

Accounts from Incomplete Records

Kerala · Class 11 · Accountancy — exam notes

Most small Kerala businesses — the neighbourhood provision store, the small textile shop — never write a full journal and ledger. They keep a cash book, a list of debtors and a note of creditors. This chapter shows how profit and financial position are still worked out from whatever records exist, using a STATEMENT OF AFFAIRS and one formula: $\text{Profit} = \text{Closing Capital} - \text{Opening Capital} + \text{Drawings} - \text{Additional Capital}$.

Key terms & definitions

Incomplete records

A system in which the full double entry is not maintained. Some accounts (usually cash and personal accounts) are kept, while real and nominal accounts are largely absent.

Single entry system

The popular name for incomplete records. It is not a system at all but a mixture of double entry, single entry and no entry.

Statement of Affairs

A statement listing all known assets and liabilities on a date, the difference being the owner's capital. It looks like a Balance Sheet but rests on estimates, not on a trial balance.

Capital (net worth)

Total assets minus total liabilities on a given date. Found as the balancing figure of a Statement of Affairs.

Opening capital

The owner's net worth at the beginning of the year, from the opening Statement of Affairs.

Closing capital

The owner's net worth at the end of the year, from the closing Statement of Affairs.

Drawings

Cash or goods withdrawn by the owner during the year. They reduce closing capital, so they must be ADDED BACK when computing profit.

Additional capital

Fresh money brought in by the owner during the year. It raises closing capital without being profit, so it must be DEDUCTED when computing profit.

Net worth method

The method of finding profit by comparing opening and closing capital, adjusted for drawings and additional capital. Also called the statement of affairs method.

Conversion method

The fuller approach of reconstructing complete double-entry records from the incomplete data, so that regular final accounts can be prepared.

Missing figure

An unknown amount — such as credit sales or drawings — found as the balancing figure of a reconstructed account.

Net worth

Another term for capital: what the business would be worth to the owner after paying off all outside liabilities.

Why incomplete records exist

- A full double-entry system needs time, training and staff that many small traders do not have.
- So they keep what is practical: a cash book, a list of customers who owe money, and a note of what is owed to suppliers.
- Real accounts (assets) and nominal accounts (expenses and incomes) are usually missing altogether.
- Because there is no complete ledger, NO TRIAL BALANCE can be prepared — and without a trial balance there are no ordinary final accounts.
- The accountant's task is therefore to extract profit and position from whatever exists.

Features and drawbacks of incomplete records

- FEATURES: incomplete, unsystematic, varies from business to business, and mixes double entry with no entry at all.
- Personal accounts and cash are usually maintained; nominal and real accounts are not.
- DRAWBACK: arithmetical accuracy cannot be checked, because no trial balance can be drawn up.
- DRAWBACK: true profit cannot be found in the normal way, and the exact financial position is uncertain.
- DRAWBACK: it is difficult to detect fraud and errors, hard to obtain a bank loan, and the figures may not satisfy the tax authorities.
- Comparison between years is unreliable, since the basis may change.

The Statement of Affairs

- It is a one-page list: all known ASSETS on one side, all known LIABILITIES on the other.
- CAPITAL is the difference: $\text{Capital} = \text{Assets} - \text{Liabilities}$. It is the BALANCING FIGURE, not a figure taken from the books.
- One is prepared at the START of the year and another at the END.
- Assets are often estimated — the value of stock, for example, may be counted or guessed.
- The statement gives net worth on a date; it does not by itself give profit.

Statement of Affairs versus Balance Sheet

- SOURCE: a Statement of Affairs is built from incomplete records and estimates; a Balance Sheet is prepared from a trial balance under full double entry.
- CAPITAL: in a Statement of Affairs capital is the BALANCING FIGURE; in a Balance Sheet capital comes from the Capital Account itself.
- RELIABILITY: a Statement of Affairs is only approximate; a Balance Sheet is precise and verifiable.
- PURPOSE: a Statement of Affairs is used to FIND capital; a Balance Sheet is used to SHOW the financial position.
- They are NOT two names for the same thing — saying so in an answer loses the mark.

