Accountancy Financial Accounting Part I Textbook for Class XI 2022-23 First Edition February 2006 Phalguna 1927 Reprinted October 2006 Kartika 1928 October 2007 Kartika 1929 January 2009 Magha 1930 January 2010 Magha 1931 January 2011 Magha 1932 June 2012 Jyaistha 1934 April 2013 Chaitra 1935 December 2013 Agrahayana 1935 April 2015 Chaitra 1937 December 2015 Pausa 1937 March 2017 Phalguna 1938 February 2018 Magha 1939 February 2019 Magha 1940 August 2019 Bhadrapada 1941 PD 300T BS ` 135.00 Printed on 80 GSM paper with NCERT watermark Published at the Publication Division by the Secretary, National Council of Educational Research and Training, Sri Aurobindo Marg, New Delhi 110 016 and printed at Amar Ujala Publications Ltd., C-21-22, Sector-59, Noida - 201 301 (U.P.) ISBN 81-7450-507-5 Publication Team Head, Publication : M. Siraj Anwar Division Chief Editor : Shveta Uppal Chief Production : Arun Chitkara Officer Chief Business : Bibash Kumar Das Manager Assistant Editor : Gobind Ram Production Assistant : Prakash Veer Singh Cover Shweta Rao OFFICES OF THE PUBLICATION DIVISION, NCERT NCERT Campus Sri Aurobindo Marg New Delhi 110 016 Phone : 011-26562708 108, 100 Feet Road Hosdakere Halli Extension Banashankari III Stage Bengaluru 560 085 Phone : 080-26725740 Navjivan Trust Building P.O.Navjivan Ahmedabad 380 014 Phone : 079-27541446 CWC Campus Opp. Dhankal Bus Stop Panihati Kolkata 700 114 Phone : 033-25530454 CWC Complex Maligaon Guwahati 781 021 Phone : 0361-2674869 2022-23 FOREWORD The National Curriculum Framework (NCF), 2005, recommends that children's life at school must be linked to their life outside the school. This principle marks a departure from the legacy of bookish learning which continues to shape our system and causes a gap between the school, home and community. The syllabi and textbooks developed on the basis of NCF signify an attempt to implement this basic idea. They also attempt to discourage rote learning and the maintenance of sharp boundaries between different subject areas. We hope these measures will take us significantly further in the direction of a child-centred system of education outlined in the National Policy on Education (1986). The success of this effort depends on the steps that school principals and teachers will take to encourage children to reflect on their own learning and to pursue imaginative activities and questions. We must recognise that, given space, time and freedom, children generate new knowledge by engaging with the information passed on to them by adults. Treating the prescribed textbook as the sole basis of examination is one of the key reasons why other resources and sites of learning are ignored. Inculcating creativity and initiative is possible if we perceive and treat children as participants in learning, not as receivers of a fixed body of knowledge. These aims imply considerable change in school routines and mode of functioning. Flexibility in the daily time-table is as necessary as rigour in implementing the annual calendar so that the required number of teaching days are actually devoted to teaching. The methods used for teaching and evaluation will also determine how effective this textbook proves for making children's life at school a happy experience, rather than a source of stress or boredom. Syllabus designers have tried to address the problem of curricular burden by restructuring and reorienting knowledge at different stages with greater consideration for child psychology and the time available for teaching. The textbook attempts to enhance this endeavour by giving higher priority and space to opportunities for contemplation and wondering, discussion in small groups, and activities requiring hands-on experience. The National Council of Educational Research and Training (NCERT) appreciates the hard work done by the textbook development committee 2022-23 responsible for this book. We wish to thank the Chairperson of the advisory group in Social Sciences Professor Hari Vasudevan and the Chief Advisor for this book, Professor R.K. Grover, (Retd.) Director, School of Management Studies (IGNOU), New Delhi for guiding the work of this committee. Several teachers contributed to the development of this textbook; we are grateful to their principals for making this possible. We are indebted to the institutions and organisations which have generously permitted us to draw upon their resources, material and personnel. We are especially grateful to the members of the National Monitoring Committee, appointed by the Department of Secondary and Higher Education, Ministry of Human Resource Development under the Chairpersonship of Professor Mrinal Miri and Professor G.P. Deshpande, for their valuable time and contribution. As an organisation committed to the systemic reform and continuous improvement in the quality of its products, NCERT welcomes comments and suggestions which will enable us to undertake further revision and refinement. Director New Delhi National Council of Educational 20 December 2005 Research and Training iv 2022-23 TEXTBOOK DEVELOPMENT COMMITTEE CHAIRPERSON, ADVISORY COMMITTEE FOR TEXTBOOKS IN SOCIAL SCIENCES AT UPPER PRIMARY LEVEL Hari Vasudevan, Professor, Department of History, University of Calcutta, Kolkata CHIEF ADVISOR R. K. Grover, Professor, (Retd.), School of Management Studies, IGNOU, New Delhi. MEMBERS A.K. Bansal, Reader, PGDAV College, Nehru Nagar, New Delhi. 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In order to appreciate the exact nature of accounting, we must understand the following relevant aspects of the definition: • Economic Events • Identification, Measurement, Recording and Communication • Organisation • Interested Users of Information Box 1 History and Development of Accounting Accounting enjoys a remarkable heritage. The history of accounting is as old as civilisation. The seeds of accounting were most likely first sown in Babylonia and Egypt around 4000 B.C. who recorded transactions of payment of wages and taxes on clay tablets. Historical evidences reveal that Egyptians used some form of accounting for their treasuries where gold and other valuables were kept. The incharge of treasuries had to send day wise reports to their superiors known as Wazirs (the prime minister) and from there month wise reports were sent to kings. Babylonia, known as the city of commerce, used accounting for business to uncover losses taken place due to frauds and lack of efficiency. In Greece, accounting was used for apportioning the revenues received among treasuries, maintaining total receipts, total payments and balance of government financial transactions. Romans used memorandum or daybook where in receipts and payments were recorded and wherefrom they were posted to ledgers on monthly basis. (700 B.C to 400 A.D). China used sophisticated form of government accounting as early as 2000 B.C. Accounting practices in India could be traced back to a period when twenty three centuries ago, Kautilya, a minister in Chandragupta's kingdom wrote a book named Arthashasthra, which also described how accounting records had to be maintained. Luca Pacioli's, a Franciscan friar (merchant class), book Summa de Arithmetica, Geometria, Proportion at Proportionality (Review of Arithmetic and Geometric proportions) in Venice (1494) is considered as the first book on double entry bookkeeping. A portion of this book contains knowledge of business and book-keeping. However, Pacioli did not claim that he was the inventor of double entry book-keeping but spread the knowledge of it. It shows that he probably relied on then–current book-keeping manuals as the basis for his masterpiece. In his book, he used the present day popular terms of accounting Debit (Dr.) and Credit (Cr.). These were the concepts used in Italian terminology. Debit comes from the Italian debito which comes from the Latin debita and debeo which means owed to the proprietor. Credit comes from the Italian credito which comes from the Latin 'credo' which means trust or belief (in the proprietor or owed by the proprietor. In explaining double entry system, Pacioli wrote that 'All entries… have to be double entries, that is if you make one creditor, you must make some debtor'. He also stated that a merchants responsibility include to give glory to God in their enterprises, to be ethical in all business activities and to earn a profit. He discussed the details of memorandum, journal, ledger and specialised accounting procedures. 2022-23 4 Accountancy 1.1.1 Economic Events Business organisations involves economic events. An economic event is known as a happening of consequence to a business organisation which consists of transactions and which are measurable in monetary terms. For example, purchase of machinery, installing and keeping it ready for manufacturing is an event which comprises number of financial transactions such as buying a machine, transportation of machine, site preparation for installation of a machine, expenditure incurred on its installation and trial runs. Thus, accounting identifies bunch of transactions relating to an economic event. If an event involves transactions between an outsider and an organisation, these are known as external events. The following are the examples of such transactions: • Sale of merchandise to the customers. • Rendering services to the customers by ABC Limited. • Purchase of materials from suppliers. • Payment of monthly rent to the landlord. An internal event is an economic event that occurs entirely between the internal wings of an enterprise, e.g., supply of raw material or components by the stores department to the manufacturing department, payment of wages to the employees, etc. 1.1.2 Identification, Measurement, Recording and Communication Identification : It means determining what transactions to record, i.e., to identity events which are to be recorded. It involves observing activities and selecting those events that are of considered financial character and relate to the organisation. The business transactions and other economic events therefore are evaluated for deciding whether it has to be recorded in books of account. For example, the value of human resources, changes in managerial policies or appointment of personnel are important but none of these are recorded in books of account. However, when a company makes a sale or purchase, whether on cash or credit, or pays salary it is recorded in the books of account. Measurement : It means quantification (including estimates) of business transactions into financial terms by using monetary unit, viz. rupees and paise as a measuring unit. If an event cannot be quantified in monetary terms, it is not considered for recording in financial accounts. That is why important items like the appointment of a new managing director, signing of contracts or changes in personnel are not shown in the books of accounts. Recording : Once the economic events are identified and measured in financial terms, these are recorded in books of account in monetary terms and in a chronological order. Recording is done in a manner that the necessary financial 2022-23 Introduction to Accounting 5 information is summarised as per well-established practice and is made available as and when required. Communication : The economic events are identified, measured and recorded in order that the pertinent information is generated and communicated in a certain form to management and other internal and external users. The information is regularly communicated through accounting reports. These reports provide information that are useful to a variety of users who have an interest in assessing the financial performance and the position of an enterprise, planning and controlling business activities and making necessary decisions from time to time. The accounting information system should be designed in such a way that the right information is communicated to the right person at the right time. Reports can be daily, weekly, monthly, or quarterly, depending upon the needs of the users. An important element in the communication process is the accountant's ability and efficiency in presenting the relevant information. 1.1.3 Organisation Organisation refers to a business enterprise, whether for profit or not-forprofit motive. Depending upon the size of activities and level of business operation, it can be a sole-proprietory concern, partnership firm, cooperative society, company, local authority, municipal corporation or any other association of persons. 1.1.4 Interested Users of Information Accounting is a means by which necessary financial information about business enterprise is communicated and is also called the language of business. Many users need financial information in order to make important decisions. These users can be divided into two broad categories: internal users and external users. Internal users include: Chief Executive, Financial Officer, Vice President, Business Unit Managers, Plant Managers, Store Managers, Line Supervisors, etc. External users include: present and potential Investors (shareholders), Creditors (Banks and other Financial Institutions, Debentureholders and other Lenders), Tax Authorities, Regulatory Agencies (Department of Company Affairs, Registrar of Companies, Securities Exchange Board of India, Labour Unions, Trade Associations, Stock Exchange and Customers, etc. Since the primary function of accounting is to provide useful information for decision-making, it is a means to an end, with the end being the decision that is helped by the availability of accounting information. You will study about the types of accounting information and its users later in this chapter. 2022-23 6 Accountancy Box 2 Why do the Users Want Accounting Information? • The owners/shareholders use them to see if they are getting a satisfactory return on their investment, and to assess the financial health of their company/business. • The directors/managers use them for making both internal and external comparisons in their attempts to evaluate the performance. They may compare the financial analysis of their company with the industry figures in order to ascertain the company's strengths and weaknesses. Management is also concerned with ensuring that the money invested in the company/organisation is generating an adequate return and that the company/organisation is able to pay its debts and remain solvent. • The creditors (lenders) want to know if they are likely to get paid and look particularly at liquidity, which is the ability of the company/organisation to pay its debts as they become due. • The prospective investors use them to assess whether or not to invest their money in the company/organisation. • The government and regulatory agencies such as Registrar of companies, Custom departments IRDA, RBI, etc. require information for the payment of various taxes such as Value Added Tax (VAT), Income Tax (IT), Customs and Excise duties for protecting the interests of investors, creditors(lenders), and also to satisfy the legal obligations imposed by The Companies Act 2013 and SEBI from time-totime. 1.2 Accounting as a Source of Information As discussed earlier, accounting is a definite processes of interlinked activities, (refer figure 1.1) that begins with the identification of transactions and ends with the preparation of financial statements. Every step in the process of accounting generates information. Generation of information is not an end in itself. It is a means to facilitate the dissemination of information among different user groups. Such information enables the interested parties to take appropriate decisions. Therefore, dissemination of information is an essential function of accounting. To be useful, the accounting information should ensure to: • provide information for making economic decisions; • serve the users who rely on financial statements as their principal source of information; • provide information useful for predicting and evaluating the amount, timing and uncertainty of potential cash-flows; • provide information for judging management's ability to utilise resources effectively in meeting goals; 2022-23 Introduction to Accounting 7 • provide factual and interpretative information by disclosing underlying assumptions on matters subject to interpretation, evaluation, prediction, or estimation; and • provide information on activities affecting the society. Test Your Understanding - I Complete the following sentences with appropriate words: (a) Information in financial reports is based on .... (b) Internal users are the .... of the business entity. (c) A .... would most likely use an entities financial report to determine whether or not the business entity is eligible for a loan. (d) The Internet has assisted in decreasing the .... in issuing financial reports to users. (e) .... users are groups outside the business entity, who uses the information to make decisions about the business entity. (f) Information is said to be relevent if it is .... (g) The process of accounting starts with .... and ends with .... (h) Accounting measures the business transactions in terms of .... units. (i) Identified and measured economic events should be recording in .... order. The role of an accountant in generating accounting information is to observe, screen and recognise events and transactions to measure and process them, and thereby compile reports comprising accounting information that are communicated to the users. These are then interpreted, decoded and used by management and other user groups. It must be ensured that the information provided is relevant, adequate and reliable for decision-making. The apparently divergent needs of internal and external users of accounting information have resulted in the development of sub-disciplines within the accounting discipline namely, financial accounting, cost accounting and management accounting (refer box 3). Financial accounting assists keeping a systematic record of financial transactions the preparation and presentation of financial reports in order to arrive at a measure of organisational success and financial soundness. It relates to the past period, serves the stewardship function and is monetary in nature. It is primarily concerned with the provision of financial information to all stakeholders. Cost accounting assists in analysing the expenditure for ascertaining the cost of various products manufactured or services rendered by the firm and 2022-23 8 Accountancy fixation of prices thereof. It also helps in controlling the costs and providing necessary costing information to management for decision-making. Management accounting deals with the provision of necessary accounting information to people within the organisation to enable them in decision-making, planning and controlling business operations. Management accounting draws the relevant information mainly from financial accounting and cost accounting which helps the management in budgeting, assessing profitability, taking pricing decisions, capital expenditure decisions and so on. Besides, it generates other information (quantitative and qualitative, financial and non-financial) which relates to the future and is relevant for decision-making in the organisation. Such information includes: sales forecast, cash flows, purchase requirement, manpower needs, environmental data about effects on air, water, land, natural resources, flora, fauna, human health, social responsibilities, etc. As a result, the scope of accounting has become so vast, that new areas like human resource accounting, social accounting, responsibility accounting have also gained prominance. Let's Do It Many People in today's society think of an accountant as simply a glorified bookkeeper. But the role of an accountant is continually changing. Discuss in the classroom what really the role of accounting is? 1.2.1 Qualitative Characteristics of Accounting Information Qualitative characteristics are the attributes of accounting information which tend to enhance its understandability and usefulness. In order to assess whether accounting information is decision useful, it must possess the characteristics of reliability, relevance, understandability and comparability. Reliability Reliability means the users must be able to depend on the information. The reliability of accounting information is determined by the degree of correspondence between what the information conveys about the transactions or events that have occurred, measured and displayed. A reliable information should be free from error and bias and faithfully represents what it is meant to represent. To ensure reliability, the information disclosed must be credible, verifiable by independent parties use the same method of measuring, and be neutral and faithful (refer figure 1.3). 2022-23 Introduction to Accounting 9 Box 3 Branches of Accounting The economic development and technological advancements have resulted in an increase in the scale of operations and the advent of the company form of business organisation. This has made the management function more and more complex and increased the importance of accounting information. This gave rise to special branches of accounting. These are briefly explained below : Financial accounting : The purpose of this branch of accounting is to keep a record of all financial transactions so that: (a) the profit earned or loss sustained by the business during an accounting period can be worked out, (b) the financial position of the business as at the end of the accounting period can be ascertained, and (c) the financial information required by the management and other interested parties can be provided. Cost Accounting : The purpose of cost accounting is to analyse the expenditure so as to ascertain the cost of various products manufactured by the firm and fix the prices. It also helps in controlling the costs and providing necessary costing information to management for decision-making. Management Accounting : The purpose of management accounting is to assist the management in taking rational policy decisions and to evaluate the impact of its decisons and actions. Relevance To be relevant, information must be available in time, must help in prediction and feedback, and must influence the decisions of users by : (a) helping them form prediction about the outcomes of past, present or future events; and/or (b) confirming or correcting their past evaluations. Understandability Understandability means decision-makers must interpret accounting information in the same sense as it is prepared and conveyed to them. The qualities that distinguish between good and bad communication in a message are fundamental to the understandability of the message. A message is said to be effectively communicated when it is interpreted by the receiver of the message in the same sense in which the sender has sent. Accountants should present the comparable information in the most intenlligible manner without sacrificing relevance and reliability. 