journal in folio number & enter in the corresponding column, the amount being debited or credited to ledger account.

The pro forma format of ledger account is as follows:

.....A/C

Dr.

Cr.

Date	Particular	L/f	Amt.	Date	Particular	L/f	Amt.

After posting each transaction in ledger account, trial balance should be prepared to verify correctness of transactions which includes cash balance, bank balance, other assets, liabilities, capital, income & expenses. Trial balance helps to find out the arithmetic accuracy as well as the verification of transactions. It also helps to prepare the profit & loss account and balance sheet as well. In trial balance, all the assets and expenses items with its corresponding amounts are presented in debit side and liabilities, capital, income items with these corresponding amounts are presented in credit side. The total balance of debit side must be equal with credit side of the trial balance.

## 2. Book keeping for Partnership Small Business

The book keeping for a partnership small business is same as that of a sole proprietorship business. But the difference is that capital accounts and drawing accounts of each partner are kept separately. Separate capital accounts of each partner are credited with the initial contribution made by them. Any subsequent investments are also credited. Capital accounts are debited with each withdrawal or drawings. For personal withdrawal of cash or goods the separate drawing account are debited. At the end of fiscal year profit from operation is credited to capital account and loss, if any, is debited.

The opening entry for the new partnership business is as follows:

### When investment made by partner

Cash A/C Dr

Assets (e.g. furniture, equipment etc) A/C Dr

To, Partners capital A/C  
(Being contributed by the partner....)

**When cash or goods are withdrawn by a partner**

a) If fixed capital accounts are prepared

Partners' drawing's A/C Dr  
To Cash or goods A/C  
(.....Withdrawing)

b) If fluctuating capital account is used

Partner's capital A/C Dr  
To, Cash or goods A/C  
(Withdrawn made by.....)

Partners share profit and loss of the firm according to the provisions made in the partnership deed. In the absence of such provision, profit or loss is shared equally. The journal entries to transfer the profit or loss to each partner's drawing accounts are as follows:

**General journal**

When there is profit:

Profit & loss account A/C Dr.  
To, partner's drawings or (partner's capital) A/C

When there is loss:

Partner's drawing or (partner's capital) A/C Dr  
To, Profit & loss A/C

**3. Book keeping for a Small Corporation**

The book keeping for a small corporation has been recommended as that of a proprietorship concern except the capital accounts and dividend. The corporation use one separate account called capital stock account. The amount of capital stock held by each stockholder is recorded in subsidiary capital ledger. The following summary clarifies the entries of capital stock.

**When shareholder purchase shares**

Cash A/C Dr.  
To, Share capital A/C  
(Being .....number of shares purchased by...)

The profit of corporation is shown in a surplus account and not in the capital stock account. The capital stock accounts remain constant at the original figure unless the original capital stock is increased or decreased. At the end of the fiscal year, the balance in the profit and loss account is close and transferred into a surplus account. The journal entry of this transaction would be as follows:

Profit & loss A/C Dr  
To, Surplus A/C  
(Transferred the net profit to the surplus account)

The board of directors may pay out all or portion of surplus account to stockholders in the form of dividends. It is transferred to dividends payable account, and appears as liability of the firms. The entry of this transaction is as follows:

Surplus A/C Dr.  
To, Dividend payable A/C  
( Rs..... Per share dividend declared)

4. To the small firms who follow the single entry system, it is recommended that statement of affairs should be prepared to ascertain the profit and loss as well as to know the financial position of the firms. (For format see Appendix 4.)

For the preparation of statement of affairs, information regarding assets and liabilities are collected from following sources.

- Information regarding assets are collected from following sources:

1. Cash balance from cash book maintained under single entry system or by physical count of cash.
2. Bank balance can be obtained from cash book or bank account.
3. Fixed assets record can be obtained from list of fixed assets and their value should be collected from purchase bills. Depreciation of these assets should be calculated and deducted from gross assets. Applicable Depreciation rate chargeable to each assets have prescribe in income tax act 2058.
4. The total amount of debtors should be arrived by adding the individual debtor's balances.
5. Receivable is also determined by analyzing the debtors balance.

- Information's about the liabilities are collected from the following sources:

1. Amount of loan can be determined with the help of loan documents or ledger accounts.
2. Overdraft balance can be obtained by consulting related bankers.
3. Amount of creditors should be determined by purchase bill and consulting with individual creditors.

4. Capital should be determined by deducting total liabilities from total assets.
5. Amount of outstanding expenses and advance income should be determined by memorizing the transactions or with the help of previous records.