The profit formula — and why each term behaves as it does

- $\text{PROFIT} = \text{CLOSING CAPITAL} - \text{OPENING CAPITAL} + \text{DRAWINGS} - \text{ADDITIONAL CAPITAL}$.
- The rise in capital over the year is the starting point, because profit is what makes capital grow.
- DRAWINGS are ADDED BACK because they reduced closing capital even though they were not a business loss. Without adding them back, profit would be understated.
- ADDITIONAL CAPITAL is DEDUCTED because it raised closing capital without being earned. Leaving it in would overstate profit.
- If the answer is negative, the business made a LOSS.
- Remember the direction by logic, not by rote: anything that raised capital WITHOUT being profit is taken out; anything that lowered capital WITHOUT being a loss is put back.

The three steps in practice

- STEP 1: prepare the OPENING Statement of Affairs → opening capital.
- STEP 2: prepare the CLOSING Statement of Affairs → closing capital.
- STEP 3: apply the profit formula, adjusting for drawings and additional capital.
- Always show each step separately in the exam — method marks are awarded for the two statements even if the final figure slips.
- Finally, VERIFY: $\text{Opening Capital} + \text{Profit} - \text{Drawings} + \text{Additional Capital}$ should equal Closing Capital.

Worked example — Sanjay Kumar's grocery, Kochi

- Opening capital on 1 April 2023 (from the Statement of Affairs) = ₹80,000.
- On 31 March 2024: total assets ₹1,40,000 and total liabilities ₹30,000.
- CLOSING CAPITAL = ₹1,40,000 – ₹30,000 = ₹1,10,000.
- Drawings during the year = ₹24,000. No additional capital was introduced.
- PROFIT = ₹1,10,000 – ₹80,000 + ₹24,000 = ₹54,000.
- VERIFY: Opening ₹80,000 + Profit ₹54,000 – Drawings ₹24,000 = ₹1,10,000, which equals the closing capital ✓
- Note how the answer would have been only ₹30,000 — badly understated — had the drawings been ignored.

Working backwards

- The examiner may give the PROFIT and ask for a missing figure — drawings, additional capital, or opening capital.
- Simply rearrange the same formula. For example: Drawings = Profit – Closing Capital + Opening Capital + Additional Capital.
- Or reconstruct the Capital Account: Opening Capital + Additional Capital + Profit – Drawings = Closing Capital, and solve for the unknown.
- Missing figures such as credit sales or total debtors can likewise be found as the balancing figure of a reconstructed Total Debtors Account.
- Being able to work in either direction is explicitly expected at Plus One level.

How reliable is the answer?

- The profit figure is only as good as the list of assets and liabilities behind it.
- If a supplier's invoice was never recorded, liabilities are understated → closing capital and profit are both OVERSTATED.
- If closing stock is counted carelessly, the error flows straight into profit.
- Estimated values for stock or fixtures introduce further approximation.
- For this reason the result is an ESTIMATE of profit, not a precise measurement — say so if asked to comment on reliability.

Three misconceptions to clear

- WRONG: 'A Statement of Affairs is just another name for a Balance Sheet.' They differ in source, in how capital is arrived at, and in reliability.
- WRONG: 'Drawings should be SUBTRACTED when calculating profit because they reduce capital.' This is the most common error in the chapter. Drawings are ADDED BACK, precisely because they reduced closing capital without being a business loss.
- WRONG: 'Once the formula is applied the answer is final.' The figure is only as accurate as the underlying list of assets and liabilities.