2022-23 10 Accountancy Comparability It is not sufficient that the financial information is relevant and reliable at a particular time, in a particular circumstance or for a particular reporting entity. But it is equally important that the users of the general purpose financial reports are able to compare various aspects of an entity over different time period and with other entities. To be comparable, accounting reports must belong to a common period and use common unit of measurement and format of reporting. Test Your Understanding - II You are a senior accountant of Ramona Enterprises Limited. What three steps would you take to make your company's financial statements understandable and decision useful? 1. ——————————————————————————————— 2. ———————————————————————————————— 3. ——————————————————————————————————— [Hint : Refer to qualitative characteristics of accounting information] 1.3 Objectives of Accounting As an information system, the basic objective of accounting is to provide useful information to the interested group of users, both external and internal. The necessary information, particularly in case of external users, is provided in the form of financial statements, viz., profit and loss account and balance sheet. Besides these, the management is provided with additional information from time to time from the accounting records of business. Thus, the primary objectives of accounting include the following: 1.3.1 Maintenance of Records of Business Transactions Accounting is used for the maintenance of a systematic record of all financial transactions in book of accounts. Even the most brilliant executive or manager cannot accurately remember the numerous amount of varied transactions such as purchases, sales, receipts, payments, etc. that takes place in business everyday. Hence, a proper and complete records of all business transactions are kept regularly. Moreover, the recorded information enables verifiability and acts as an evidence. 1.3.2 Calculation of Profit and Loss The owners of business are keen to have an idea about the net results of their business operations periodically, i.e. whether the business has earned profits 2022-23 Introduction to Accounting 11 or incurred losses. Thus, another objective of accounting is to ascertain the profit earned or loss sustained by a business during an accounting period which can be easily workout with help of record of incomes and expenses relating to the business by preparing a profit or loss account for the period. Profit represents excess of revenue (income), over expenses. If the total revenue of a given period is ` 6,00,000 and total expenses are ` 5,40,000 the profit will be equal to ` 60,000(` 6,00,000 – ` 5,40,000). If however, the total expenses exceed the total revenue, the difference reflects the loss. 1.3.3 Depiction of Financial Position Accounting also aims at ascertaining the financial position of the business concern in the form of its assets and liabilities at the end of every accounting period. A proper record of resources owned by business organisation (Assets) Fig. 1.3 : The qualitative characteristics of accounting information Qualitative Characteristics of Accounting Information Decision Makers (Users of Accounting Information) Understandability Decision Usefulness Relevance Reliability Timeliness Dedicative Feedback Verifiability Faithfulness Value Value Neutrality Comparability 2022-23 12 Accountancy and claims against such resources (Liabilities) facilitates the preparation of a statement known as balance sheet position statement. 1.3.4 Providing Accounting Information to its Users The accounting information generated by the accounting process is communicated in the form of reports, statements, graphs and charts to the users who need it in different decision situations. As already stated, there are two main user groups, viz. internal users, mainly management, who needs timely information on cost of sales, profitability, etc. for planning, controlling and decision-making and external users who have limited authority, ability and resources to obtain the necessary information and have to rely on financial statements (Balance Sheet, Profit and Loss account). Primarily, the external users are interested in the following: • Investors and potential investors-information on the risks and return on investment; • Unions and employee groups-information on the stability, profitability and distribution of wealth within the business; • Lenders and financial institutions-information on the creditworthiness of the company and its ability to repay loans and pay interest; • Suppliers and creditors-information on whether amounts owed will be repaid when due, and on the continued existence of the business; • Customers-information on the continued existence of the business and thus the probability of a continued supply of products, parts and after sales service; • Government and other regulators- information on the allocation of resources and the compliance to regulations; • Social responsibility groups, such as environmental groups-information on the impact on environment and its protection; • Competitors-information on the relative strengths and weaknesses of their competition and for comparative and benchmarking purposes. Whereas the above categories of users share in the wealth of the company, competitors require the information mainly for strategic purposes. Test Your Understanding - III Which stakeholder group… would be most interested in ______________________________ (a) the VAT and other tax liabilities of the firm ______________________________ (b) the potential for pay awards and bouns deals ______________________________ (c) the ethical or environmental activities of the firm ______________________________ (d) whether the firm has a long-term future ______________________________ (e) profitability and share performance ______________________________ (f) the ability of the firm to carry on providing a service or producing a product. 2022-23 Introduction to Accounting 13 1.4 Role of Accounting For centuries, the role of accounting has been changing with the changes in economic development and increasing societal demands. It describes and analyses a mass of data of an enterprise through measurement, classification and summarisation, and reduces those date into reports and statements, which show the financial condition and results of operations of that enterprise. Hence, it is regarded as a language of business. It also performs the service activity by providing quantitative financial information that helps the users in various ways. Accounting as an information system collects and communicates economic information about an enterprise to a wide variety of interested parties. However, accounting information relates to the past transactions and is quantitative and financial in nature, it does not provide qualitative and non-financial information. These limitations of accounting must be kept in view while making use of the accounting information. Test Your Understanding - IV Tick the Correct Answer 1. Which of the following is not a business transaction? a. Bought furniture of `10,000 for business b. Paid for salaries of employees ` 5,000 c. Paid sons fees from her personal bank account ` 20,000 d. Paid sons fees from the business ` 2,000 2. Deepti wants to buy a building for her business today. Which of the following is the relevant data for his decision? a. Similar business acquired the required building in 2000 for ` 10,00,000 b. Building cost details of 2003 c. Building cost details of 1998 d. Similar building cost in August, 2005 ` 25,00,000 3. Which is the last step of accounting as a process of information? a. Recording of data in the books of accounts b. Preparation of summaries in the form of financial statements c. Communication of information d. Analysis and interpretation of information 4. Which qualitative characteristics of accounting information is reflected when accounting information is clearly presented? a. Understandability b. Relevance c. Comparability d. Reliability 5. Use of common unit of measurement and common format of reporting promotes; a. Comparability b. Understandability c. Relevance d. Reliability 2022-23 14 Accountancy Box 4 Different Roles of Accounting ü As a language – it is perceived as the language of business which is used to communicate information on enterprises; ü As a historical record- it is viewed as chronological record of financial transactions of an organisation at actual amounts involved; ü As current economic reality- it is viewed as the means of determining the true income of an entity namely the change of wealth over time; ü As an information system – it is viewed as a process that links an information source (the accountant) to a set of receivers (external users) by means of a channel of communication; ü As a commodity- specialised information is viewed as a service which is in demand in society, with accountants being willing to and capable of providing it. 1.5 Basic Terms in Accounting 1.5.1 Entity Entity means a reality that has a definite individual existence. Business entity means a specifically identifiable business enterprise like Super Bazaar, Hire Jewellers, ITC Limited, etc. An accounting system is always devised for a specific business entity (also called accounting entity). 1.5.2 Transaction An event involving some value between two or more entities. It can be a purchase of goods, receipt of money, payment to a creditor, incurring expenses, etc. It can be a cash transaction or a credit transaction. 1.5.3 Assets Assets are economic resources of an enterprise that can be usefully expressed in monetary terms. Assets are items of value used by the business in its operations. For example, Super Bazar owns a fleet of trucks, which is used by it for delivering foodstuffs; the trucks, thus, provide economic benefit to the enterprise. This item will be shown on the asset side of the balance sheet of Super Bazaar. Assets can be broadly classified into two types: current and Non-current (Figure 1.4). 2022-23 15 Introduction to Accounting Figure 1.4 : Classification of Assets 2022-23 16 Accountancy 1.5.4 Liabilities Liabilities are obligations or debts that an enterprise has to pay at some time in the future. They represent creditors' claims on the firm's assets. Both small and big businesses find it necessary to borrow money at one time or the other, and to purchase goods on credit. Super Bazar, for example, purchases goods for ` 10,000 on credit for a month from Fast Food Products on March 25, 2005. If the balance sheet of Super Bazaar is prepared as at March 31, 2005, Fast Food Products will be shown as creditors on the liabilities side of the balance sheet. If Super Bazaar takes a loan for a period of three years from Delhi State Co-operative Bank, this will also be shown as a liability in the balance sheet of Super Bazaar. Liabilities are classified as current and non-current (Figure 1.5). Figure 1.5 : Classification of Liabilities Box 5 Distinction between current and non-current items: 1. Current assets or liabilities are involved in operating cycle. 2. Current assets or liabilities are realised/settled within 12 months. 3. Current items are primarily for trading. 4. Current items are cash or cash equivalent. 1.5.5 Capital Capital Amount invested by the owner in the firm is known as capital. It may be brought in the form of cash or assets by the owner for the business entity capital is an obligation and a claim on the assets of business. It is, therefore, shown as capital on the liabilities side of the balance sheet. 1.5.6 Sales Sales are total revenues from goods or services sold or provided to customers. Sales may be cash sales or credit sales. Liabilities Non-Current Liabilities Current Liabilities Short Term Provisions Long Term Borrowings Deferred Tax Liabilities (Net) Other Long Term Liabilities Long Terms Provisions Short Term Borrowings Trade Payables Other Current Liabilities 2022-23 Introduction to Accounting 17 1.5.7 Revenues These are the amounts of the business earned by selling its products or providing services to customers, called sales revenue. Other items of revenue common to many businesses are: commission, interest, dividends, royalities, rent received, etc. Revenue is also called income. 1.5.8 Expenses Costs incurred by a business in the process of earning revenue are known as expenses. Generally, expenses are measured by the cost of assets consumed or services used during an accounting period. The usual items of expenses are: depreciation, rent, wages, salaries, interest, cost of heater, light and water, telephone, etc. 1.5.9 Expenditure Spending money or incurring a liability for some benefit, service or property received is called expenditure. Purchase of goods, purchase of machinery, purchase of furniture, etc. are examples of expenditure. If the benefit of expenditure is exhausted within a year, it is treated as an expense (also called revenue expenditure). On the other hand, the benefit of an expenditure lasts for more than a year, it is treated as an asset (also called capital expenditure) such as purchase of machinery, furniture, etc. 1.5.10 Profit The excess of revenues of a period over its related expenses during an accounting year is profit. Profit increases the investment of the owners. 1.5.11 Gain A profit that arises from events or transactions which are incidental to business such as sale of fixed assets, winning a court case, appreciation in the value of an asset. 1.5.12 Loss The excess of expenses of a period over its related revenues its termed as loss. It decreases in owner's equity. It also refers to money or money's worth lost (or cost incurred) without receiving any benefit in return, e.g., cash or goods lost by theft or a fire accident, etc. It also includes loss on sale of fixed assets. 2022-23 18 Accountancy 1.5.13 Discount Discount is the deduction in the price of the goods sold. It is offered in two ways. Offering deduction of agreed percentage of list price at the time selling goods is one way of giving discount. Such discount is called 'trade discount'. It is generally offered by manufactures to wholesellers and by wholesellers to retailers. After selling the goods on credit basis the debtors may be given certain deduction in amount due in case if they pay the amount within the stipulated period or earlier. This deduction is given at the time of payment on the amount payable. Hence, it is called as cash discount. Cash discount acts as an incentive that encourages prompt payment by the debtors. 1.5.14 Voucher Voucher Voucher The documentary evidence in support of a transaction is known as voucher. For example, if we buy goods for cash, we get cash memo, if we buy on credit, we get an invoice; when we make a payment we get a receipt and so on. 1.5.15 Goods It refers to the products in which the business unit is dealing, i.e. in terms of which it is buying and selling or producting and selling. The items that are purchased for use in the business are not called goods. For example, for a furniture dealer purchase of chairs and tables is termed as goods, while for other it is furniture and is treated as an asset. Similarly, for a stationery merchant, stationery is goods, whereas for others it is an item of expense (not purchases) 1.5.16 Drawings Withdrawal of money and/or goods by the owner from the business for personal use is known as drawings. Drawings reduces the investment of the owners. 1.5.17 Purchases Purchases are total amount of goods procured by a business on credit and on cash, for use or sale. In a trading concern, purchases are made of merchandise for resale with or without processing. In a manufacturing concern, raw materials are purchased, processed further into finished goods and then sold. Purchases may be cash purchases or credit purchases. 1.5.18 Stock Stock (inventory) is a measure of something on hand-goods, spares and other items in a business. It is called Stock in hand. In a trading concern, the stock on hand is the amount of goods which are lying unsold as at the end of an accounting 2022-23 Introduction to Accounting 19 period is called closing stock (ending inventory). In a manufacturing company, closing stock comprises raw materials, semi-finished goods and finished goods on hand on the closing date. Similarly, opening stock (beginning inventory) is the amount of stock at the beginning of the accounting period. 1.5.19 Debtors Debtors Debtors Debtors are persons and/or other entities who owe to an enterprise an amount for buying goods and services on credit. The total amount standing against such persons and/or entities on the closing date, is shown in the balance sheet as sundry debtors on the asset side. 1.5.20 Creditors Creditors are persons and/or other entities who have to be paid by an enterprise an amount for providing the enterprise goods and services on credit. The total amount standing to the favour of such persons and/or entities on the closing date, is shown in the Balance Sheet as sundry creditors on the liabilities side. Test Your Understanding - V Mr. Sunrise started a business for buying and selling of stationery with ` 5,00,000 as an initial investment. Of which he paid `1,00,000 for furniture, ` 2,00,000 for buying stationery items. He employed a sales person and clerk. At the end of the month he paid ` 5,000 as their salaries. Out of the stationery bought he sold some stationery for `1,50,000 for cash and some other stationery for `1,00,000 on credit basis to Mr.Ravi. Subsequently, he bought stationery items of `1,50,000 from Mr. Peace. In the first week of next month there was a fire accident and he lost ` 30,000 worth of stationery. A part of the machinery, which cost ` 40,000, was sold for ` 45,000. From the above, answer the following : 1. What is the amount of capital with which Mr. Sunrise started business. 2. What are the fixed assets he bought? 3. What is the value of the goods purchased? 4. Who is the creditor and state the amount payable to him? 5. What are the expenses? 6. What is the gain he earned? 7. What is the loss he incurred? 8. Who is the debtor? What is the amount receivable from him? 9. What is the total amount of expenses and losses incurred? 10. Determine if the following are assets, liabilities, revenues, expenses or none of the these: sales, debtors, creditors, salary to manager, discount to debtors, drawings by the owner. 2022-23 20 Accountancy Summary with Reference to Learning Objectives 1. Meaning of Accounting : Accounting is a process of identifying, measuring, recording the business transactions and communicating thereof the required information to the interested users. 2. Accounting as a source of information : Accounting as a source of information system is the process of identifying, measuring, recording and communicating the economic events of an organisation to interested users of the information. 3. Users of accounting information : Accounting plays a significant role in society by providing information to management at all levels and to those having a direct financial interest in the enterprise, such as present and potential investors and creditors. Accounting information is also important to those having indirect financial interest, such as regulatory agencies, tax authorities, customers, labour unions, trade associations, stock exchanges and others. 4. Qualitative characteristics of Accounting : To make accounting information decision useful, it should possess the following qualitative characteristics. • Reliability • Understandability • Relevance • Comparability 5. Objective of accounting : The primary objectives of accounting are to : • maintain records of business; • calculate profit or loss; • depict the financial position; and • make information available to various groups and users. 6. Role of accounting : Accounting is not an end in itself. It is a means to an end. It plays the role of a : • Language of a business • Historical record • Current economic reality • Information system • Service to users Questions for Practice Short Answers 1. Define accounting. 2. State the end product of financial accounting. 3. Enumerate main objectives of accounting. 4. Who are the users of accounting information. 5. State the nature of accounting information required by long-term lenders. 6. Who are the external users of information? 7. Enumerate information needs of management. 8. Give any three examples of revenues. 9. Distinguish between debtors and creditors; profit and gain 10. 'Accounting information should be comparable'. Do you agree with this statement. Give two reasons. 2022-23 Introduction to Accounting 21 11. If the accounting information is not clearly presented, which of the qualitative characteristic of the accounting information is violated? 12. "The role of accounting has changed over the period of time"- Do you agree? Explain. 13. Giving examples, explain each of the following accounting terms : • Fixed assets • Revenue • Expenses • Short-term liability • Capital 14. Define revenues and expenses? 15. What is the primiary reason for the business students and others to familiarise themselves with the accounting discipline? Long Answers 1. What is accounting? Define its objectives. 2. Explain the factors which necessitated systematic accounting. 3. Describe the informational needs of external users. 