After finding all of those transactions profit of the firm can be ascertained by using following equation.

$$\text{Profit} = \text{Ending capital} + \text{Drawing during the year} - \text{Opening capital} - \text{Additional capital introducing during the year}$$

5. Those firms, who use double entry book keeping system, it is recommended them to prepare receipt & payment, income & expenditure account, profit & loss account and balance sheet. Final accounts help to know the financial position of the business firm, and to forecast future plan and program. Some Pro forma formats of the financial statements used by Clinic & law firm are presented in Appendix 5.

## **6. Control of small business**

To build the good accounting system, control mechanism or internal control procedure should be maintained by business firms. In small industries cash and inventory management may involve high cost. So it is recommended that firm should be very careful to control of cash as well as inventory. Embezzlement of cash as well as purchase should be controlled. Firms should follow the following mechanisms to maintain control on these items.

1. Only minimum amount of cash should be in hand at all times.
2. All receipts should be accounted and deposited daily in a bank and all amount of cash disbursement or payment should be made by cheque. For effective control of cash, cash budget should be prepared.
3. For inventory control, purchase and issued system should be controlled by following purchase order cycle and maintaining stock ledger.

There are some controlling mechanisms to control the overall financial aspects of the firms presented as follows:

- Budgetary control
- Break even analysis
- Control reports
- Ration analysis
- Internal audit
- Personal visit

Generally, control aspects are based on mathematics statistical and accounting calculation. Quantitative tools of management such as operation research, linear programming, program evaluation and review technique (PERT), critical path method (CPM) are used to make decision.

7. It is recommended that all the small entrepreneurs should demand to lunch the special accounting training programs, principles and methods to create account base market, such training helps to increase the accounting knowledge among the small entrepreneur including their employees.
8. It is recommended that, entrepreneur should participate compulsorily in the accounting base training organized by the recognized organizations to improve the quality in accounting practice. They should also resound contact with them even after training program to enable themselves to clear the minor practical problem faced by entrepreneurs.

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M .Main product/service.....

N. Types of employees	<u>Number</u>	<u>%</u>
1. Highly skilled	( )	( )
2. Skilled	( )	( )
3. Semi skilled	( )	( )
4. Unskilled	( )	( )

O. Status of employees'	<u>Number</u>	<u>%</u>
1. Full timer	( )	( )
2. Part timer	( )	( )
3. Outsider/ hired	( )	( )

2. Do you maintain accounting records in your organization?

- I. Yes ( )
- II. No ( )

2. A.)If not, why don't you maintain records of your business transaction?

- I. I don't felt necessary. ( )
- II. I have no qualified accountant. ( )
- III. Tax problems to maintain the accounts. ( )
- IV. Any other please specify.....

3. Who maintained the accounting records in your organization?

- I. Owners/ partner ( )
- II. One accountant ( )
- III. Separate account department ( )
- IV. More than one accountant ( )
- V. No one. ( )

4. Who are interested to know the financial position of your organization?

- I. Owners ( )
- II. Suppliers ( )
- III. Government ( )
- IV. Creditors ( )
- V. All of above ( )

5. Which accounting system does your firm use?

- I. Single entry system ( )
- II double entry system ( )

6. How the account is maintained?

- I. Manual ( )

II. Computerized ( )

II. Not maintained ( )

7. What is the basis of maintaining accounts?

I. Cash basis ( )

II. Accrual basis ( )

7. A) If you use cash basis, please give the reason why you use cash basis?

.....  
.....

7. B.) If you use accrual basis, Please give the reason why you use accrual basis?

.....  
.....

8. Which principle and concept generally used to maintain the account?

I. Money Measurement Concept ( )

II. Business Entity Concept ( )

III. Going Concern Concept ( )

IV. Dual Aspect Concept ( )

V. Realization Principle ( )

VI. Matching Principle ( )

9. What is the basis of closing account?

I. Periodic basis ( )

II. Transaction basis ( )

10. What is the method of charging depreciation in your organization?

I. Fixed installment method ( )

II. Diminishing balance method ( )

III. Sum of year digit method ( )

IV. Depreciation fund method ( )

10. A). Do you know that Income Tax act does not recognize the above methods of depreciation.

I. Yes ( )

II. No ( )

10. B) If yes, why you have followed this method?

.....  
.....