Formulas & formats

- THE profit formula:
$$\text{Profit} = \text{Closing Capital} - \text{Opening Capital} + \text{Drawings} - \text{Additional Capital}$$

(A negative result is a LOSS)
- Capital from a Statement of Affairs:
$$\text{Capital (Net Worth)} = \text{Total Assets} - \text{Total Liabilities}$$
- Statement of Affairs as at

LIABILITIES		ASSETS	
Creditors	30,000	Stock	50,000
Bills Payable	—	Debtors	40,000
Capital (bal. fig.)	1,10,000	Cash	20,000
		Furniture	30,000
	-----		-----
	1,40,000		1,40,000
- Verification (Capital Account):
$$\text{Opening Capital} + \text{Additional Capital} + \text{Profit} - \text{Drawings} = \text{Closing Capital}$$

$$80,000 + 0 + 54,000 - 24,000 = 1,10,000 \quad \checkmark$$
- Working backwards:
$$\text{Drawings} = \text{Profit} - \text{Closing Capital} + \text{Opening Capital} + \text{Additional Capital}$$

$$\text{Opening Capital} = \text{Closing Capital} + \text{Drawings} - \text{Additional Capital} - \text{Profit}$$

Important questions & model answers

2 marks What is meant by incomplete records?

- Incomplete records is a system of book-keeping in which the double-entry principle is not followed for all transactions.
- Usually only the cash book and personal accounts of debtors and creditors are maintained, while real and nominal accounts are missing.
- It is popularly called the single entry system, although it is in fact a mixture of double entry, single entry and no entry at all.

4 marks State any four limitations of incomplete records.

- A trial balance cannot be prepared, so the arithmetical accuracy of the books cannot be verified.
- True profit or loss cannot be ascertained in the normal way, since nominal accounts are not maintained.
- The exact financial position is uncertain, because many asset values are estimated.
- Errors and frauds are difficult to detect for want of complete records.
- Banks and tax authorities may not accept such accounts, and meaningful comparison between years is unreliable.

4 marks Distinguish between a Statement of Affairs and a Balance Sheet.

- **SOURCE:** A Statement of Affairs is prepared from incomplete records and partly from estimates; a Balance Sheet is prepared from a trial balance under complete double entry.
- **CAPITAL:** In a Statement of Affairs capital is the **BALANCING FIGURE** (Assets – Liabilities); in a Balance Sheet capital is taken from the Capital Account.
- **RELIABILITY:** A Statement of Affairs is approximate; a Balance Sheet is accurate and verifiable.
- **OBJECTIVE:** A Statement of Affairs is prepared mainly to **FIND** capital; a Balance Sheet is prepared to **SHOW** the financial position of the business.

3 marks Give the formula for computing profit under the net worth method and explain why drawings are added.

- Profit = Closing Capital – Opening Capital + Drawings – Additional Capital.
- Drawings are cash or goods taken by the owner for personal use. They reduce the closing capital even though they are not a loss of the business.
- If drawings were not added back, the increase in capital would appear smaller than the profit actually earned, and profit would be understated.
- For the same reason additional capital is **DEDUCTED** — it increased closing capital without having been earned.

5 marks Sanjay's opening capital on 1 April 2023 was ₹80,000. On 31 March 2024 his assets were ₹1,40,000 and liabilities ₹30,000. He withdrew ₹24,000 during the year. Compute his profit and verify your answer.

- **CLOSING CAPITAL** = Total Assets – Total Liabilities = ₹1,40,000 – ₹30,000 = ₹1,10,000.
- **PROFIT** = Closing Capital – Opening Capital + Drawings – Additional Capital
- = ₹1,10,000 – ₹80,000 + ₹24,000 – Nil = ₹54,000.
- **VERIFICATION:** Opening Capital + Profit – Drawings = ₹80,000 + ₹54,000 – ₹24,000 = ₹1,10,000.
- This equals the closing capital, so the answer is confirmed ✓
- Note that ignoring the drawings would have given only ₹30,000 — a serious understatement of profit.

3 marks How is capital ascertained when a business keeps incomplete records?