4. What do you mean by an asset and what are different types of assets? 5. Explain the meaning of gain and profit. Distinguish between these two terms. 6. Explain the qualitative characteristics of accounting information. 7. Describe the role of accounting in the modern world. Checklist to Test Your Understanding Test Your Understanding – I (a) Economic Transactions (b) Management/Employees (c) Creditor (d) Time-gap (e) External (f) Free from bias (g) Identifying the transactions and communicating information (h) Monetary (i) Chronological Test Your Understanding - II 1. Reliability, i.e. Verifiability, Faithfulness, Nutrality 2. Relevance, i.e. Timeliness 3. Understandability and Comparibility Test Your Understanding - III (a) Government and other regulators (b) Management (c) Social responsibility groups (d) Lenders (e) Suppliers and Creditors (f) Customers Test Your Understanding - IV 1. (c) 2. (a) 3. (c) 4. (a) 5. (a) 2022-23 22 Accountancy Test Your Understanding - V 1. ` 5,00,000 2. ` 1,00,000, 3. ` 2,00,000 4. Mr. Reace, ` 1,50,000 5. ` 5,000 6. ` 5,000 7. ` 30,000 8. Mr. Ravi, ` 1,00,000 9. ` 35,000 10. Assets : debtors; Liabilities : creditors; drawings; Revenues : sales expenses, discount, salary. Activity 1 : Tick (ü) the appropriate one: Items Current Non-Current Current Non-Current Assets Assets Liabilities Liabilities Machinery Sundry Creditors Cash at Bank Goodwill Bills Payable Land & Building Furniture Computer Software Motor Vehicles Inventory Investments Loan from Bank Sundry Debtors Patents Air-Conditioners Loose tools 2022-23Theory Base of Accounting 23 LEARNING OBJECTIVES After studying this chapter, you will be able to: • identify the need for theory base of accounting; • explain the nature of Generally Accepted Accounting Principles (GAAP); • state the meaning and purpose of the basic accounting concepts; • list the accounting standards issued by Institute of Chartered Accountants of India; • describe the systems of accounting; and • describe the basis of accounting. A s discussed in the previous chapter, accounting is concerned with the recording, classifying and summarising of financial transactions and events and interpreting the results thereof. It aims at providing information about the financial performance of a firm to its various users such as owners, managers employees, investors, creditors, suppliers of goods and services and tax authorities and help them in taking important decisions. The investors, for example, may be interested in knowing the extent of profit or loss earned by the firm during a given period and compare it with the performance of other similar enterprises. The suppliers of credit, say a banker, may, in addition, be interested in liquidity position of the enterprise. All these people look forward to accounting for appropriate, useful and reliable information. For making the accounting information meaningful to its internal and external users, it is important that such information is reliable as well as comparable. The comparability of information is required both to make inter-firm comparisons, i.e. to see how a firm has performed as compared to the other firms, as well as to make inter-period comparison, i.e. how it has performed as compared to the previous years. This becomes possible only if the information provided by the financial statements is based on consistent accounting policies, principles and practices. Such consistency is required throughout the process of identifying the events and Theory Base of Accounting 2 2022-23 24 Accountancy transactions to be accounted for, measuring them, communicating them in the book of accounts, summarising the results thereof and reporting them to the interested parties. This calls for developing a proper theory base of accounting. The importance of accounting theory need not be over-emphasised as no discipline can develop without a sound theoretical base. The theory base of accounting consists of principles, concepts, rules and guidelines developed over a period of time to bring uniformity and consistency to the process of accounting and enhance its utility to different users of accounting information. Apart from these, the Institute of Chartered Accountants of India, (ICAI), which is the regulatory body for standardisation of accounting policies in the country has issued Accounting Standards which are expected to be uniformly adhered to, in order to bring consistency in the accounting practices. These are discussed in the sections to follow. 2.1 Generally Accepted Accounting Principles In order to maintain uniformity and consistency in accounting records, certain rules or principles have been developed which are generally accepted by the accounting profession. These rules are called by different names such as principles, concepts, conventions, postulates, assumptions and modifying principles. The term 'principle' has been defined by AICPA as 'A general law or rule adopted or professed as a guide to action, a settled ground or basis of conduct or practice'. The word 'generally' means 'in a general manner', i.e., pertaining to many persons or cases or occasions. Thus, Generally Accepted Accounting Principles (GAAP) refers to the rules or guidelines adopted for recording and reporting of business transactions, in order to bring uniformity in the preparation and the presentation of financial statements. For example, one of the important rule is to record all transactions on the basis of historical cost, which is verifiable from the documents such as cash receipt for the money paid. This brings in objectivity in the process of recording and makes the accounting statements more acceptable to various users. The Generally Accepted Accounting Principles have evolved over a long period of time on the basis of past experiences, usages or customs, statements by individuals and professional bodies and regulations by government agencies and have general acceptability among most accounting professionals. However, the principles of accounting are not static in nature. These are constantly influenced by changes in the legal, social and economic environment as well as the needs of the users. These principles are also referred as concepts and conventions. The term concept refers to the necessary assumptions and ideas which are fundamental to accounting practice, and the term convention connotes customs or traditions as a guide to the preparation of accounting statements. In practice, the same rules or guidelines have been described by one author as a concept, by another 2022-23 Theory Base of Accounting 25 as a postulate and still by another as convention. This at times becomes confusing to the learners. Instead of going into the semantics of these terms, it is important to concentrate on the practicability of their usage. From the practicability view point, it is observed that the various terms such as principles, postulates, conventions, modifying principles, assumptions, etc. have been used interchangeably and are referred to as Basic Accounting Concepts in the present chapter. 2.2 Basic Accounting Concepts The basic accounting concepts are referred to as the fundamental ideas or basic assumptions underlying the theory and practice of financial accounting and are broad working rules for all accounting activities and developed by the accounting profession. The important concepts have been listed as below: • Business entity; • Money measurement; • Going concern; • Accounting period; • Cost • Dual aspect (or Duality); • Revenue recognition (Realisation); • Matching; • Full disclosure; • Consistency; • Conservatism (Prudence); • Materiality; • Objectivity. 2.2.1 Business Entity Concept The concept of business entity assumes that business has a distinct and separate entity from its owners. It means that for the purposes of accounting, the business and its owners are to be treated as two separate entities. Keeping this in view, when a person brings in some money as capital into his business, in accounting records, it is treated as liability of the business to the owner. Here, one separate entity (owner) is assumed to be giving money to another distinct entity (business unit). Similarly, when the owner withdraws any money from the business for his personal expenses(drawings), it is treated as reduction of the owner's capital and consequently a reduction in the liabilities of the business. The accounting records are made in the book of accounts from the point of view of the business unit and not that of the owner. The personal assets and liabilities of the owner are, therefore, not considered while recording and reporting the assets and liabilities of the business. Similarly, personal transactions of the owner are not recorded in the books of the business, unless it involves inflow or outflow of business funds. 2.2.2 Money Measurement Concept The concept of money measurement states that only those transactions and happenings in an organisation which can be expressed in terms of money such as sale of goods or payment of expenses or receipt of income, etc., are to be recorded in the book of accounts. All such transactions or happenings which 2022-23 26 Accountancy can not be expressed in monetary terms, for example, the appointment of a manager, capabilities of its human resources or creativity of its research department or image of the organisation among people in general do not find a place in the accounting records of a firm. Another important aspect of the concept of money measurement is that the records of the transactions are to be kept not in the physical units but in the monetary unit. For example, an organisation may, on a particular day, have a factory on a piece of land measuring 2 acres, office building containing 10 rooms, 30 personal computers, 30 office chairs and tables, a bank balance of `5 lakh, raw material weighing 20-tons, and 100 cartons of finished goods. These assets are expressed in different units, so can not be added to give any meaningful information about the total worth of business. For accounting purposes, therefore, these are shown in money terms and recorded in rupees and paise. In this case, the cost of factory land may be say ` 2 crore; office building ` 1 crore; computers `15 lakh; office chairs and tables ` 2 lakh; raw material ` 33 lakh and finished goods ` 4 lakh. Thus, the total assets of the enterprise are valued at ` 3 crore and 59 lakh. Similarly, all transactions are recorded in rupees and paise as and when they take place. The money measurement assumption is not free from limitations. Due to the changes in prices, the value of money does not remain the same over a period of time. The value of rupee today on account of rise in prices is much less than what it was, say ten years back. Therefore, in the balance sheet, when we add different assets bought at different points of time, say building purchased in 1995 for ` 2 crore, and plant purchased in 2005 for ` 1 crore, we are in fact adding heterogeneous values, which can not be clubbed together. As the change in the value of money is not reflected in the book of accounts, the accounting data does not reflect the true and fair view of the affairs of an enterprise. 2.2.3 Going Concern Concept The concept of going concern assumes that a business firm would continue to carry out its operations indefinitely, i.e. for a fairly long period of time and would not be liquidated in the foreseeable future. This is an important assumption of accounting as it provides the very basis for showing the value of assets in the balance sheet. An asset may be defined as a bundle of services. When we purchase an asset, for example, a personal computer, for a sum of ` 50,000, what we are buying really is the services of the computer that we shall be getting over its estimated life span, say 5 years. It will not be fair to charge the whole amount of ` 50,000, from the revenue of the year in which the asset is purchased. Instead, that part of the asset which has been consumed or used during a period should be charged from the revenue of that period. The assumption regarding continuity 2022-23 Theory Base of Accounting 27 of business allows us to charge from the revenues of a period only that part of the asset which has been consumed or used to earn that revenue in that period and carry forward the remaining amount to the next years, over the estimated life of the asset. Thus, we may charge ` 10,000 every year for 5 years from the profit and loss account. In case the continuity assumption is not there, the whole cost (` 50,000 in the present example) will need to be charged from the revenue of the year in which the asset was purchased. 2.2.4 Accounting Period Concept Accounting period refers to the span of time at the end of which the financial statements of an enterprise are prepared, to know whether it has earned profits or incurred losses during that period and what exactly is the position of its assets and liabilities at the end of that period. Such information is required by different users at regular interval for various purposes, as no firm can wait for long to know its financial results as various decisions are to be taken at regular intervals on the basis of such information. The financial statements are, therefore, prepared at regular interval, normally after a period of one year, so that timely information is made available to the users. This interval of time is called accounting period. The Companies Act 2013 and the Income Tax Act require that the income statements should be prepared annually. However, in case of certain situations, preparation of interim financial statements become necessary. For example, at the time of retirement of a partner, the accounting period can be different from twelve months period. Apart from these companies whose shares are listed on the stock exchange, are required to publish quarterly results to ascertain the profitability and financial position at the end of every three months period. Test Your Understanding - I Choose the Correct Answer 1. During the life-time of an entity accounting produce financial statements in accordance with which basic accounting concept: (a) Conservation (b) Matching (c) Accounting period (d) None of the above 2. When information about two different enterprises have been prepared presented in a similar manner the information exhibits the characteristic of: (a) Verifiability (b) Relevance (c) Reliability (d) None of the above 2022-23 28 Accountancy 3. A concept that a business enterprise will not be sold or liquidated in the near future is known as : (a) Going concern (b) Economic entity (c) Monetary unit (d) None of the above 4. The primary qualities that make accounting information useful for decision-making are : (a) Relevance and freedom from bias (b) Reliability and comparability (c) Comparability and consistency (d) None of the above 2.2.5 Cost Concept The cost concept requires that all assets are recorded in the book of accounts at their purchase price, which includes cost of acquisition, transportation, installation and making the asset ready to use. To illustrate, on June 2005, an old plant was purchased for ` 50 lakh by Shiva Enterprise, which is into the business of manufacturing detergent powder. An amount of ` 10,000 was spent on transporting the plant to the factory site. In addition, ` 15,000 was spent on repairs for bringing the plant into running position and ` 25,000 on its installation. The total amount at which the plant will be recorded in the books of account would be the sum of all these, i.e. ` 50,50,000. The concept of cost is historical in nature as it is something, which has been paid on the date of acquisition and does not change year after year. For example, if a building has been purchased by a firm for ` 2.5 crore, the purchase price will remain the same for all years to come, though its market value may change. Adoption of historical cost brings in objectivity in recording as the cost of acquisition is easily verifiable from the purchase documents. The market value basis, on the other hand, is not reliable as the value of an asset may change from time to time, making the comparisons between one period to another rather difficult. However, an important limitation of the historical cost basis is that it does not show the true worth of the business and may lead to hidden profits. During the period of rising prices, the market value or the cost at (which the assets can be replaced are higher than the value at which these are shown in the book of accounts) leading to hidden profits. 2.2.6 Dual Aspect Concept Dual aspect is the foundation or basic principle of accounting. It provides the very basis for recording business transactions into the book of accounts. This concept states that every transaction has a dual or two-fold effect and should 2022-23 Theory Base of Accounting 29 therefore be recorded at two places. In other words, at least two accounts will be involved in recording a transaction. This can be explained with the help of an example. Ram started business by investing in a sum of ` 50,00,000. The amount of money brought in by Ram will result in an increase in the assets (cash) of business by ` 50,00,000. At the same time, the owner’s equity or capital will also increase by an equal amount. It may be seen that the two items that got affected by this transaction are cash and capital account. Let us take another example to understand this point further. Suppose the firm purchase goods worth ` 10,00,000 on cash. This will increase an asset (stock of goods) on the one hand and reduce another asset (cash) on the other. Similarly, if the firm purchases a machine worth ` 30,00,000 on credit from Reliable Industries. This will increase an asset (machinery) on the one hand and a liability (creditor) on the other. This type of dual effect takes place in case of all business transactions and is also known as duality principle. The duality principle is commonly expressed in terms of fundamental Accounting Equation, which is as follows : Assets = Liabilities + Capital In other words, the equation states that the assets of a business are always equal to the claims of owners and the outsiders. The claims also called equity of owners is termed as Capital(owners' equity) and that of outsiders, as Liabilities(creditors equity). The two-fold effect of each transaction affects in such a manner that the equality of both sides of equation is maintained. The two-fold effect in respect of all transactions must be duly recorded in the book of accounts of the business. In fact, this concept forms the core of Double Entry System of accounting, which has been dealt in detail, in chapter 3. 2.2.7 Revenue Recognition (Realisation) Concept The concept of revenue recognition requires that the revenue for a business transaction should be included in the accounting records only when it is realised. Here arises two questions in mind. First, is termed as revenue and the other, when the revenue is realised. Let us take the first one first. Revenue is the gross inflow of cash arising from (i) the sale of goods and services by an enterprise; and (ii) use by others of the enterprise's resources yielding interest, royalties and dividends. Secondly, revenue is assumed to be realised when a legal right to receive it arises, i.e. the point of time when goods have been sold or service has been rendered. Thus, credit sales are treated as revenue on the day sales are made and not when money is received from the buyer. As for the income such as rent, commission, interest, etc. these are recongnised on a time basis. For example, rent for the month of March 2017, even if received in April 2017, will be taken into the profit and loss account of the financial year ending March 31, 2017 and not into financial year beginning with April 2017. 2022-23 30 Accountancy Similarly, if interest for April 2017 is received in advance in March 2017, it will be taken to the profit and loss account of the financial year ending March 2018. There are some exceptions to this general rule of revenue recognition. In case of contracts like construction work, which take long time, say 2-3 years to complete, proportionate amount of revenue, based on the part of contract completed by the end of the period is treated as realised. Similarly, when goods are sold on hire purchase, the amount collected in installments is treated as realised. 2.2.8 Matching Concept The process of ascertaining the amount of profit earned or the loss incurred during a particular period involves deduction of related expenses from the revenue earned during that period. The matching concept emphasises exactly on this aspect. It states that expenses incurred in an accounting period should be matched with revenues during that period. It follows from this that the revenue and expenses incurred to earn these revenues must belong to the same accounting period. As already stated, revenue is recognised when a sale is complete or service is rendered rather when cash is received. Similarly, an expense is recognised not when cash is paid but when an asset or service has been used to generate revenue. For example, expenses such as salaries, rent, insurance are recognised on the basis of period to which they relate and not when these are paid. Similarly, costs like depreciation of fixed asset is divided over the periods during which the asset is used. Let us also understand how cost of goods are matched with their sales revenue. While ascertaining the profit or loss of an accounting year, we should not take the cost of all the goods produced or purchased during that period but consider only the cost of goods that have been sold during that year. For this purpose, the cost of unsold goods should be deducted from the cost of the goods produced or purchased. You will learn about this aspect in detail in the chapter on financial statement. The matching concept, thus, implies that all revenues earned during an accounting year, whether received during that year, or not and all costs incurred, whether paid during the year, or not should be taken into account while ascertaining profit or loss for that year. 2.2.9 Full Disclosure Concept Information provided by financial statements are used by different groups of people such as investors, lenders, suppliers and others in taking various financial decisions. In the corporate form of organisation, there is a distinction 2022-23 Theory Base of Accounting 31 between those managing the affairs of the enterprise and those owning it. Financial statements, however, are the only or basic means of communicating financial information to all interested parties. It becomes all the more important, therefore, that the financial statements makes a full, fair and adequate disclosure of all information which is relevant for taking financial decisions. The principle of full disclosure requires that all material and relevant facts concerning financial performance of an enterprise must be fully and completely disclosed in the financial statements and their accompanying footnotes. This is to enable the users to make correct assessment about the profitability and financial soundness of the enterprise and help them to take informed decisions. To ensure proper disclosure of material accounting information, the Indian Companies Act 1956 has provided a format for the preparation of profit and loss account and balance sheet of a company, which needs to be compulsorily adhered to, for the preparation of these statements. The regulatory bodies like SEBI, also mandates complete disclosures to be made by the companies, to give a true and fair view of profitability and the state of affairs. 