11. What accounting books are maintained in your organization?

I. Vouchers (Types of voucher used) ( )

II. Subsidiary books

- a. Cash book ( )
- b. Purchase book ( )
- c. Sales book ( )
- d. Account receivable ( )
- e. Account payable ( )
- f. Purchase return ( )
- g. Sales return ( )
- h. All of above ( )

12. How do you select the books of account maintained in enterprises?

- I. As prescribed in the accountant training ( )
- II. As per own requirement or advice delay consultant. ( )
- III. As prescribed by the Income Tax ( )
- IV. As prescribe by a GAAP ( )

13. What is the final output of the books maintained in your organization?

- I. Periodical trial balance ( )
- II. Profit and loss account ( )
- III. Balance sheet ( )
- IV. Receipt and payments account ( )
- V. Book kept on single entry system with separate registered. ( )

14. Why accounting records are maintained in your organization?

- I. To know result of operation ( )
- II. To manage the cash. ( )
- III For expansion of existing capacity ( )
- IV. To convert the business in to large scale of enterprises. ( )
- V. To make important future decisions facing threats grabbing opportunity. ( )

15. What are the major items of fixed assets in your organization?

- I. Land and building ( )
- II. Plant and machinery ( )
- III. Furniture ( )
- IV. Vehicles ( )
- V. Others ( )

16. Do the existing accounting system provide sufficient and reliable information in your organization?

- a) Yes ( )                      b) No ( )                      c) Partly ( )

16.A.) If not, what type of accounting system you have felt need?

- a)  
b)  
c)  
d)

17. Are the supporting institution provides the support in your organization?

- a) Yes ( )                      b) No ( )                      c) Partly ( )

18. If yes, in which sector they support?

.....  
.....

19. Are the accounts audited in your organization?

- a) Yes ( )                      b) No ( )

19. A). If not, what are the problems in auditing?

.....  
.....

19.B.) How these problems could be removed?

.....  
.....

20. What are the major threats faced by your organization for implementing existing accounting system?

.....  
.....

**20.A.) In your opinion, how these threats could be removed?**

.....  
.....

**21. Have your organization approached to conduct a systematic training program to staff members?**

- a) Yes ( )                      b) No ( )

21.A.) If not, why not approach?

.....

- .....
- 21.B).If yes, what are the methods of training?
- a) On the job training ( ) ( b) Off the job training ( ) c) Both ( )
23. Generally, What is the duration of the training?
- a) One week ( ) b) fourteen days ( ) c) One month ( ) d) Above ( )
24. To what extent the training is effective in your organization after and before training?
- .....
25. What is the mode of operation financial transaction?
- a) Through bank ( ) b) In cash ( ) c) Other, in any ( )
26. Are you satisfied with your account keeping system?
- a) Yes ( ) b) No ( ) c) Partly ( )
- 26.A.) If not, please give the reason for your dissatisfaction?
- .....
- 26.B) If not, Give the appropriate suggestions to make account keeping system effective.
- .....
27. What are the features in an accounting you desired most?
- .....

### Appendix-2

Calculation of expected frequencies (E) under I (a) null hypothesis ( $H_0$ ) and <sup>2</sup>

<b>R, C</b>	<b>O</b>	<b>RTxCT/N= E</b>	<b>O-E</b>	<b>(O-E)<sup>2</sup></b>	<b>(O-E)<sup>2</sup>/E</b>
1,1	0	2.95	-2.95	8.69	2.95
1,2	3	2.76	0.24	0.06	0.02
1,3	4	1.29	2.71	7.35	5.70
2,1	2	3.79	-1.79	3.20	0.85
2,2	4	3.55	0.45	0.20	0.06
2,3	3	1.66	1.34	1.80	1.09
3,1	6	5.89	0.11	0.01	0.00
3,2	8	5.53	2.47	6.12	1.11
3,3	0	2.58	-2.58	6.65	2.58
4,1	8	3.37	4.63	21.45	6.37
4,2	0	3.16	-3.16	9.97	3.16
4,3	0	1.47	-1.47	2.17	1.47
					<b>25.34</b>

### Appendix-3

Calculation of expected frequencies (E) under II (a) null hypothesis ( $H_0$ ) and <sup>2</sup>

<b>R, C</b>	<b>O</b>	<b>RTxCT/N= E</b>	<b>O-E</b>	<b>(O-E)<sup>2</sup></b>	<b>(O-E)<sup>2</sup>/E</b>
1,1	25	16.50	8.50	72.25	4.38
1,2	8	8.58	-0.58	0.34	0.04
1,3	0	7.92	-7.92	62.73	7.92
2,1	0	8.50	-8.50	72.25	8.50
2,2	5	4.42	0.58	0.34	0.08
2,3	12	4.08	7.92	62.73	15.37
					<b>36.29</b>

### Appendix-4

#### Pro forma for Ruling for statement of affairs for small business

Statement of Affairs at.....