- By preparing a **STATEMENT OF AFFAIRS** on the date concerned.
- All known assets are listed on one side and all known liabilities on the other.
- Capital is then found as the **BALANCING FIGURE**: Capital = Total Assets – Total Liabilities.
- A statement is prepared both at the beginning and at the end of the year, giving opening and closing capital respectively.

3 marks If a liability has been omitted from the closing Statement of Affairs, what is the effect on the computed profit?

- Omitting a liability makes total liabilities too low, so closing capital (Assets – Liabilities) is **OVERSTATED**.
- Since profit is computed from the increase in capital, the profit figure is also **OVERSTATED** by the same amount.
- The owner would therefore believe the business earned more than it really did, and might withdraw funds he cannot afford.
- This illustrates that the result of the net worth method is only as reliable as the underlying list of assets and liabilities.

4 marks A trader's opening capital was ₹60,000 and his closing capital ₹95,000. He introduced ₹15,000 of additional capital and withdrew ₹12,000. Compute profit.

- Profit = Closing Capital – Opening Capital + Drawings – Additional Capital.
- Profit = ₹95,000 – ₹60,000 + ₹12,000 – ₹15,000.
- Profit = ₹35,000 + ₹12,000 – ₹15,000 = ₹32,000.
- VERIFICATION: ₹60,000 + ₹15,000 + ₹32,000 – ₹12,000 = ₹95,000 ✓

3 marks Distinguish between the net worth method and the conversion method.

- Under the NET WORTH (Statement of Affairs) method, profit is found simply by comparing opening and closing capital and adjusting for drawings and additional capital.
- Under the CONVERSION method, the incomplete records are reconstructed into complete double-entry books, so that a trial balance and regular final accounts can be prepared.
- The net worth method gives only the profit figure; the conversion method also gives gross profit, the composition of expenses and a full Balance Sheet.
- The net worth method is quick but approximate; the conversion method is laborious but far more informative.

2 marks Why can a trial balance not be prepared from incomplete records?

- A trial balance is a list of the balances of ALL ledger accounts, and it depends on every transaction having been recorded with both its debit and its credit.
- Under incomplete records, real and nominal accounts are largely not maintained and many transactions are recorded on one side only.
- Since the double entry is incomplete, the debit and credit totals could never be expected to agree, and no meaningful trial balance can be drawn up.

Exam tips

- Memorise the formula exactly: Profit = Closing Capital – Opening Capital + Drawings – Additional Capital. Write it down before substituting numbers.
- ADD drawings, DEDUCT additional capital. Reversing these is the single most common error in this chapter.
- Always compute closing capital as Assets – Liabilities and show that working as a separate line.
- Present the opening and closing Statements of Affairs as proper statements; method marks are given for them even if the final answer is wrong.
- Finish every numerical answer with the verification line — Opening + Profit – Drawings + Additional = Closing — and tick it.
- If the result is negative, write clearly 'LOSS of ₹...' rather than leaving a minus sign unexplained.
- Never call a Statement of Affairs a Balance Sheet; the distinction is itself an examinable point.

Quick revision

- Incomplete records = single entry = a mixture of double entry, single entry and no entry.
- No complete ledger → no trial balance → no ordinary final accounts.
- Statement of Affairs: Assets on one side, Liabilities on the other, Capital = balancing figure.
- Statement of Affairs ≠ Balance Sheet (source, capital, reliability, purpose all differ).
- Profit = Closing Capital – Opening Capital + Drawings – Additional Capital.
- Drawings are ADDED BACK; additional capital is DEDUCTED.
- Sanjay: (1,40,000 – 30,000) – 80,000 + 24,000 = ₹54,000. Check: 80,000 + 54,000 – 24,000 = 1,10,000 ✓
- Three steps: opening capital → closing capital → apply the formula → verify.
- The answer is only as reliable as the list of assets and liabilities behind it.