2.2.10 Consistency Concept The accounting information provided by the financial statements would be useful in drawing conclusions regarding the working of an enterprise only when it allows comparisons over a period of time as well as with the working of other enterprises. Thus, both inter-firm and inter-period comparisons are required to be made. This can be possible only when accounting policies and practices followed by enterprises are uniform and are consistent over the period of time. To illustrate, an investor wants to know the financial performance of an enterprise in the current year as compared to that in the previous year. He may compare this year's net profit with that in the last year. But, if the accounting policies adopted, say with respect to depreciation in the two years are different, the profit figures will not be comparable. Because the method adopted for the valuation of stock in the past two years is inconsistent. It is, therefore, important that the concept of consistency is followed in preparation of financial statements so that the results of two accounting periods are comparable. Consistency eliminates personal bias and helps in achieving results that are comparable. Also the comparison between the financial results of two enterprises would be meaningful only if same kind of accounting methods and policies are adopted in the preparation of financial statements. However, consistency does not prohibit change in accounting policies. Necessary required changes are fully disclosed by presenting them in the financial statements indicating their probable effects on the financial results of business. 2022-23 32 Accountancy 2.2.11 Conservatism Concept The concept of conservatism (also called 'prudence') provides guidance for recording transactions in the book of accounts and is based on the policy of playing safe. The concept states that a conscious approach should be adopted in ascertaining income so that profits of the enterprise are not overstated. If the profits ascertained are more than the actual, it may lead to distribution of dividend out of capital, which is not fair as it will lead to reduction in the capital of the enterprise. The concept of conservatism requires that profits should not to be recorded until realised but all losses, even those which may have a remote possibility, are to be provided for in the books of account. To illustrate, valuing closing stock at cost or market value whichever is lower; creating provision for doubtful debts, discount on debtors; writing of intangible assets like goodwill, patents, etc. from the book of accounts are some of the examples of the application of the principle of conservatism. Thus, if market value of the goods purchased has fallen down, the stock will be shown at cost price in the books but if the market value has gone up, the gain is not to be recorded until the stock is sold. This approach of providing for the losses but not recognising the gains until realised is called conservatism approach. This may be reflecting a generally pessimist attitude adopted by the accountants but is an important way of dealing with uncertainty and protecting the interests of creditors against an unwanted distribution of firm's assets. However, deliberate attempt to underestimate the value of assets should be discouraged as it will lead to hidden profits, called secret reserves. 2.2.12 Materiality Concept The concept of materiality requires that accounting should focus on material facts. Efforts should not be wasted in recording and presenting facts, which are immaterial in the determination of income. The question that arises here is what is a material fact. The materiality of a fact depends on its nature and the amount involved. Any fact would be considered as material if it is reasonably believed that its knowledge would influence the decision of informed user of financial statements. For example, money spent on creation of additional capacity of a theatre would be a material fact as it is going to increase the future earning capacity of the enterprise. Similarly, information about any change in the method of depreciation adopted or any liability which is likely to arise in the near future would be significant information. All such information about material facts should be disclosed through the financial statements and the accompanying notes so that users can take informed decisions. In certain cases, when the amount involved is very small, strict adherence to accounting principles is not required. For example, stock of erasers, pencils, scales, etc. are not shown as assets, whatever amount of stationery is bought in an accounting period is treated as the expense of that period, whether consumed or not. The amount spent is treated as revenue expenditure and taken to the profit and loss account of the year in which the expenditure is incurred. 2022-23 Theory Base of Accounting 33 2.2.13 Objectivity Concept The concept of objectivity requires that accounting transaction should be recorded in an objective manner, free from the bias of accountants and others. This can be possible when each of the transaction is supported by verifiable documents or vouchers. For example, the transaction for the purchase of materials may be supported by the cash receipt for the money paid, if the same is purchased on cash or copy of invoice and delivery challan, if the same is purchased on credit. Similarly, receipt for the amount paid for purchase of a machine becomes the documentary evidence for the cost of machine and provides an objective basis for verifying this transaction. One of the reasons for the adoption of 'Historical Cost' as the basis of recording accounting transaction is that adherence to the principle of objectivity is made possible by it. As stated above, the cost actually paid for an asset can be verified from the documents but it is very difficult to ascertain the market value of an asset until it is actually sold. Not only that, the market value may vary from person to person and from place to place, and so 'objectivity' cannot be maintained if such value is adopted for accounting purposes. Test Your Understanding - II Fill in the correct word: 1. Recognition of expenses in the same period as associated revenues is called ________________concept. 2. The accounting concept that refers to the tendency of accountants to resolve uncertainty and doubt in favour of understating assets and revenues and overstating liabilities and expenses is known as ________________. 3. Revenue is generally recongnised at the point of sale denotes the concept of ________________. 4. The ________________concept requires that the same accounting method should be used from one accounting period to the next. 5. The________________concept requires that accounting transaction should be free from the bias of accountants and others. 2.3 Systems of Accounting The systems of recording transactions in the book of accounts are generally classified into two types, viz. Double entry system and Single entry system. Double entry system is based on the principle of "Dual Aspect" which states that every transaction has two effects, viz. receiving of a benefit and giving of a benefit. Each transaction, therefore, involves two or more accounts and is recorded at different places in the ledger. The basic principle followed is that every debit must have a corresponding credit. Thus, one account is debited and the other is credited. Double entry system is a complete system as both the aspects of a transaction are recorded in the book of accounts. The system is accurate and 2022-23 34 Accountancy more reliable as the possibilities of frauds and mis-appropriations are minimised. The arithmetic inaccuracies in records can mostly be checked by preparing the trial balance. The system of double entry can be implemented by big as well as small organisations. Single entry system is not a complete system of maintaining records of financial transactions. It does not record two-fold effect of each and every transaction. Instead of maintaining all the accounts, only personal accounts and cash book are maintained under this system. In fact, this is not a system but a lack of system as no uniformity is maintained in the recording of transactions. For some transactions, only one aspect is recorded, for others, both the aspects are recorded. The accounts maintained under this system are incomplete and unsystematic and therefore, not reliable. The system is, however, followed by small business firms as it is very simple and flexible (you will study about them in detail later in this book). 2.4 Basis of Accounting From the point of view the timing of recognition of revenue and costs, there can be two broad approaches to accounting. These are: (i) Cash basis; and (ii) Accrual basis. Under the cash basis, entries in the book of accounts are made when cash is received or paid and not when the receipt or payment becomes due. Let us say, for example, if office rent for the month of December 2014, is paid in January 2015, it would be recorded in the book of account only in January 2015. Similarly sale of goods on credit in the month of January 2015 would not be recorded in January but say in April, when the payment for the same is received. Thus this system is incompatible with the matching principle, which states that the revenue of a period is matched with the cost of the same period. Though simple, this method is inappropriate for most organisations as profit is calculated as a difference between the receipts and disbursement of money for the given period rather than on happening of the transactions. Under the accrual basis, however, revenues and costs are recognised in the period in which they occur rather when they are paid. A distinction is made between the receipt of cash and the right to receive cash and payment of cash and legal obligation to pay cash. Thus, under this system, the monitory effect of a transaction is taken into account in the period in which they are earned rather than in the period in which cash is actually received or paid by the enterprise. This is a more appropriate basis for the calculation of profits as expenses are matched against revenue earned in relation thereto. For example, raw material consumed are matched against the cost of goods sold. 2022-23 Theory Base of Accounting 35 2.5 Accounting Standards Accounting standards are written policy documents covering the aspects of recognition, measurement, treatment, presentation and disclosure of accounting transactions in financial statements. Accounting standard is an authoritative statement issued by ICAI, a professional body of accounting in our country. The objective of accounting standard is to bring uniformity in different accounting policies in order to eliminate non comparability of financial statements for enhancing reliability of financial statements. Secondly, the accounting standard provides a set of standard accounting policies, valuation norms and disclosure requirements. In addition to improving credibility of accounting data, accounting standard enhances comparability of financial statements, both intra and inter enterprises. Such comparisons are very effective and widely used for assessment of firms' performance by the users of accounting. Need for Accounting Standards Accounting extends information to various users of information. Accounting information can serve the interest of different users only if it possesses uniformity and full disclosure of relevant information. There can be alternate accounting treatment and valuation norms which may be used by any business entity. Accounting standard facilitate the scope of those alternatives which fulfil the basic qualitative characteristics of true and fair financial statement. Benefits of Accounting Standards 1. Accounting standard helps in eliminating variations in accounting treatment to prepare financial statements. 2. Accounting standard may call for disclosures of certain information which may not be required by law, but such information might be useful for general public, investors and creditors. 3. Accounting standard facilitate comparability between financial statements of inter and intra companies. Limitations of Accounting Standards 1. Accounting standard makes choice between different alternate accounting treatments difficult to apply. 2. It is rigidly followed and fails to extend flexibility in applying accounting standards. 3. Accounting standard cannot override the statue. The standards are required to be farmed within the ambit of prevailing status. 2022-23 36 Accountancy Applicability of Accounting Standards Except the purely charitable organisation which does not have any commercial, industrial and business activity, accounting standard is applicable to: 1. Sole proprietorship unit 2. Partnership firm 3. Societies 4. Trusts 5. Hindu undivided family 6. Association of persons 7. Cooperative societies 8. Companies 9. International Financial Reporting System 10.There have been vast changes in the global economic scenario with the emergence of globalisation, liberalisation and privatization. The advent of translational corporations in search of funds in order to sustain their ongoing operations in addition to fuelling the growth of economy has resulted in raising capital globally, i.e., cutting across international boundaries. Since each country has its own set of rules and regulations for maintaining business records for accounting purposes and financial reporting, it becomes a cumbersome and complex exercise to comply with the existing accounting rules and regulations of the country in case the business enterprise decides to raise its capital needs from foreign country. In order to make economy more dynamic, competitive and to boost confidence amongst international analysts and investors, it is important that the financial statements put forward by the business organisations across the countries are comparable on similar parameters, investor friendly, fair, transparent and decisions worthy. In view of this, a trend towards global convergence of accounting standards is seeking momentum for international financial reporting. Need for IFRS 1. The important economic decisions are made on the basis of financial statements. In order to avoid manipulations of figures in the financial accounts, there is a need for consistent way of deciding which elements require recognition and measurement and how information is presented in the financial statements. Hence, IFRS helps to prevent material manipulation or errors in financial statements. 2. IFRS helps in global harmonisation. Unless accounting activities are regulated, different countries will apply different set of accounting rules and regulations are prevalent in each country. This will restrict uniformity 2022-23 Theory Base of Accounting 37 and comparability of financial statements. Hence, IFRS promotes global standards for each of business growth. 3. It facilitates global investment. The convergence of financial reporting and accounting standards is a valuable process that contributes to the free flow of global investments and achieves substantial benefits for all capital market stakeholders. To uniform accounting policies and procedures almost all countries have agreed to apply IFRS. But the name of this IFRS has been converged as Ind AS. In substance , Ind AS is not different from IFRS. Ind AS is accounting standard notified by ministry of corporate affairs and has wide range of convergence as compared to existing accounting standards. The list of Ind AS and existing standards for comparative analysis is given below: Ind_AS Title 1 Presentation of Financial Statements 2 Inventories 7 Cash Flow Statements 8 Accounting Policies, Changes in Accounting Estimates and Errors 10 Events after the Balance Sheet Date 11 Construction Contracts 12 Income Taxes 16 Property, Plant and Equipment 17 Leases 18 Revenue 19 Employee Benefits 20 Accounting for Government Grants and Disclosure of Government Assistance 21 The Effects of Changes in Foreign Exchange Rates 23 Borrowing Costs 24 Related Party Disclosures AS Title 1 Disclosure of accounting policies —- Framework for preparation and presentation of financial statements 2 Valuation of inventories 3 Cash flow statements 5 Net profit or loss for the period, prior period items and changes in accounting policies 4 Contingencies and events occurring after the balance sheet date 7 Construction contracts 22 Accounting for taxes on income 10 Accounting for fixed assets 6 Depreciation accounting 19 Leases 9 Revenue recognition 15 Employee Benefits 12 Accounting for government grants 11 The effects of changes in foreign exchange rates 16 Borrowing Costs 18 Related Party Disclosures 2022-23 38 Accountancy 27 Consolidated and Separate Financial Statements 28 Investments in Associates 29 Financial Reporting in Hyperinflationary Economics 31 Interests in Joint Ventures 32 Financial Instruments: Presentation 33 Earnings Per Share 34 Interim Financial Reporting 36 Impairment of assets 37 Provisions, contingent liabilities and contingent assets 38 Intangible assets 39 Financial instruments: Recognition and measurement 40 Investment property 101 First time adoption of international financial reporting standards 102 Share-based payments 103 Business combinations 104 Insurance Contracts 105 Non-current Assets held for Sale and Discontinued Operations 106 Exploration for and Evaluation of Mineral Resources 107 Financial Instruments: Disclosures 108 Operating Segments 21 Consolidated Financial Statements 23 Accounting for Investment in Associates in CFS —- 27 Financial reporting of interest in joint venture 31 Financial instrument: Presentation 20 Earnings Per Share 25 Interim Financial reporting 28 Impairment of Asset 29 Provisions, contingent liabilities and contingent assets 30 Intangible assets 13 Financial instruments: Recognition and measurement 13 Accounting for investments 13 Accounting for investments --- --- G.N. on employee share based payment 14 Accounting for amalgamations —- 24 Discontinuing Operation —- --- 32 Financial Instrument : Disclosure 17 Segment Reporting 2022-23 Theory Base of Accounting 39 Goods and Services Tax (One Country One Tex) GST is a destination based tax on consumption of goods and services. It is proposed to be levied at all stages right from manufacture up to final consumption with credit of taxes paid at previous stages available as setoff. In a nutshell, only value addition will be taxed and burden of tax is to be borne by the final consumer. The concept of destination based tax on consumption implies has the tax would accrue to the taxing authority which has jurisdiction over the place of consumption which is also termed as place of supply. GST has a dual aspect with the Centre and States simultaneously levying on a common tax base. There are three main components of GST which are CGST, SGST, CGST means Central Goods and Services Tax. Taxes collected under CGST will constitute the revenues of the Central Government . The present central taxes like central excise duty, additional excise duty, special excise duty, central sales tax etc., will be subsumed under CGST. SGST means State Good and Services Tax. A collection of SGST is the revenue of the State Government. With GST all state taxes like VAT, entertainment tax, luxury tax, entry tax etc, will be merged with GST. For example, Ramesh a dealer in Punjab sell goods to Seema in Punjab worth ` 10,000. If the GST rate is 18%, i.e., 9% CGST and 9% SGST, ` 900 will go to Central Government and 900 will go to Punjab Government. IGST means Integrated Goods and Services Tax. Revenue collected under IGST is divided between Central and State Government as per the rates specified by the Government. IGST is charged on transfer of goods and services from one state to another. Import of goods and services are also covered under IGST. For example, if the goods are transferred from Madhya Pradesh to Rajasthan then this transaction will attract IGST. Lets extend the above example to understand SGST. If Ramesh in Madhya Pradesh sell goods to Anand in Rajasthan worth ` 1,000,000. Applicable GST late is 18% i.e., 9% CGST and 9% SGST. In this case, the dealer will charge 18,000 as IGST and will go the Central Government. India is a federal country where both the Centre and the States have been assigned the powers to levy and collect taxes through appropriate legislation. Both the levels of government have distinct responsibilities to perform according to the division of powers prescribed in the Constitution for which they need to rise resources. A dual GST will, therefore, be in keeping with the Constitutional requirement of fiscal federalism. Hence, Centre will levy and administer CGST & IGST while respective states will levy and administer SGST. The Constitution of India has been amended for this purpose. 