<b>Liabilities</b>	<b>Amount</b>	<b>Assets</b>	<b>Amount</b>
Sundry creditors	xxxxx	Cash balance	xxxxx
Long & short term loan		Bank balance	xxxxx
Bank overdraft	xxxxx	All fixed assets	xxxxx
Bills payable	xxxxx	Advance expenses	xxxxx
Other liabilities	xxxxx	Outstanding income	xxxxx
Capital- (Bal. Figure) (Excess of assets over liabilities)	xxxxx	Other assets	xxxxx
<b>Total</b>	<b>xxxxxxx</b>	<b>Total</b>	<b>xxxxx</b>

### Appendix-5

#### Format of receipt and payment account (Clinic)

Receipts and payments Account

Dr.	For the period ending...	Cr.
-----	--------------------------	-----

Receipts	Amount	Payments	Amount
To, Balance b/d		By, Balance b/d (Bank O/D)	XXX
Cash	XXX	By, Purchase of medicine	XXX
Bank	XXX	By, Salaries and wages	XXX
To, Cash in hand	XXX	By, Insurance	XXX
To, Consultation fees	XXX	By, Books and periodicals	XXX
To, Sale of Medicine	XXX	By, Bank charges	XXX
To, Fees from operation		By, postage and telegram	XXX
To, balance c/d (Bank O/D)	XXX	By, water and electricity	XXX
	XXX	By, Repair and maintenances	XXX
		By, Traveling & conveyance	
		By Balance c/d	XXX
		Cash	
		Bank	XXX
		Fixed deposit	XXX
			XXX
			XXX
			XXX
<b>Total</b>	<b>xxxxxxx</b>	<b>Total</b>	<b>xxxxx</b>

**Pro forma income & expenditure account for small business from (Clinic)**

Income and Expenditure Account

Dr. For the period ending on... Cr.

Expenditure	Amount	Income	Amount
To, Medicines(used)	XXX	By, Fees	XXX
Opening stock	XXX	Add: accrued	XXX
Add: purchase	XXX	By, Sale of medicine	XXX
Less: closing stock	(XXX)	By, gift from patients	XXX
To, Salaries an wages	XXX	By, Sundry receipt	XXX
To, Rent, rates and taxes	XXX	By Deficit (excess of	XXX
To, Depreciation	XXX	expenditure over	
To, Postage and telegram	XXX	income)	
To, Electricity and water	XXX		
To, Journal & periodicals	XXX		
To, Traveling & conveyance	XXX		
To, Sundry expenses	XXX		
To, Surplus (excess income over expenses)	XXX		
<b>Total</b>	xxxxxx	<b>Total</b>	xxxxxx

**Pro forma profit & loss account for small firm (Law Firm)**

Profit & Loss Account

Dr. For the year ending..... Cr

Particulars	Amount	Particulars	Amount
To, Gross Loss b/d	XXX	By, Gross profit b/d	XXX
To, Salary	XXX	By, Fee Collected	XXX
To, Rent rates and taxes	XXX	By, Sale of old law books	XXX
To, Postage and telegram	XXX	By, Gift from client	XXX
To, Legal charge	XXX	By, Net loss	XXX
To, Telephone expenses	XXX		
To, Insurance premium	XXX		
To, Entertainment expenses	XXX		
To, Repairs and maintenance	XXX		
To, Depreciation	XXX		
To, Interest	XXX		
To, Traveling & conveyance	XXX		
To, Bank charges	XXX		
To, Office expenses	XXX		
To, Subscription to bar council	XXX		
To, Provision for accrued fee	XXX		
To, Advertisement	XXX		
To, Discount	XXX		
To, Net profit	XXX		
<b>Total</b>	XXXX	<b>Total</b>	XXXX

**Pro forma Balance Sheet of small business firm**

Balance sheet

As on.....

Liabilities	Amount	Assets	Amount
<i>Current liabilities:</i>		<i>Current Assets:</i>	
Bills payable	XXX	Cash in hand	XXX
Creditors	XXX	Cash at bank	XXX
Outstanding expenses	XXX	Bills receivable	XXX
Unearned income	XXX	Sundry debtors	XXX
Bank overdraft	XXX	Closing stock	XXX
Short term loan	XXX	Prepaid expenses	XXX
<i>Fixed Assets:</i>		Accrued income	XXX
Long term loan	XXX	<i>Fixed assets:</i>	
Share capital	XXX	Furniture and fitting	XXX
Net Profit	XXX	Vehicle	XXX
Less: drawing	<u>XXX</u>	Plant and machinery	XXX
Reserves	XXX	Building	XXX
Total	XXXX	Total	XXXX