2022-23 40 Accountancy Characteristics of Goods and Services Tax 1. GST is a common law and procedure throughout the country under single administration. 2. GST is a destination based tax and levied at a single point at the time of consumption of goods and services by the end consumer. 3. GST is a comprehensive levy and collection on both goods and services at the same rate with benefit of input tax credit or subtraction of value. 4. Minimum number of rates of tax does not exceed two. 5. There is no scope for levy of cess, resale tax, additional tax, turnover tax etc. 6. There is no multiple levy of tax on goods and services, such as sales tax, entry tax, octroi, entertainment tax or luxury tax etc. Do it yourself State how the GST rates will be applicable if CGST is 9%, SGST is 9% and IGST 18% in each of the following situations: 1. Goods worth ` 10,000 is sold by a Manufacturer 1 in Maharashtra to a Dealer A in Maharastra. 2. Dealer A sell goods worth ` 25,000 to Dealer B in Gujarat. 3. Dealer B sell goods to Sunita in Gujarat worth ` 30,000. 4. Sunita sell goods to Ravindra in Rajasthan worth ` 65,000. 2022-23 Theory Base of Accounting 41 Advantages 1. Introduction of GST has resulted in the abolition of multiple types of taxes in goods and services. 2. GST widens the tax base and increased revenue to Centre and State thereby reducing administrative cost for the Government. 3. GST has reduced compliance cost and increases voluntary compliance. 4. GST has affected rates of tax to the maximum of two floor rates. 5. GST has removed the cascading effect on taxation. 6. GST will result in enhancing manufacturing and distribution system affecting the cost of production of goods and services and consequently the demand and production of goods and services will increase. 7. It will eventually promote economic efficiency and sustainable long term economic growth as GST is neutral to business processes, business models, organisational structure and geographical location. 8. GST would help to extend competitive edge in international market for goods and services produced in the country leading to increased exports. GST Intra-State Movement Inter-State Movement CGST SGST IGST GST levied by the Centre GST levied by the State GST levied by the Centre and States Concurrently Key Terms Introduced in the Chapter • Cost • Matching • Materiality • Objectivity • Consistency • Dual aspect • Conservatism(Prudence) • Going concern • Comparibility • Full discloser • Generally accepted • Revenue Relisation • Operating guidelines • Accounting period • Money measurement • Accounting concept • Accounting Principles (GAAP) • GAAP • GST 2022-23 42 Accountancy Summary with Reference to Learning Objectives 1. Generally Accepted Accounting Principles (GAAP): Generally Accepted Accounting principles refer to the rules or guidelines adopted for recording and reporting of business transactions in order to bring uniformity in the preparation and presentation of financial statements. These principles are also referred to as concepts and conventions. From the practicality view point, the various terms such as principles, postulates, conventions modifying principles, assumptions, etc. have been used interchangeably and are referred to as basic accounting concepts, in the present book. 2. Basic Accounting Concepts: The basic accounting concepts are referred to as the fundamental ideas or basic assumptions underlying the theory and practice of financial accounting and are broad working rules of accounting activities. 3. Business Entity: This concept assumes that business has distinct and separate entity from its owners. Thus, for the purpose of accounting, business and its owners are to be treated as two separate entities. 4. Money Measurement: The concept of money measurement states that only those transactions and happenings in an organisation, which can be expressed in terms of money are to be recorded in the book of accounts. Also, the records of the transactions are to be kept not in the physical units but in the monetary units. 5. Going Concern: The concept of going concern assumes that a business firm would continue to carry out its operations indefinitely (for a fairly long period of time) and would not be liquidated in the near future. 6. Accounting Period: Accounting period refers to the span of time at the end of which the financial statements of an enterprise are prepared to know whether it has earned profits or incurred losses during that period and what exactly is the position of its assets and liabilities, at the end of that period. 7. Cost Concept: The cost concept requires that all assets are recorded in the book of accounts at their cost price, which includes cost of acquisition, transportation, installation and making the asset ready for the use. 8. Dual Aspect: This concept states that every transaction has a dual or two-fold effect on various accounts and should therefore be recorded at two places. The duality principle is commonly expressed in terms of fundamental accounting equation, which is: Assets = Liabilities + Capital 9. Revenue Recognition: Revenue is the gross in-flow of cash arising from the sale of goods and services by an enterprise and use by others of the enterprise resources yielding interest royalities and divididends. The concept of revenue recognition requires that the revenue for a business transaction should be considered realised when a legal right to receive it arises. 10. Matching: The concept of matching emphasises that expenses incurred in an accounting period should be matched with revenues during that period. It follows from this that the revenue and expenses incurred to earn these revenue must belong to the same accounting period. 11. Full Disclosure: This concept requires that all material and relevant facts concerning financial performance of an enterprise must be fully and completely disclosed in the financial statements and their accompanying footnotes. 12. Consistency: This concepts states that accounting policies and practices followed by enterprises should be uniform and consistent one the period of time so that results 2022-23 Theory Base of Accounting 43 are composable. Comparability results when the same accounting principles are consistently being applied by different enterprises for the period under comparison, or the same firm for a number of periods. 13. Conservatism: This concept requires that business transactions should be recorded in such a manner that profits are not overstated. All anticipated losses should be accounted for but all unrealised gains should be ignored. 14. Materiality: This concept states that accounting should focus on material facts. If the item is likely to influence the decision of a reasonably prudent investor or creditor, it should be regarded as material, and shown in the financial statements. 15. Objectivity: According to this concept, accounting transactions should be recorded in the manner so that it is free from the bias of accountants and others. 16. Systems of Accounting: There are two systems of recording business transactions, viz. double entry system and single entry system. Under double entry system every transaction has two-fold effects where as single entry system is known as incomplete records. 17. Basis of Accounting: The two broad approach of accounting are cash basis and accrual basis. Under cash basis transactions are recorded only when cash are received or paid. Whereas under accrual basis, revenues or costs are recognises when they occur rather than when they are paid. 18. Accounting Standards: Accounting standards are written statements of uniform accounting rules and guidelines in practice for preparing the uniform and consistent financial statements. These standards cannot over ride the provisions of applicable laws, customs, usages and business environment in the country. 19. GST is a destination tax on the consumption of goods and services levied at all stages right from manufacturing up to the final consumption with credit of taxes paid at previous stages. Questions for Practice Short Answers 1. Why is it necessary for accountants to assume that business entity will remain a going concern? 2. When should revenue be recognised? Are there exceptions to the general rule? 3. What is the basic accounting equation? 4. The realisation concept determines when goods sent on credit to customers are to be included in the sales figure for the purpose of computing the profit or loss for the accounting period. Which of the following tends to be used in practice to determine when to include a transaction in the sales figure for the period. When the goods have been: a. dispatched b. invoiced c. delivered d. paid for Give reasons for your answer. 5. Complete the following worksheet: (i) If a firm believes that some of its debtors may ‘default’, it should act on this by making sure that all possible losses are recorded in the books. This is an example of the ___________ concept. (ii) The fact that a business is separate and distinguishable from its owner is best exemplified by the ___________ concept. 2022-23 44 Accountancy (iii) Everything a firm owns, it also owns out to somebody. This co-incidence is explained by the ___________ concept. (iv) The ___________ concept states that if straight line method of depreciation is used in one year, then it should also be used in the next year. (v) A firm may hold stock which is heavily in demand. Consequently, the market value of this stock may be increased. Normal accounting procedure is to ignore this because of the ___________. (vi) If a firm receives an order for goods, it would not be included in the sales figure owing to the ___________. (vii) The management of a firm is remarkably incompetent, but the firms accountants can not take this into account while preparing book of accounts because of ___________ concept. Long Answers 1. ‘The accounting concepts and accounting standards are generally referred to as the essence of financial accounting’. Comment. 2. Why is it important to adopt a consistent basis for the preparation of financial statements? Explain. 3. Discuss the concept-based on the premise ‘do not anticipate profits but provide for all losses'. 4. What is matching concept? Why should a business concern follow this concept? Discuss. 5. What is the money measurement concept? Which one factor can make it difficult to compare the monetary values of one year with the monetary values of another year? Activity 1 Ruchica's father is the sole proprietor of 'Friends Gifts', a firm engaged in the sale of gift items. In the process of preparing financial statements, the accountant of the firm Mr. Goyal fell ill and had to proceed on leave. Ruchica's father was urgently in need of the statements as these had to be submitted to the bank, in pursuance of a loan of ` 5 lakh applied for the expansion of the business of the firm. Ruchica who is studying Accounting in her school, volunteered to complete the work. On scrutinising the accounts, the banker found that the value of building bought a few years back for ` 7 lakh has been shown in the books at ` 20 lakh, which is its present market value. Similarly, as compared to the last year, the method of valuation of stock was changed, resulting in value of goods to be about 15 per cent higher. Also, the whole amount of ` 70,000 spent on purchase of personal computer (expected life 5 years) during the year had been charged to the profits of the current year. The banker did not rely on the financial data provided by Ruchica. Advise Ruchica for the mistakes committed by her in the preparation of financial statements in the context of basic concepts in accounting. Activity 2 A customer has filed a suit against a trader who has supplied poor quality goods to him. It is known that the court judgment will be in favour of the customer and the trader will be required to pay the damages. However, the amount of legal damages is not known with certainity. The accounting year has already been ended and the books are now finalised to ascertain true profit or loss. The accountant of the trader has advised him not to consider 2022-23 Theory Base of Accounting 45 the expected loss on account of payment of legal damages because the amount is not certain and the final judgment of the court is not yet out. Do you think the accountant is right in his approach. Checklist to Test Your Understanding Test Your Understanding - I 1. (c) 2. (d) 3. (a) 4. (b) Test Your Understanding - II 1. Matching 2. Conservatism 3. Revenue Realisation 4. Consistency 5. Objectivity 2022-2346 Accountancy LEARNING OBJECTIVES After studying this chapter, you will be able to: • describe the nature of transaction and source documents; • explain the preparation of accounting vouchers; • apply accounting equation to explain the effect of transactions; • record transactions using rules of debit and credit; • explain the concept of book of original entry and recording of transactions in journal; • explain the concept of ledger and posting of journal entries to the ledger accounts. I n chapter 1 and 2, while explaining the development and importance of accounting as a source of disseminating the financial information along with the discussion on basic accounting concepts that guide the recording of business transactions, it has been indicated that accounting involves a process of identifying and analysing the business transactions, recording them, classifying and summarising their effects and finally communicating it to the interested users of accounting information. In this chapter, we will discuss the details of each step involved in the accounting process. The first step involves identifying the transactions to be recorded and preparing the source documents which are in turn recorded in the basic book of original entry called journal and are then posted to individual accounts in the principal book called ledger. 3.1 Business Transactions and Source Document After securing good percentage in your previous examination, as promised, your father wishes to buy you a computer. You go to the market along with your father to buy a computer. The dealer gives a cash memo along with the computer and in exchange your father makes cash payment of ` 35,000. Purchase of computer for cash is an example of a transaction, which involves reciprocal exchange of two things: (i) payment of cash, (ii) delivery of a computer. Hence, the transaction Recording of Transactions-I 3 2022-23 Recording of Transactions - I 47 involves this aspect, i.e. Give and Take. Payment of cash involves give aspect and delivery of computer is a take aspect. Thus, business transactions are exchanges of economic consideration between parties and have two-fold effects that are recorded in at least two accounts. Business transactions are usually evidenced by an appropriate documents such as Cash memo, Invoice, Sales bill, Pay-in-slip, Cheque, Salary slip, etc. A document which provides evidence of the transactions is called the Source Document or a Voucher. At times, there may be no documentary for certain items as in case of petty expenses. In such case voucher may be prepared showing the necessary details and got approved by appropriate authority within the firm. All such documents (vouchers) are arranged in chronological order and are serially numbered and kept in a separate file. All recording in books of account is done on the basis of vouchers. Transaction Voucher Name of Firm : Voucher No : Date : Debit account : Credit account: Amount (`) : Narration : Authorised By : Prepared By : Fig. 3.1 : Showing specimen transaction voucher 3.1.1 Preparation of Accounting Vouchers Accounting vouchers may be classified as cash vouchers, debit vouchers, credit vouchers, journal vouchers, etc. There is no set format of accounting vouchers. A specimen of a simple transaction voucher is used in practice is shown in figure 3.1. These must be preserved in any case till the audit of the accounts and tax assessments for the relevant period are completed. Now a days, accounting is computerised and the necessary accounting vouchers showing the code number and name of the accounts to be debited and credited are prepared for the purpose of necessary recording of transactions. A transaction with one debit and one credit is a simple transaction and the accounting vouchers prepared for such transaction is known as Transaction Voucher, the format of 2022-23 48 Accountancy which is shown in figure 3.1. Voucher which records a transaction that entails multiple debits/credits and one credit/debit is called compound voucher. Compound voucher may be: (a) Debit Voucher o7r (b) Credit Voucher; the specimen is shown in figure 3.2. Debit Voucher Name of Firm : Voucher No : Date : Credit Account : Amount : Debit Accounts S. No. Code Account Name Amount Narration (i.e. Explanation) ` Authorised By : Prepared By : Credit Voucher Name of Firm : Voucher No : Date : Debit Account : Amount : Credit Accounts S. No. Code Account Name Amount Narration (i.e. Explanation) ` Authorised By : Prepared By : Fig. 3.2 : Showing debit and credit vouchers 2022-23 Recording of Transactions - I 49 Transactions with multiple debits and multiple credits are called complex transactions and the accounting voucher prepared for such transaction is known as Complex Voucher/ Journal Voucher. The format of a complex transaction voucher is shown in figure 3.3. Journal Voucher Name of Firm : Voucher No : Date : Debit Accounts S. No. Code Account Name Amount Narration (i.e. Explanation) ` Credit Accounts S. No. Code Account Name Amount Narration (i.e. Explanation) ` Authorised By : Prepared By : Fig. 3.3 : Showing specimen of complex transaction voucher The design of the accounting vouchers depends upon the nature, requirement and convenience of the business. There is no set format of an accounting voucher. To distinguish various vouchers, different colour papers and different fonts of printing are used. Some of the specimen of the accounting vouchers are given in the earlier pages. An accounting voucher must contain the following essential elements : • It is written on a good quality paper; • Name of the firm must be printed on the top; • Date of transaction is filled up against the date and not the date of recording of transaction is to be mentioned; • The number of the voucher is to be in a serial order; • Name of the account to be debited or credited is mentioned; 2022-23 50 Accountancy • Debit and credit amount is to be written in figures against the amount; • Description of the transaction is to be given account wise; • The person who prepares the voucher must mention his name along with signature; and • The name and signature of the authorised person are mentioned on the voucher. 3.2 Accounting Equation Accounting equation signifies that the assets of a business are always equal to the total of its liabilities and capital (owner's equity). The equation reads as follows: A = L + C Where, A = Assets L = Liabilities C = Capital The above equation can also be presented in the following forms as its derivatives to enable the determination of missing figures of Capital(C) or Liabilities(L). (i) A – L = C (ii) A – C = L Since, the accounting equation depicts the fundamental relationship among the components of the balance sheet, it is also called the Balance Sheet Equation. As the name suggests, the balance sheet is a statement of assets, liabilities and capital. At any point of time resources of the business entity must be equal to the claims of those who have financed these resources. The proprietors and outsiders provide the resources of the business. The claim of the proprietors is called capital and that of the outsides is known as liabilities. Each element of the equation is the part of balance sheet, which states the financial position of the business on a particular date. When we analyse the transactions, we actually try to know that how balance sheet of a business entity gets affected. Asset side of the balance sheet is the list of assets, which the business entity owns. The liabilities side of the balance sheet is the list of owner's claims and outsider's claims, i.e., what the business entity owes. The equality of the assets side and the liabilities side of the balance sheet is an undeniable fact and this justifies the name of accounting equation as balance sheet equation also. 2022-23 Recording of Transactions - I 51 For example, Rohit started business with a capital of ` 5,00,000. From the accounting point of view, the resources of this business entity is in the form of cash, i.e., ` 5,00,000. Sources of this business entity is the contribution by Rohit (Proprietor) ` 5,00,000 as Capital . (For the purpose of understanding we will refer this example as example 1, throughout the chapter) . If we put this information in the form of equality of resources and sources, the picture would emerge somewhat as follows: Books of Rohit Balance Sheet as at .... Liabilities Amount Assets Amount ` ` Capital 5,00,000 Cash in hand 5,00,000 5,00,000 5,00,000 In the above balance sheet, the total assets are equal to the liabilities of the business. Since, the business has not yet started its activities and has not earned any profits; the amount invested in business is still ` 5,00,000. In case any profits are earned, it will increase the invested amount in business. On the other hand, if business suffers any losses, it will decrease the invested amount in business. We will now analyse the transactions listed in example 1 and its effect on different elements and you will observe that the accounting equation always remain balanced: Example 1. 1. Opened a bank account in State Bank of India with an amount of ` 4,80,000. Analysis of transaction: This transaction increases the cash at bank (assets) and decreases cash (asset) by ` 4,80,000. 2. Bought furniture for ` 60,000 and cheque was issued on the same day. Analysis of transaction: This transaction increases furniture (assets) and decreases bank (assets) by ` 60,000. 3. Bought plant and machinery for the business for ` 1,25,000 and an advance of ` 10,000 in cash is paid to M/s Ramjee Lal. Analysis of transaction: This transaction increases plant and machinery (assets) by ` 1,25,000, decreases cash by ` 10,000 and increases liabilities (M/s Ramjee lal as creditor) by ` 1,15,000. 2022-23 52 Accountancy 4. Goods purchased from M/s Sumit Traders for ` 55,000. Analysis of transaction: This transaction increases goods (assets) and increases liabilities (M/s Sumit Traders as creditors) by ` 55,000. 5. Goods costing ` 25,000 sold to Rajani Enterprises for ` 35,000. Analysis of transaction: This transaction decreases stock of goods (assets) by ` 25,000 and increases assets (Rajani Enterprises as debtors ` 35,000) and capital (with the profit of ` 10,000) The final equation as per the above analysis table can be summarised in the form of a balance sheet as under: Balance Sheet as at.....2017 Liabilities Amount Assets Amount ` ` Outsider's Claims (Creditors) 1,70,000 Cash 10,000 Capital 5,10,000 Bank 4,20,000 Debtors 35,000 Stock 30,000 Furniture 60,000 Plant & Machinery 1,25,000 6,80,000 6,80,000 In terms of accounting equation A = L + C ` 6,80,000 = ` 1,70,000 + ` 5,10,000 3.3 Using Debit and Credit As already stated every transaction involves give and take aspect. In double entry accounting, every transaction affects and is recorded in at least two accounts. When recording each transaction, the total amount debited must equal to the total amount credited. In accounting, the terms — debit and credit indicate whether the transactions are to be recorded on the left hand side or right hand side of the account. In its simplest form, an account looks like the letter T. Because of its shape, this simple form called a T-account (refer figure 3.4). Notice that the T format has a left side and a right side for recording increases and decreases in the item. This helps in ascertaining the ultimate position of each item at the end of an accounting period. For example, if it is an account of a customer all goods sold shall appear on the left (debit) side of customer's account and all payments received on the right side. The difference between the totals of the two sides called balance shall reflect the amount due to the customer. In a T account, the left side is called debit (often abbreviated as Dr.) and the right side is known as credit (often abbreviated as Cr.). To 2022-23 53 Recording of Transactions - I The summary of effects of transactions on accounting equation is in the following analysis table: (Figures in rupees) Transaction Cash Bank Assets Goods Furniture Plant and Total Liabilities Capital Total No. Debtors (Stock) Machinery Assets 5,00,000 5,00,000 .... 5,00,000 5,00,000 1. (4,80,000) 4,80,000 .... Post Trans. 20,000 4,80,000 5,00,000 5,00,000 5,00,000 Equation 2. .... (60,000) 60,000 .... Post Trans. 20,000 4,20,000 60,000 5,00,000 5,00,,000 5,00,000 Equation 3. (10,000) 1,25,000 1,15,000 1,15,000 1,15,000 Post Trans. 10,000 4,20,000 60,000 1,25,000 6,15,000 1,15,000 5,00,000 6,15,000 Equation 4. 55,000 55,000 55,000 55,000 Post Trans. 10,000 4,20,000 55,000 60,000 1,25,000 6,70,000 1,70,000 5,00,000 6,70,000 Equation 5. 35,000 (25,000) 10,000 10,000 10,000 Final 10,000 4,20,000 35,000 30,000 60,000 1,25,000 6,80,000 1,70,000 5,10,000 6,80,000 Equation 2022-23 54 Accountancy enter amount on the left side of an account is to debit the account. To enter amount on the right side is to credit the account. Account Title (Left Side) (Right Side) Fig. 3.4 : Showing T-account 3.3.1 Rules of Debit and Credit All accounts are divided into five categories for the purposes of recording the transactions: (a) Asset (b) Liability (c) Capital (d) Expenses/Losses, and (e) Revenues/Gains. Two fundamental rules are followed to record the changes in these accounts: (1) For recording changes in Assets/Expenses (Losses): (i) "Increase in asset is debited, and decrease in asset is credited." (ii) "Increase in expenses/losses is debited, and decrease in expenses/ losses is credited." (2) For recording changes in Liabilities and Capital/Revenues (Gains): (i) "Increase in liabilities is credited and decrease in liabilities is debited." (ii) "Increase in capital is credited and decrease in capital is debited." (iii) "Increase in revenue/gain is credited and decrease in revenue/gain is debited." The rules applicable to the different kinds of accounts have been summarised in the following chart: Rules of Debit and Credit Asset (Increase) (Decrease) + – Debit Credit Capital (Decrease) (Increase) – + Debit Credit Revenues/Gains (Decrease) (Increase) – + Debit Credit Liabilities (Decrease) (Increase) – + Debit Credit Expenses/Losses (Increase) (Decrease) + – Debit Credit 2022-23 Recording of Transactions - I 55 The transactions in Example 1 on page 46 will help you to learn how to apply these debit and credit rules. Observe the analysis table given on page 48 carefully to be sure that you understand before you go on to the next one. To illustrate different kinds of events, three more transactions have been added (transactions 7 to 9). 1. Rohit started business with cash ` 5,00,000 Analysis of Transaction : The transaction increases cash on one hand and increases capital on the other hand. Increases in assets are debited and increases in capital are credited. Therefore record the transaction with debit to Cash and credit to Rohit's Capital. 2. Opened a bank account with an amount of ` 4,80,000 Analysis of Transaction: The transaction increases the cash at bank on one hand and decreases cash in hand on the other hand. Increases in assets are debited and a decreases in assets are credited. Therefore, record the transactions with debit to Bank account and credit to Cash account. 3. Bought furniture for ` 60,000 and issued cheque for the same Analysis of Transaction : This transaction increases furniture (assets) on one hand and decreases bank (assets) on the other hand by ` 60,000. Increases in assets are debited and decreases are credited. Therefore record the transactions with debit to Furniture account and credit to Bank account. 4. Bought Plant and Machinery from Ramjee lal for the business for - ` 1,25,000 and an advance of ` 10,000 in cash is given. Analysis of Transaction : This transaction increases plant and machinery (assets) by ` 1,25,000, decreases cash by ` 10,000 and increases liabilities (M/s Ramjee Lal as creditor) by ` 1,15,000. Increases in assets are debited whereas decreases in assets are credited. On the other hand increases in liabilities are credited. Therefore, record the transaction with debit to furniture account and with credit to Cash and Ramjee Lal's account. Cash Account (1) 5,00,000 Capital Account (1) 5,00,000 (6) 10,000 Cash Account (1) 5,00,000 (2) 4,80,000 Bank Account (2) 4,80,000 Furniture Account (1) 60,000 Bank Account (2) 4,80,000 (3) 60,000 2022-23 56 Accountancy 5. Goods purchased from Sumit Traders for ` 55,000 Analysis of transaction : This transaction increases purchases (expenses) and increases liabilities (M/s Sumit Traders as creditors) by ` 55,000. Increases in expenses are debited and increases in liabilities are credited. Therefore record the transaction with debit to Purchases account and credit to Sumit Traders account. 6. Goods costing ` 25,000 sold to Rajani Enterprises for ` 35,000 Analysis of transaction : This transaction increases sales (Revenue) and increases assets (Rajani Enterprises as debtors). Increases in assets are debited and increases in revenue are credited. Therefore record the entry with credit to Sales account and debit to Rajani Enterprises account. 7. Paid the monthly store rent ` 2,500 in cash Analysis of transaction : The payment of rent is an expense which decreases capital thus, are recorded as debits. Credit cash to record decrease in assets. 8. Paid ` 5,000 as salary to the office employees Analysis of transaction : The payment of salary is an expense which decreases capital thus, are recorded as debits. Credit Cash to record decrease in assets. Cash Account (1) 5,00,000 (2) 4,80,000 (4) 10,000 Plant and Machinery Account (4) 1,25,000 Ramjee Lal's Account (4) 1,15,000 Purchases Account (5) 55,000 Sumit Traders Account (5) 55,000 Sales Account (6) 35,000 Rajani Enterprises Account (6) 35,000 Rent Account (7) 2,500 Cash Account (7) 5,00,000 (2) 4,80,000 (4) 10,000 (7) 2,500 2022-23 Recording of Transactions - I 57 9. Received cheque as full payment from Rajani Enterprises and deposited same day into bank Analysis of transaction : This transaction increase assets (Bank) on the one hand and decreases assets (Rajani Enterprises as debtors) on the other hand. Increase in assets is debited whereas decrease in assets is credited. Therefore record the entry with debit to Bank account and credit to Rajani Enterprises account. Test Your Understanding - I 1. Double entry accounting requires that : (i) All transactions that create debits to asset accounts must create credits to liability or capital accounts; (ii) A transaction that requires a debit to a liability account require a credit to an asset account; (iii) Every transaction must be recorded with equal debits equal total credits. 2. State different kinds of transactions that increase and decrease capital. 3. Does debit always mean increase and credit always mean decrease? 4. Which of the following answers properly classifies these commonly used accounts: (1) Building (2) Wages (3) Credit sales (4) Credit purchases (5) Electricity charges due but not yet paid (outstanding electricity bills) (6) Godown rent paid in advance (prepaid godown rent) (7) Sales (8) Fresh capital introduced (9) Drawings (10) Discount paid Assets Liabilities Capital Revenue Expense (i) 5,4, 3, 9,6 2,10 8,7 (ii) 1, 6 4, 5 8 7, 3 2,9,10 (iii) 2,10,4 4,6 8 7,5 1,3,9 Illustration 1 Analyse the effect of each transaction on assets and liabilities and show that the both sides of Accounting Equation (A = L + C) remains equal : (i) Introduced ` 8,00,000 as cash and ` 50,000 by stock. Salary Account (8) 5,000 Cash Account (1) 5,00,000 (2) 4,80,000 (4) 10,000 (7) 2,500 (8) 5,000 Rajani Enterprises Account (6) 35,000 (9) 35,000 Bank's Account (2) 4,80,000 (3) 60,000 (9) 35,000 2022-23 58 Accountancy (ii) Purchased plant for ` 3,00,000 by paying ` 15,000 in cash and balance at a later date. (iii) Deposited ` 6,00,000 into the bank. (iv) Purchased office furniture for ` 1,00,000 and made payment by cheque. (v) Purchased goods worth ` 80,000 for cash and for ` 35,000 in credit. (vi) Goods amounting to ` 45,000 was sold for ` 60,000 on cash basis. (vii) Goods costing to ` 80,000 was sold for ` 1,25,000 on credit. (viii) Cheque issued to the supplier of goods worth ` 35,000. (ix) Cheque received from customer amounting to ` 75,000. (x) Withdrawn by owner for personal use ` 25,000. Solution Transaction (i) It affects Cash and Inventory on the assets side and Capital on the other hand. There is increase in cash by ` 8, 00,000 and Inventory of goods by ` 50,000 on assets side of the equation. Capital is increased by ` 8, 50,000. ` Assets = Liabilities + Capital Cash + Inventory(Stock) 8,00,000 + 50,000 = 8,50,000 Total 8,50,000 = 8,50,000 Transaction (ii) It affects Cash and Plant and Machinery on the assets side and liabilities on the other side of the equation. There is an increase in plant and machinery by ` 3, 00,000 and decrease in cash by ` 15,000. Liability to pay to the supplier of plant and machinery increases by ` 2,85,000. ` Assets = Liabilities + Capital Cash +Inventory + Plant and Machinery 8,00,000 + 50,000 = 8,50,000 (15,000) 3,00,000 = 2,85,000 7,85,000 + 50,000 +3,00,000 = 2,85,000 + 8,50,000 Total 11,35,000 = 11,35,000 Transaction (iii) It affects assets side only. The composition of the asset side changes. Cash decreases by `

6,00,000 and by the same amount bank increases. ` Assets = Liabilities+ Capital Cash +Inventory + Plant and + Bank = Machinery 7,85,000 + 5,0000 + 3,00,000 = 2,85,000 + 8,50,000 (6,00,000) + 6,00,000 1,85,000 + 50,000 + 3,00,000 + 6,00,000 = 2,85,000 + 8,50,000 Total 11,35,000 = 11,35,000 Transaction (iv) It affects assets side only. The composition of the asset side changes. Furniture increases by ` 1,00,000 and by the same amount bank decreases. 2022-23 Recording of Transactions - I 59 ` Assets =Liabilities + Capital Cash +Inventory + Plant and + Bank + Furniture Machinery 1,85,000+ 50,000 + 3,00,000 + 6,00,000 = 2,85,000 + 8,50,000 (1,00,000) + 1,00,000 1,85,000+ 50,000 +3,00,000 +5,00,000 +1,00,000 = 2,85,000+ 8,50,000 Total 11,35,000 = 11,35,000 Transaction (v) It affects Cash and Inventory on the assets side and liability on the other side. There is decrease in cash by ` 80,000 and increase of inventory of goods by ` 1,15,000 on the assts side of the equation. Liabilities increases by ` 35,000. ` Assets = Liabilities + Capital Cash +Inventory +Plant and + Bank +Furniture Machinery 1,85,000 + 50,000 + 3,00,000 + 5,00,000 + 1,00,000 = 2,85,000 + 8,50,000 (80,000) + 1,15,000 = 35,000 1,05,000 + 1,65,000 +3,00,000 +5,00,000 + 1,00,000 = 3,20,000 + 8,50,000 Total 11,70,000 =11,70,000 Transaction (vi) It affects Cash and Inventory on the assets side and capital on the other side. There is an increase in cash by ` 60,000 and decrease in inventory of goods by ` 45,000 on the assets side of the equation. Capital increases by ` 15,000. ` Assets =Liabilities + Capital Cash +Inventory + Plant and + Bank + Furniture Machinery 1,05,000 + 1,65,000 + 3,00,000 + 5,00,000 + 1,00,000 = 3,20,000 + 8,50,000 60,000 + (45,000) + 15,000 1,65,000 + 1,20,000 +3,00,000 +5,00,000 + 1,00,000 = 3,20,000 + 8,65,000 Total 11,85,000 = 11,85,000 Transaction (vii) It affects Debtors and Inventory on the assets side and capital on the other side. There is increase in debtors by ` 1, 25,000 and decrease in Inventory of goods by ` 80,000 on the assets side of the equation. Capital increases by Rs.45, 000. ` Assets =Liabilities + Capital Cash +Inventory +Plant and + Bank +Furniture + Debtors Machinery 1,65,000 + 1,20,000 + 3,00,000 + 5,00,000 + 1,00,000 = 3,20,000 + 8,65,000 (80,000) + 1,25,000 = + 45,000 1,65,000+ 40,000 +3,00,000 +5,00,000 + 1,00,000 + 1,25,000 = 3,20,000 + 9,10,000 Total 12,30,000 = 12,30,000 Transaction (viii) It affects Bank on the assets side on one side and liability on the other side. There is decrease in bank by ` 35,000 on the assets side and liability also decreases by ` 35,000. 2022-23 60 Accountancy ` Assets =Liabilities + Capital Cash +Inventory +Plant and + Bank +Furniture + Debtors Machinery 1,65,000 + 40,000 + 3,00,000 + 5,00,000 + 1,00,000 + 1,25,000 = 3,20,000 + 9,10,000 (35,000) = (35,000) 1,65,000 + 40,000 + 3,00,000 +4,65,000 + 1,00,000 + 1,25,000= 2,85,000 + 9,10,000 Total 11,95,000 = 11,95,000 Transaction (ix) It affects assets side only. The composition of the assets side changes. Bank increases by ` 75,000 and by the same amount Debtors decreases. ` Assets =Liabilities + Capital Cash +Inventory +Plant and + Bank +Furniture + Debtors Machinery 1,65,000 + 40,000 + 3,00,000 + 4,65,000 + 1,00,000 + 1,25,000 = 2,85,000 + 9,10,000 + 75,000 (75,000) 1,65,000 + 40,000 + 3,00,000 + 5,40,000 + 1,00,000 + 50,000 = 2,85,000 + 9,10,000 Total 11,95,000 = 11,95,000 Transaction (x) It affects Cash on the asset side and Capital on the other hand. There is decrease in Cash by ` 25,000 on the assets side whereas capital decreases by ` 25,000. ` Assets =Liabilities + Capital Cash +Inventory +Plant and + Bank +Furniture + Debtors Machinery 1,65,000 + 40,000 + 3,00,000 + 5,40,000 + 1,00,000 + 50,000 = 2,85,000 + 9,10,000 (25,000) + (25,000) 1,40,000+ 40,000 +3,00,000 +5,40,000 + 1,00,000 + 50,000 = 2,85,000 + 8,85,000 Total 11,95,000 = 11,95,000 3.4 Books of Original Entry In the preceding pages, you learnt about debits and credits and observed how transactions affect accounts. This process of analysing transactions and recording their effects directly in the accounts is helpful as a learning exercise. However, real accounting systems do not record transactions directly in the accounts. The book in which the transaction is recorded for the first time is called journal or book of original entry. The source document, as discussed earlier, is required to record the transaction in the journal. This practice provides a complete record of each transaction in one place and links the debits and credits for each transaction. After the debits and credits for each transaction are entered in the journal, they are transferred to the individual accounts. The process of recording transactions in journal is called journalising. Once the journalising process is completed, the journal entry provides 2022-23 Recording of Transactions - I 61 a complete and useful description of the event's effect on the organisation. The process of transferring journal entry to individual accounts is called posting. This sequence causes the journal to be called the Book of Original Entry and the ledger account as the Principal Book of entry. In this context, it should be noted that on account of the number and commonality of most transactions, the journal is subdivided into a number of books of original entry as follows: (a) Journal Proper (b) Cash book (c) Other day books: (i) Purchases (journal) book (ii) Sales (journal) book (iii) Purchase Returns (journal) book (iv) Sale Returns (journal) book (v) Bills Receivable (journal) book (vi) Bills Payable (journal) book In this chapter you will learn about the process of journalising and their posting into ledger. The cash book and other day books are dealt in detail in chapter 4. 3.4.1 Journal This is the basic book of original entry. In this book, transactions are recorded in the chronological order, as and when they take place. Afterwards, transactions from this book are posted to the respective accounts. Each transaction is separately recorded after determining the particular account to be debited or credited. The format of Journal is shown is figure 3.5 Journal Date Particulars L.F. Debit Credit Amount Amount ` ` Fig. 3.5 : Showing the format of journal The first column in a journal is Date on which the transaction took place. In the Particulars column, the account title to be debited is written on the first line beginning from the left hand corner and the word 'Dr.' is written at the end of the column. The account title to be credited is written on the second line leaving sufficient margin on the left side with a prefix 'To'. Below the account titles, a 2022-23 62 Accountancy brief description of the transaction is given which is called Narration. Having written the Narration a line is drawn in the Particulars column, which indicates the end of recording the specific journal entry. The column relating to Ledger Folio records the page number of the ledger book on which relevant account is appears. This column is filled up at the time of posting and not at the time of making journal entry. The Debit amount column records the amount against the account to be debited and similarly the Credit Amount column records the amount against the account to be credited. It may be noted that, the number of transactions is very large and these are recorded in number of pages in the journal book. Hence, at the end of each page of the journal book, the amount columns are totaled and carried forward (c/f) to the next page where such amounts are recorded as brought forward (b/f) balances. The journal entry is the basic record of a business transaction. It may be simple or compound. When only two accounts are involved to record a transaction, it is called a simple journal entry. For Example, Goods Purchased on credit for Rs.30,000 from M/s Govind Traders on December 24, 2017, involves only two accounts: (a) Purchases A/c (Goods), (b) Govind Traders A/c (Creditors). This transaction is recorded in the journal as follows : Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2014 Dec.24 Purchases A/c Dr. 30,000 To Govind Traders A/c 30,000 (Purchase of goods- in-trade from Govind Traders) It will be noticed that although the transaction results in an increase in stock of goods, the account debited is purchases, not goods. In fact, the goods account is divided into five accounts, viz. purchases account, sales account, purchases returns account, sales returns account, and stock account. When the number of accounts to be debited or credited is more than one, entry made for recording the transaction is called compound journal entry. That means compound journal entry involves multiple accounts. For example, Office furniture is purchased from Modern Furniture's on July 4, 2017 for ` 25,000 and ` 5,000 is paid by cash immediately and balance of ` 20,000 is still payable. It increases furniture (assets) by ` 25,000, decreases cash (assets) by ` 5,000 and increases liability by ` 20,000. The entry made in the journal on July 4, 2017 is : 2022-23 Recording of Transactions - I 63 Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Office Furniture A/c Dr. 25,000 July 4 To Cash A/c 5,000 To Modern Furniture A/c 20,000 (Purchase of office furniture from Modern Furnitures) Now refer to example 1on page 46 again and observe how the transactions listed are recorded in the journal: Books of Rohit Journal Date Particulars L.F. Debit Credit Amount Amount ` ` Cash A/c Dr.

5,00,000 To Capital A/c 5,00,000 (Business started with cash) Bank A/c Dr. 4,80,000 To Cash A/c 4,80,000 (Opened bank account with State Bank of India) Furniture A/c Dr. 60,000 To Bank A/c 60,000 (Purchased furniture and made payment through bank) Plant and Machinery A/c Dr. 1,25,000 To Cash A/c 10,000 To Ramjee Lal 1,15,000 (Bought Plant and Machinery from M/s Ramjee Lal, made an advance payment by cash for ` 10,000 and balance at the later date) Purchases A/c Dr. 55,000 To M/s Sumit Traders A/c 55,000 (Goods bought on credit) Rajani Enterprises A/c Dr. 35,000 To Sales A/c 35,000 (Goods sold on profit) Total 12,55,000 12,55,000 2022-23 64 Accountancy Illustration 2. Soraj Mart furnishes the following information : Transactions during the month of April, 2017 are as under : Date Details 01.4.2017 Business started with cash ` 1,50,000. 01.4.2017 Goods purchased form Manisha ` 36,000. 01.4.2017 Stationery purchased for cash ` 2,200. 02.4.2017 Open a bank account with SBI for ` 35,000. 02.4.2017 Goods sold to Priya for ` 16,000. 03.4.2017 Received a cheque of ` 16,000 from Priya. 05.4.2017 Sold goods to Nidhi ` 14,000. 08.4.2017 Nidhi pays ` 14,000 cash. 10.4.2017 Purchased goods for ` 20,000 on credit from Ritu. 14.4.2017 Insurance paid by cheque ` 6,000. 18.4.2017 Paid rent ` 2,000. 20.4.2017 Goods costing ` 1,500 given as charity. 24.4.2017 Purchased office furniture for ` 11,200. 29.4.2017 Cash withdrawn for household purposes ` 5000. 30.4.2017 Interest received cash ` 1,200. 30.4.2017 Cash sales ` 2,300. 30.4.2017 Commission paid ` 3,000 by cehque. 30.4.2017 Telephone bill paid by cheque ` 2,000. 30.4.2017 Payment of salaries in cash ` 12,000. Journalise the transactions. Solution Books of Saroj Mart Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Apr.01 Cash A/c Dr. 1,50,000 To Capital A/c 1,50,000 (Business started with cash) Apr.01 Purchases A/c Dr. 36,000 To Manisha A/c 36,000 (Goods purchase on credit) Apr.01 Stationery A/c Dr. 2,200 To Cash A/c 2,200 (Purchase of stationery for cash) Total c/f 1,88,200 1,88,200 2022-23 Recording of Transactions - I 65 Total b/f 1,88,200 1,88,200 Apr.02 Bank A/c Dr. 35,000 To Cash A/c 35,000 (Opened a bank account with SBI) Apr.02 Priya A/c Dr. 16,000 To Sales A/c 16,000 (Goods sold to Priya On Credit) Apr.03 Bank A/c Dr. 16,000 To Priya A/c 16,000 (Cheque Received from Priya) Apr.05 Nidhi A/c Dr. 14,000 To Sales A/c 14,000 (Sale of goods to Nidhi on credit) Apr.08 Cash A/c Dr. 14,000 To Nidhi A/c 14,000 (Cash received from Nidhi) Apr.10 Purchases A/c Dr. 20,000 To Ritu A/c 20,000 (Purchase of goods on credit) Apr.14 Insurance Premium A/c Dr. 6,000 To Bank A/c 6,000 (Payment of Insurance premium by cheque) Apr.18 Rent A/c Dr. 2,000 To Cash A/c 2,000 (Rent paid) Apr.20 Charity A/c Dr. 1,500 To Purchases A/c 1,500 (Goods given as charity) Apr.24 Furniture A/c Dr. 11,200 To Cash A/c 11,200 (Purchase of office furniture) Apr.29 Drawings A/c Dr. 5,000 To Cash A/c 5,000 (With drawl of cash from the business for personal use of the proprietor) Apr.30 Cash A/c Dr. 1,200 To Interest received A/c 1,200 (Interest received) Apr.30 Cash A/c Dr. 2,300 To Sales A/c 2,300 (Sale of goods for cash) Total c/f 3,32,400 3,32,400 2022-23 66 Accountancy Total c/f 3,32,400 3,32,400 Apr.30 Commission A/c Dr. 3,000 To Bank A/c 3,000 (Commission paid by cheque) Apr.30 Telephone expenses A/c Dr. 2,000 To Cash A/c 2,000 (Payment of telephone bill) Apr.30 Salaries A/c Dr. 12,000 To Cash A/c 12,000 (Payment of salary to the office persons) Total 3,49,400 3,49,400 Illustration 3 Prove that the accounting equation is satisfied in all the following transactions of Sita Ram house by preparing the analysis table. Also record the transactions in Journal. (i) Business commenced with a capital of ` 6,00,000. (ii) ` 4,50,000 deposited in a bank account. (iii) ` 2,30,000 Plant and Machinery Purchased by paying ` 30,000 cash immediately. (iv) Purchased goods worth ` 40,000 for cash and ` 45,000 on account. (v) Paid a cheque of ` 2, 00,000 to the supplier for Plant and Machinery. (vi) ` 70,000 cash sales (of goods costing ` 50,000). (vii) Withdrawn by the proprietor ` 35,000 cash for personal use. (viii) Insurance paid by cheque of ` 2,500. (ix) Salary of ` 5,500 outstanding. (x) Furniture of ` 30,000 purchased in cash. Solution Journal Date Particulars L.F. Debit Credit Amount Amount ` ` (i) Cash A/c Dr. 6,00,000 To Capital A/c 6,00,000 (Business started with cash) (ii) Bank A/c Dr. 4,50,000 To Cash A/c 4,50,000 (Cash deposited into the bank) Total c/f 10,50,000 10,50,000 2022-23 Recording of Transactions - I 67 Total c/f 10,50,000 10,50,000 (iii) Plant and Machinery A/c Dr. 2.30,000 To Cash A/c 30,000 To Creditors

A/c 2,00,000 (Purchase of plant and machinery by paying ` 30,000 cash and balance on a later date) (iv) Purchases A/c Dr. 85,000 To Cash A/c 40,000 To Creditors A/c 45,000 (Bought goods for cash as well as on credit) (v) Creditor's A/c Dr. 2,00,000 To Bank A/c 2,00,000 (Payment made to the supplier of plant and machinery) (vi) Cash A/c Dr. 70,000 To Sales A/c 70,000 (Sold goods on profit) (vii) Drawings A/c Dr. 35,000 To Cash A/c 35,000 (Withdrew cash for personal use) (viii) Insurance A/c Dr. 2,500 To Bank A/c 2,500 (Paid insurance by cheque) (ix) Salary A/c Dr. 5,500 To Outstanding salary A/c 5,500 (Salary outstanding) (x) Furniture A/c Dr. 30,000 To Cash A/c 30,000 (Furniture purchased for cash) Total 17,08,000 17,08,000 Test Your Understanding - II State the title of the accounts affected, type of account and the account to be debited and account to be credited : ` 1. Bhanu commenced business with cash 1,00,000 2. Purchased goods on credit from Ramesh 40,000 3. Sold goods for cash 30,000 4. Paid salaries 3,000 5. Furniture purchased for cash 10,000 2022-23 68 Accountancy Statement showing the effect of various transaction on accounting equation (Figures in rupees) No. Cash Bank Stock Fur- Plant and Total = Non-trade Trade Capital Total niture Machinery Creditors Creditors 1 6,00,000 6,00,000 = 6,00,000 6,00,000 6,00,000 - - - - 6,00,000 = - - 6,00,000 6,00,000 2 (4,50,000) 4,50,000 1,50,000 4,50,000 -- -- - 6,00,000 = - - 6,00,000 6,00,000 3 (30,000) - - - 2,30,000 2,00,000 2,00,000 - - 2,00,000 1,20,000 4,50,000 - - 2,30,000 8,00,000 = 2,00,000 - 600,000 8,00,000 4 (40,000) - 85,000 - - 45,000 - 45,000 - 45,000 80,000 4,50,000 85,000 - 2,30,000 8,45,000 = 2,00,000 45,000 600,000 8,45,000 5 - (2,00,000) - - - (2,00,000) (2,00,000) - - (2,00,000) 80,000 2,50,000 85,000 - 2,30,000 6,45,000 = - 45,000 6,00,000 20,000 6 70,000 - (50,000) - - 20,000 - - 20,000 20,000 1,50,000 2,50,000 35,000 - 2,30,000 6,65,000 = - 45,000 6,20,000 6,65,000 7 (35,000) - - (35,000) (35,000) (35,000) 1,15,000 2,50,000 35,000 - 2,30,000 6,30,000 = - 45,000 5,85,000 6,30,000 8 (2,500) (2,500) (2,500) (2,500) 1,15,000 2,47,500 35,000 - 2,30,000 6,27,500 = - 45,000 5,82,500 6,27,500 9 5,500 - (5,500) 1,15,000 2,47,500 35,000 - 2,30,000 6,27,500 = 5,500 45,000 5,77,000 6,27,500 10 (30,000) - - 30,000 - - - - - 85,000 2,47,500 35,000 30,000 2,30,000 6,27,500 = 5,500 45,000 5,77,000 6,27,500 2022-23 Recording of Transactions - I 69 6. Borrowed from bank 50,000 7. Sold goods to Sarita 10,000 8. Cash paid to Ramesh on account 20,000 9. Rent paid 1,500 Transaction Name of Accounts Type of Accounts Affected Accounts No. Affected (Assets, Liabilities Capital, Increase/Decrease Revenues and Expenses) 1 2 1 2 1 2 1. 2. 3. 4. 5. 6. 7. 8. 9. Accounting Entries under Goods and Services Tax Illustration : 4 Record necessary Journal entries assuming CGST @ 5% and SGST @ 5% and all transactions are occurred within Delhi) i. Shobit bought goods ` 1,00,000 on credit ii. He sold them for ` 1,35,000 in the same state on credit iii. He paid for Railway transport ` 8,000 iv. He bought computer printer for ` 10,000 v. Paid postal charges ` 2000 2022-23 70 Accountancy Solution Journal Date Particulars L.F. Debit Credit Amount Amount ` ` (i) Purchases A/c Dr. 1,00,000 Input CGST A/c Dr. 5,000 Input SGST A/c Dr. 5,000 To Creditors A/c (Being Goods bought on credit) 1,10,000 (ii) Debtors A/c Dr. 1,48,500 To Sales A/c 1,35,000 To Output CGST A/c 6,750 To Output SGST A/c 6,750 (Being Goods sold on credit) (iii) Transport Charges A/c Dr. 8,000 Input CGST A/c Dr. 400 Input SGST A/c Dr. 400 To Bank A/c 8,800 (Being tranport charges paid) (iv) Computer printer A/c Dr. 10,000 Input CGST A/c Dr. 500 Input SGST A/c Dr. 500 To Bank A/c 11,000 (Being Computer-Printer bought) (v) Postal charges A/c Dr. 2,000 Input CGST A/c Dr. 100 Input SGST A/c Dr. 100 To Bank A/c 2,200 (Being Paid for Portage) (vi) Output CGST A/c Dr. 6,7503 Output SGST A/c Dr. 6,7504 To Input CGST A/c 6,0001 To Input SGST A/c 6,0002 To Electronic Cash Ledger A/c 1,500 (Being GST set off and balance paid) Working Notes :- Total Input CGST = ` 5,000 + ` 400 + `500 + `100 = `6,0001 Total Input SGST = ` 5,000 + ` 400 + `500 + `100 = `6,0002 Total Output CGST = ` 6,7503 Total Output SGST = ` 6,7504 Net CGST Payable = ` 6,750 - `6,000 = `750 Net SGST Payable = ` 6,750 - `6,000 = `750 Illustration : 5 Record necessary Journal entries in the books of Suman of Bihar assuming CGST @ 9% and SGST @ 9% : a. Bought goods ` 3,50,000 from Jharkhand. b. Sold goods for ` 2,00,000 Uttar Pradesh. c. Sold goods for ` 4,00,000 locally. d. Paid Insurance premium ` 30,000. e. Bought furniture for office ` 50,000. 2022-23 Recording of Transactions - I 71 Solution Books of

Suman Journal Date Particulars L.F. Debit Credit Amount Amount ` ` (i) Purchases A/c Dr. 3,50,000 Input IGST A/c Dr. 63,000 To Bank A/c 4,13,000 (Being goods bought) (ii) Bank A/c Dr. 2,36,000 To Sales A/c 2,00,000 To Output IGST A/c 36,000 (Being goods sold outside the state) (iii) Debtors A/c Dr. 4,72,000 To Sales A/c 4,00,000 To Output CGST A/c 36,000 To Output SGST A/c 36,000 (Being goods sold on credit locally) (iv) Insurance Premium A/c Dr. 30,000 Input CGST A/c Dr. 2,700 Input SGST A/c Dr. 2,700 To Bank A/c 35,400 (Being insurance premium paid) (v) Furniture A/c Dr. 50,000 Input CGST A/c Dr. 4,500 Input SGST A/c Dr. 4,500 To Bank A/c 59,000 (Being furniture bought) (vi) Output CGST A/c Dr. 34,200 To Input CGST A/c 7,200 To Input IGST A/c 27,000 (Being set off against CGST ouput made) (vii) Output SGST A/c Dr. 7,200 To Input SGST A/c 7,200 (Being set off against SGST output made) (viii) Output IGST A/c Dr. 36,200 To Input IGST A/c 36,000 (Being set off against SGST output made) (ix) Output CGST A/c Dr. 1,800 Output SGST A/c 28,800 To Electronic Cash Ledger A/c 30,600 (Being final payment made) 2022-23 72 Accountancy Working Notes : Calculation Sheet Particulars CGST SGST IGST Output liability 36,000 36,000 36,000 Loss : Input tax Credit CGST 7,200 SGST 7,200 IGST 27,000 36,000 Amount Payable 1,800 28,800 NIL • Any IGST credit will first be applied to set off IGST and then CGST. Balance, if any, will be applied to set off SGST. 3.5 The Ledger The ledger is the principal book of accounting system. It contains different accounts where transactions relating to that account are recorded. A ledger is the collection of all the accounts, debited or credited, in the journal proper and various special journal (about which you will learn in chapter 4). A ledger may be in the form of bound register, or cards, or separate sheets may be maintained in a loose leaf binder. In the ledger, each account is opened preferably on separate page or card. Utility A ledger is very useful and is of utmost importance in the organisation. The net result of all transactions in respect of a particular account on a given date can be ascertained only from the ledger. For example, the management on a particular date wants to know the amount due from a certain customer or the amount the firm has to pay to a particular supplier, such information can be found only in the ledger. Such information is very difficult to ascertain from the journal because the transactions are recorded in the chronological order and defies classification. For easy posting and location, accounts are opened in the ledger in some definite order. For example, they may be opened in the same order as they appear in the profit and loss account and in balance sheet. In the beginning, an index is also provided. For easy identification, in big organisations, each account is also allotted a code number. Format of the account is shown in figure 3.6. 2022-23 Recording of Transactions - I 73 Name of the Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Fig. 3.6 : Showing format of a ledger According to this format the columns will contain the information as given below: An account is debited or credited according to the rules of debit and credit already explained in respect of each category of account. Title of the account : The Name of the item is written at the top of the format as the title of the account. The title of the account ends with suffix 'Account'. Dr./Cr. : Dr. means Debit side of the account that is left side and Cr. means Credit side of the account, i.e. right side. Date : Year, Month and Date of transactions are posted in chronological order in this column. Particulars : Name of the item with reference to the original book of entry is written on debit/credit side of the account. Journal Folio : It records the page number of the original book of entry on which relevant transaction is recorded. This column is filled up at the time of posting. Amount : This column records the amount in numerical figure, corresponding to what has been entered in the amount column of the original book of entry. Test Your Understanding - III Choose the Correct Answer : 1. The ledger folio column of journal is used to: (a) Record the date on which amount posted to a ledger account. (b) Record the number of ledger account to which information is posted. (c) Record the number of amounts posted to the ledger account. (d) Record the page number of the ledger account. 2. The journal entry to record the sale of services on credit should include: (a) Debit to debtors and credit to capital. (b) Debit to cash and Credit to debtors. (c) Debit to fees income and Credit to debtors. (d) Debit to debtors and Credit to fees income. 3. The journal entry to record purchase of equipment for ` 2,00,000 cash and a balance of ` 8,00,000 due in 30 days include: (a) Debit equipment for ` 2,00,000 and Credit cash ` 2,00,000. 2022-23 74 Accountancy (b) Debit equipment for ` 10,00,000 and Credit cash ` 2,00,000 and creditors ` 8,00,000. (c) Debit equipment ` 2,00,000 and Credit debtors ` 8,00,000. (d) Debit equipment ` 10,00,000 and Credit cash ` 10,00,000. 4. When an entry is made in journal: (a) Assets are listed first. (b) Accounts to be debited listed first. (c) Accounts to be credited listed first. (d) Accounts may be listed in any order. 5. If a transaction is properly analysed and recorded: (a) Only two accounts will be used to record the transaction. (b) One account will be used to record transaction. (c) One account balance will increase and another will decrease. (d) Total amount debited will equals total amount credited. 6. The journal entry to record payment of monthly bill will include: (a) Debit monthly bill and Credit capital. (b) Debit capital and Credit cash. (c) Debit monthly bill and Credit cash. (d) Debit monthly bill and Credit creditors. 7. Journal entry to record salaries will include: (a) Debit salaries Credit cash. (b) Debit capital Credit cash. (c) Debit cash Credit salary. (d) Debit salary Credit creditors. Distinction between Journal and Ledger The Journal and the Ledger are the most important books of the double entry mechanism of accounting and are indispensable for an accounting system. Following points of comparison are worth noting : 1. The Journal is the book of first entry (original entry); the ledger is the book of second entry. 2. The Journal is the book for chronological record; the ledger is the book for analytical record. 3. The Journal, as a book of source entry, gets greater importance as legal evidence than the ledger. 4. Transaction is the basis of classification of data within the Journal; Account is the basis of classification of data within the ledger. 5. Process of recording in the Journal is called Journalising; the process of recording in the ledger is known as Posting. 2022-23 Recording of Transactions - I 75 3.5.1 Classification of Ledger Accounts We have seen earlier that all ledger accounts are put into five categories namely, assets, liabilities, capital, revenues/gains and expense losses. All these accounts may further be put into two groups, i.e. permanent accounts and temporary accounts. All permanent accounts are balanced and carried forward to the next accounting period. The temporary accounts are closed at the end of the accounting period by transferring them to the trading and profit and loss account. All permanent accounts appears in the balance sheet. Thus, all assets, liabilities and capital accounts are permanent accounts and all revenue and expense accounts are temporary accounts. This classification is also relevant for preparing the financial statements. 3.6 Posting from Journal Posting is the process of transferring the entries from the books of original entry (journal) to the ledger. In other words, posting means grouping of all the transactions in respect to a particular account at one place for meaningful conclusion and to further the accounting process. Posting from the journal is done periodically, may be, weekly or fortnightly or monthly as per the requirements and convenience of the business. The complete process of posting from journal to ledger has been discussed below: Step 1 : Locate in the ledger, the account to be debited as entered in the journal. Step 2 : Enter the date of transaction in the date column on the debit side. Step 3: In the 'Particulars' column write the name of the account through which it has been debited in the journal. For example, furniture sold for cash ` 34,000. Now, in cash account on the debit side in the particulars column 'Furniture' will be entered signifying that cash is received from the sale of furniture. In Furniture account, in the ledger on the credit side is the particulars column, the word, cash will be recorded. The same procedure is followed in respect of all the entries recorded in the journal. Step 4 : Enter the page number of the journal in the folio column and in the journal write the page number of the ledger on which a particular account appears. Step 5 : Enter the relevant amount in the amount column on the debit side. It may be noted that the same procedure is followed for making the entry on the credit side of that account to be credited. An account is opened only once in the ledger and all entries relating to a particular account is posted on the debit or credit side, as the case may be. We will now see how the transactions listed in example on page 46-47 are posted to different accounts from the journal. 2022-23 76 Accountancy Cash Account Dr. Cr. Date Particulars J.F.

Amount Date Particulars J.F. Amount ` ` Capital 5,00,000 Bank 4,80,000 Plant and 10,000 Machinery Capital Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Cash 5,00,000 Bank Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Cash 4,80,000 Furniture 60,000 Furniture Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Bank 60,000 Plant and Machinery Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Cash 10,000 Ramjee lal 1,15,000 Ramjee Lal's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Plant and 1,15,000 Machinery 2022-23 Recording of Transactions - I 77 Purchases Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Sumit 55,000 Traders Sumit Traders Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Purchases 55,000 Rajani Enterprises Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Sales 35,000 Sales Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Rajani Enter 35,000 prises Test Your Understanding - IV Fill in the blanks: 1. Issued a cheque for `8,000 to pay rent. The account to be debited is ............ 2. Collected ` 35,000 from debtors. The account to be credited is .... 3. Purchased office stationary for ` 18,000. The account to be credited is ........... 4. Purchased new machine for ` 1,70,000 and issued cheque for the same. The account to be debited is .... 5. Issued cheque for ` 70,000 to pay off on of the creditors. The account to be debited is ............ 6. Returned damaged office stationary and received ` 50,000. The account to be credited is .... 7. Provided services for ` 65,000 on credit. The account to be debited is ........... 2022-23 78 Accountancy Illustration 4 Journalise the following transactions of M/s Mallika Fashion House and post the entries to the Ledger: Date Details Amount 2017 ` June 05 Business started with cash 2,00,000 June 08 Opened a bank account with Syndicate Bank 80,000 June 12 Goods purchased on credit from M/s Gulmohar Fashion House 30,000 June 12 Purchase office machines, paid by cheque 20,000 June 18 Rent paid by cheque 5,000 June 20 Sale of goods on credit to M/s Mohit Bros 10,000 June 22 Cash sales 15,000 June 25 Cash paid to M/s Gulmohar Fashion House 30,000 June 28 Received a cheque from M/s Mohit Bros 10,000 June 30 Salary paid in cash 6,000 Solution (i) Recording the transactions Books of Mallika Fashion House Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 June 05 Cash A/c Dr. 2,00,000 To Capital A/c 2,00,000 (Business started with cash) June 08 Bank A/c Dr. 80,000 To Cash A/c 80,000 (Opened a current account with syndicate bank) June 12 Purchases A/c Dr. 30,000 To Gulmohar Fashion House A/c 30,000 (Goods purchased on credit) June 12 Office Machines A/c Dr. 20,000 To Bank A/c 20,000 (Office machine purchased) June 18 Rent A/c Dr. 5,000 To Bank A/c 5,000 (Rent paid) June 20 Mohit Bros A/c Dr. 10,000 To Sales A/c 10,000 (Goods sold on credit) Total c/f 3,45,000 3,45,000 2022-23 Recording of Transactions - I 79 Total b/f 3,45,000 3,45,000 June 22 Cash A/c Dr. 15,000 To Sales A/c 15,000 (Goods sold for cash) June 25 Gulmohar Fashion House A/c Dr. 30,000 To Cash A/c 30,000 (Cash paid to Gulmohar Fashion House) June 28 Bank A/c Dr. 10,000 To Mohit Bros A/c 10,000 (Payment received in full and final settlement) June 30 Salary A/c Dr. 6,000 To Cash A/c 6,000 (Monthly salary paid) Total 4,06,000 4,06,000 (ii) Posting in the Ledger Book Cash Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 June 5 Capital 2,00,000 June 8 Bank 80,000 June 22 Sales 15,000 June 25 Gulmohar 30,000 Fashion House June 30 Salary 6,000 Capital Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 June 5 Cash 2,00,000 Bank Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 June 08 Cash 80,000 June 12 Office Machines 30,000 June 28 Mohit Bros. 10,000 June 18 Rent 5,000 2022-23 80 Accountancy Purchases Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 June 12 Gulmohar 30,000 Fashion House Gulmohar Fashion House Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 June 25 Cash 30,000 June 12 Purchases 30,000 Office Machines Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 June 12 Bank 20,000 Rent Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 June 18 Bank 5,000 Mohit Bros. Account Dr. Cr. Date Particulars J.F.

Amount Date Particulars J.F. Amount ` ` 2017 2017 June 20 Sales 10,000 June 28 Cash 10,000 Sales Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 June 20 June 20 Mohit Bros. 10,000 June 22 Cash 15,000 2022-23 Recording of Transactions - I 81 Salary Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 June 30 Cash 6,000 Illustration 5 Journalise the following transactions of M/s Time Zone and post them to the ledger accounts : Date Details Amount 2017 ` Dec. 01 Business started with cash 1,20,000 Dec. 02 Opened a bank account with ICICI 4,00,00 Dec. 04 Goods purchased for cash 12,000 Dec. 10 Paid cartage 500 Dec. 12 Goods sold on credit to M/s Lara India 25,000 Dec. 14 Cash received from M/s Lara India 10,000 Dec. 16 Goods returned from Lara India 3,000 Dec. 18 Paid trade expenses 700 Dec. 19 Goods purchased on credit from Taranum 32,000 Dec. 20 Cheque received from M/s Lara India for final settlement 11,500 and deposited sameday into bank Dec. 22 Goods returned to Taranum 1,500 Dec. 24 Paid for stationery 1,200 Dec. 26 Cheque given to Taranum on account 20,000 Dec. 28 Paid rent by cheque 4,000 Dec. 29 Drew cash for personal use 10,000 Dec. 30 Cash sales 12,000 Dec. 31 Goods sold to M/s Rupak Traders 11,000 Solution Books of Time Zone Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Dec. 01 Cash A/c Dr. 1,20,000 To Capital A/c 1,20,000 (Business started with cash) 02 Bank A/c Dr. 40,000 To Cash A/c 40,000 (Opened a current account with ICICI bank) 04 Purchases A/c Dr. 12,000 To Cash A/c 12,000 (Goods purchased for cash) Total c/f 1,72,000 1,72,000 2022-23 82 Accountancy Total b/f 1,72,000 1,72,000 10 Cartage A/c Dr. 500 To Cash A/c 500 (Cartage paid) 12 Lara India A/c Dr. 25,000 To Sales A/c 25,000 (Goods sold on credit) 14 Cash A/c Dr. 10,000 To Lara India A/c 10,000 (Cash received from Lara India) 16 Sales Return A/c Dr. 3,000 To Lara India A/c 3,000 (Goods returned from Lara India) 18 Trade Expenses A/c Dr. 700 To Cash A/c 700 (Trade expenses paid) 19 Purchases A/c Dr. 32,000 To Tranum's A/c 32,000 (Goods purchased on credit) 20 Bank A/c Dr. 11,500 Discount A/c Dr. 500 To Lara India A/c 12,000 (Cheque received for final settlement) 22 Taranum's A/c Dr. 1,500 To Purchase Return's A/c 1,500 (Goods returned to Tranum) 24 Stationery A/c Dr. 1,200 To Cash A/c 1,200 (Cash paid for stationery) 26 Taranum's A/c Dr. 20,000 To Bank A/c 20,000 (Cheque given to Tranum) 28 Rent A/c Dr. 4,000 To Bank A/c 4,000 (Rent paid by cheque) 29 Drawings A/c Dr. 10,000 To Cash A/c 10,000 (Cash withdrawn for personal use) 30 Cash A/c Dr. 12,000 To Sales A/c 12,000 (Goods sold for cash) 31 Rupak Trader A/c Dr. 11,000 To Sales A/c 11,000 (Goods sold on credit) Total 3,14,900 3,14, 900 2022-23 Recording of Transactions - I 83 Posting in the Ledger Book : Cash Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Dec. 01 Capital 1,20,000 Dec. 02 Bank 40,000 Dec. 14 Lara India 10,000 Dec. 04 Purchase 12,000 Dec. 30 Sales 12,000 Dec. 10 Cartage 500 Dec. 18 Trade 700 Expenses Dec. 24. Stationery 1,200 Dec. 29 Drawings 1,000 Capital Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Dec.01 Cash 1,20,000 Bank Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Dec.02 Cash 40,000 Dec.26 Taranum's 20,000 Dec.20 Lara India 11,500 Dec.28 Rent 4,000 Purchases Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Dec.04 Cash 12,000 Dec.19 Taranum 32,000 Cartage Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Dec.10 Cash 500 2022-23 84 Accountancy Lara India Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Dec.12 Sales 25,000 Dec. 14 Cash 10,000 Dec. 16 Sales return 3,000 Dec. 20 Bank 11,500 Discount 500 Sales Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Dec.12 Lara India 25,000 Dec.30 Cash 12,000 Dec.31 Rupak Traders 11,000 Sales Return Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Dec.16 Lara India 3,000 Trade Expenses Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Dec.18 Cash 700 Taranum Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Dec.22 Purchase 1,500 Dec.19 Purchase 32,000 Return Dec.26 Bank 20,000 2022-23 Recording of Transactions - I 85 Discount Paid Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Dec.20 Lara India 500 Purchases Return Account Dr. Cr. Date Particulars J.F. Amount

Date Particulars J.F. Amount ` ` 2017 Dec.22 Taranum 1,500 Stationery Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Dec. Cash 1,200 Rent Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Dec. 28 Bank 4,000 Drawings Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Dec. 29 Cash 10,000 Rupak Traders Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Dec. 31 Sales 11,000 2022-23 86 Accountancy Test Your Understanding - V Select Right Answer: 1. Voucher is prepared for: (i) Cash received and paid (ii) Cash/Credit sales (iii) Cash/Credit purchase (iv) All of the above 2. Voucher is prepared from: (i) Documentary evidence (ii) Journal entry (iii) Ledger account (iv) All of the above 3. How many sides does an account have? (i) Two (ii) Three (iii) one (iv) None of These 4. A purchase of machine for cash should be debited to: (i) Cash account (ii) Machine account (iii) Purchase account (iv) None of these 5. Which of the following is correct? (i) Liabilities = Assets + Capital (ii) Assets = Liabilities – Capital (iii) Capital = Assets – Liabilities (iv) Capital = Assets + Liabilities. 6. Cash withdrawn by the Proprietor should be credited to: (i) Drawings account (ii) Capital account (iii) Profit and loss account (iv) Cash account 7. Find the correct statement: (i) Credit a decrease in assets (ii) Credit the increase in expenses (iii) Debit the increase in revenue (iv) Credit the increase in capital 8. The book in which all accounts are maintained is known as: (i) Cash Book (ii) Journal (iii) Purchases Book (iv) Ledger 9. Recording of transaction in the Journal is called: (i) Casting (ii) Posting (iii) Journalising (iv) Recording 2022-23 Recording of Transactions - I 87 Key Terms Introduced in the Chapter • Source Documents • Credit • Accounting Equation • Debit • Books of Original Entry • Account • Journalising and Posting • Ledger • Double Entry Book Keeping· • Journal Summary with Reference to Learning Objectives 1. Meaning of source documents : Various business documents such as invoice, bills, cash memos, vouchers, which form the basis and evidence of a business transaction recorded in the books of account, are called source documents. 2. Meaning of accounting equation : A statement of equality between debits and credits signifying that the assets of a business are always equal to the total liabilities and capital. 3. Rules of debit and credit : An account is divided into two sides. The left side of an account is known as debit and the credit. The rules of debit and credit depend on the nature of an account. Debit and Credit both represent either increase or decrease, depending on the nature of an account. These rules are summarised as follows : Name of an account Debit Credit Assets Increase Decrease Liabilities Decrease Increase Capital Decrease Increase Revenues Decrease Increase Expenses increase Decrease 4. Books of Original entry : The transactions are first recorded in these books in a chronological order. Journal is one of the books of original entry. The process of recording entries in the journal is called journalising. 5. Ledger : A book containing all accounts to which entries are transferred from the books of original entry. Posting is process of transferring entries from books of original entry to the ledger. Questions for Practice Short Answers 1. State the three fundamental steps in the accounting process. 2. Why is the evidence provided by source documents important to accounting? 3. Should a transaction be first recorded in a journal or ledger? Why? 4. Are debits or credits listed first in journal entries? Are debits or credits indented? 5. Why are some accounting systems called double accounting systems? 6. Give a specimen of an account. 2022-23 88 Accountancy 7. Why are the rules of debit and credit same for both liability and capital? 8. What is the purpose of posting J.F numbers that are entered in the journal at the time entries are posted to the accounts. 9. What entry (debit or credit) would you make to: (a) increase revenue (b) decrease in expense, (c) record drawings (d) record the fresh capital introduced by the owner. 10. If a transaction has the effect of decreasing an asset, is the decrease recorded as a debit or as a credit? If the transaction has the effect of decreasing a liability, is the decrease recorded as a debit or as a credit? Long Answers 1. Describe the events recorded in accounting systems and the importance of source documents in those systems? 2. Describe how debits and credits are used to analyse transactions. 3. Describe how accounts are used to record information about the effects of transactions? 4. What is a journal? Give a specimen of journal showing at least five entries. 5. Differentiate between source documents and vouchers. 6. Accounting equation remains intact under all circumstances. Justify the statement with the help of an example. 7. Explain the double entry mechanism with an illustrative example. Numerical Questions Analysis of Transactions 1. Prepare accounting equation on the basis of the following : (a) Harsha started business with cash `2,00,000 (b) Purchased goods from Naman for cash ` 40,000 (c) Sold goods to Bhanu costing `10,000/- ` 12,000 (d) Bought furniture on credit ` 7,000 (Ans: Asset = cash ` 1,60,000 + Goods ` 30,000 + Debtors ` 12,000 + Furniture ` 7,000 = ` 2,09,000; Liabilities = Creditors ` 7,000 + Capital ` 2,02,000 = ` 2,09,000) 2. Prepare accounting equation from the following: (a) Kunal started business with cash `2,50000 (b) He purchased furniture for cash ` 35,000 (c) He paid commission ` 2,000 2022-23 Recording of Transactions - I 89 (d) He purchases goods on credit ` 40,000 (e) He sold goods (Costing `20,000) for cash ` 26,000 (Ans: Asset = Cash ` 2,39,000 + Furniture ` 35,000 + Goods ` 20,000 = ` 2,94,000; Liabilities = Creditors ` 40,000 + Capital ` 2,54,000= ` 2,94,000) 3. Mohit has the following transactions, prepare accounting equation: (a) Business started with cash ` 1,75,000 (b) Purchased goods from Rohit ` 50,000 (c) Sales goods on credit to Manish (Costing ` 17,500) ` 20,000 (d) Purchased furniture for office use ` 10,000 (e) Cash paid to Rohit in full settlement ` 48,500 (f) Cash received from Manish ` 20,000 (g) Rent paid ` 1,000 (h) Cash withdrew for personal use ` 3,000 (Ans: Cash ` 1,32,500 + Goods ` 32,500 + Furniture ` 10,000 = ` 1,75,000; Liabilition = Capital ` 1,75,000) 4. Rohit has the following transactions : (a) Commenced business with cash `1,50,000 (b) Purchased machinery on credit ` 40,000 (c) Purchased goods for cash ` 20,000 (d) Purchased car for personal use ` 80,000 (e) Paid to creditors in full settlement ` 38,000 (f) Sold goods for cash costing ` 5,000 ` 4,500 (g) Paid rent ` 1,000 (h) Commission received in advance ` 2,000 Prepare the Accounting Equation to show the effect of the above transactions on the assets, liabilities and capital. (Ans: Assets = Cash ` 17,500 + Machine ` 40,000 + Goods ` 15,000 = ` 72,500; Liabilities = Commission ` 2,000 + Capital ` 70,500 = ` 72,500) 5. Use accounting equation to show the effect of the following transactions of M/s Royal Traders: (a) Started business with cash `1,20,000 (b) Purchased goods for cash ` 10,000 (c) Rent received ` 5,000 (d) Salary outstanding ` 2,000 (e) Prepaid Insurance ` 1,000 (f) Received interest ` 700 2022-23 90 Accountancy (g) Sold goods for cash (Costing ` 5,000) ` 7,000 (h) Goods destroyed by fire ` 500 (Ans: Assets = Cash ` 1,21,200 + Goods ` 4,500 + Prepaid insurance ` 1,000; Liabilities = Outstanding salary ` 2,000 + Capital ` 1,25,200) 6. Show the accounting equation on the basis of the following transaction: (a) Udit started business with: (i) Cash ` 5,00,000 (ii) Goods ` 1,00,000 (b) Purchased building for cash ` 2, 00,000 (c) Purchased goods from Himani ` 50,000 (d) Sold goods to Ashu (Cost ` 25,000) ` 36, 000 (e) Paid insurance premium ` 3,000 (f) Rent outstanding ` 5,000 (g) Depreciation on building ` 8,000 (h) Cash withdrawn for personal use ` 20,000 (i) Rent received in advance ` 5,000 (j) Cash paid to himani on account ` 20,000 (k) Cash received from Ashu ` 30,000 (Ans : Assets = Cash ` 2,92,000 + Goods ` 1,25,000 + Building ` 1,92,000 + Debtors ` 6,000 = 6,15,000: Laibilities = Creditors ` 30,000 + Outstanding Rent ` 5,000 + Accounts receiavable ` 5,000 + Capital ` 5,75,000 = ` 6,15,000) 7. Show the effect of the following transactions on Assets, Liabilities and Capital through accounting equation: (a) Started business with cash ` 1,20,000 (b) Rent received ` 10,000 (c) Invested in shares ` 50,000 (d) Received dividend ` 5,000 (e) Purchase goods on credit from Ragani ` 35,000 (f) Paid cash for house hold Expenses ` 7,000 (g) Sold goods for cash (costing `10,000) ` 14,000 (h) Cash paid to Ragani ` 35,000 (i) Deposited into bank ` 20,000 (Ans: Assets = Cash ` 37,000 + Shares ` 50,000 + Goods ` 25,000 + Bank ` 20,000 = ` 1,32,000; Liabilities = Capital ` 1,32,000) 8. Show the effect of following transaction on the accounting equation: (a) Manoj started business with (i) Cash ` 2,30,000 (ii) Goods ` 1,00,000 (iii) Building ` 2,00,000 2022-23 Recording of Transactions - I 91 (b) He purchased goods for cash ` 50,000 (c) He sold goods (costing `20,000) ` 35,000 (d) He purchased goods from Rahul ` 55,000 (e) He sold goods to Varun (Costing ` 52,000) ` 60,000 (f) He paid cash to Rahul in full settlement ` 53,000 (g) Salary paid by him ` 20,000 (h) Received cash from Varun in full settlement ` 59,000 (i) Rent outstanding ` 3,000 (j) Prepaid Insurance ` 2,000 (k)

Commission received by him ` 13, 000 (l) Amount withdrawn by him for personal use ` 20,000 (m) Depreciation charge on building ` 10,000 (n) Fresh capital invested ` 50,000 (o) Purchased goods from Rakhi ` 10,000 (Ans: Assets = Cash ` 2,42,000 + Goods ` 1,43,000 +Building `1,90,000 + Prepaid Insurouce ` 2,000 = ` 5,77,000; Liabilities = Outstanding Rent ` 3,000 + Creditor ` 10,000 + Capital ` 5,64,000 = ` 5,77,000) 9. Transactions of M/s Vipin Traders are given below. Show the effects on Assets, Liabilities and Capital with the help of accounting Equation. (a) Business started with cash ` 1,25,000 (b) Purchased goods for cash ` 50,000 (c) Purchase furniture from R.K. Furniture ` 10,000 (d) Sold goods to Parul Traders (Costing ` 7,000 vide `9,000 bill no. 5674) (e) Paid cartage ` 100 (f) Cash Paid to R.K. furniture in full settlement ` 9,700 (g) Cash sales (costing `10,000) ` 12,000 (h) Rent received ` 4,000 (i) Cash withdrew for personal use ` 3,000 (Ans: Asset = cash ` 78,200 + Goods ` 33,000 + Furniture ` 10,000 Debtors ` 9,000 = ` 1,30,200; Liabilities = Capital ` 1,30,200) 10. Bobby opened a consulting firm and completed these transactions during November, 2017: (a) Invested ` 4,00,000 cash and office equipment with ` 1,50,000 in a business called Bobbie Consulting. (b) Purchased land and a small office building. The land was worth ` 1,50,000 and the building worth ` 3, 50,000. The purchase price was 2022-23 92 Accountancy paid with ` 2,00,000 cash and a long term note payable for ` 3,00,000. (c) Purchased office supplies on credit for ` 12,000. (d) Bobbie transferred title of motor car to the business. The motor car was worth ` 90,000. (e) Purchased for ` 30,000 additional office equipment on credit. (f) Paid ` 75,00 salary to the office manager. (g) Provided services to a client and collected ` 30,000 (h) Paid ` 4,000 for the month's utilities. (i) Paid supplier created in transaction c. (j) Purchase new office equipment by paying ` 93,000 cash and trading in old equipment with a recorded cost of ` 7,000. (k) Completed services of a client for ` 26,000. This amount is to be paid within 30 days. (l) Received ` 19,000 payment from the client created in transaction k. (m) Bobby withdrew ` 20,000 from the business. Analyse the above stated transactions and open the following T-accounts: Cash, client, office supplies, motor car, building, land, long term payables, capital, withdrawals, salary, expense and utilities expense. Journalising 11. Journalise the following transactions in the books of Himanshu: 2017 ` Dec.01 Business started with cash 75,000 Dec.07 Purchased goods for cash 10,000 Dec.09 Sold goods to Swati 5,000 Dec.12 Purchased furniture 3,000 Dec.18 Cash received from Swati In full settlement 4,000 Dec.25 Paid rent 1,000 Dec.30 Paid salary 1,500 12. Enter the following Transactions in the Journal of Mudit : 2017 ` Jan.01 Commenced business with cash 1,75,000 Jan.01 Building 1,00,000 Jan.02 Goods purchased for cash 75,000 Jan.03 Sold goods to Ramesh 30,000 Jan.04 Paid wages 500 Jan.06 Sold goods for cash 10,000 Jan.10 Paid for trade expenses 700 2022-23 Recording of Transactions - I 93 Jan.12 Cash received from Ramesh 29,500 Discount allowed 500 Jan.14 Goods purchased for Sudhir 27,000 Jan.18 Cartage paid 1,000 Jan.20 Drew cash for personal use 5,000 Jan.22 Goods use for house hold 2,000 Jan.25 Cash paid to Sudhir 26,700 Discount allowed 300 13. Journalise the following transactions: 2017 ` Dec. 01 Hema started business with cash 1,00,000 Dec. 02 Open a bank account with SBI 30,000 Dec. 04 Purchased goods from Ashu 20,000 Dec.06 Sold goods to Rahul for cash 15,000 Dec.10 Bought goods from Tara for cash 40,000 Dec.13 Sold goods to Suman 20,000 Dec.16 Received cheque from Suman 19,500 Discount allowed 500 Dec.20 Cheque given to Ashu on account 10,000 Dec.22 Rent paid by cheque 2,000 Dec.23 Deposited into bank 16,000 Dec.25 Machine purchased from Parigya 10,000 Dec.26 Trade expenses 2,000 Dec.28 Cheque issued to Parigya 10,000 Dec.29 Paid telephone expenses by cheque 1,200 Dec.31 Paid salary 4,500 14. Jouranlise the following transactions in the books of Harpreet Bros.: (a) `1,000 due from Rohit are now bad debts. (b) Goods worth `2,000 were used by the proprietor. (c) Charge depreciation @ 10% p.a for two month on machine costing `30,000. (d) Provide interest on capital of ` 1,50,000 at 6% p.a. for 9 months. (e) Rahul become insolvent, who owed is ` 2,000 a final dividend of 60 paise in a rupee is received from his estate. 15. Prepare Journal from the transactions given below : (a) Cash paid for installation of machine ` 500 (b) Goods given as charity ` 2,000 2022-23 94 Accountancy (c) Interest charge on capital @7% p.a. when total `70,000 capital were (d) Received `1,200 of a bad debts written-off last year. (e) Goods destroyed by fire ` 2,000 (f) Rent outstanding ` 1,000 (g) Interest on drawings ` 900 (h) Sudhir Kumar who owed me ` 3,000 has failed to pay the amount. He pays me a compensation of 45 paise in a rupee. (i) Commission received in advance ` 7,000 Posting 16. Journalise the following transactions, post to the ledger: 2017 ` Nov. 01 Business started with (i) Cash 1,50,000 (ii) Goods 50,000 Nov. 03 Purchased goods from Harish 30,000 Nov. 05 Sold goods for cash 12,000 Nov. 08 Purchase furniture for cash 5,000 Nov. 10 Cash paid to Harish on account 15,000 Nov. 13 Paid sundry expenses 200 Nov. 15 Cash sales 15,000 Nov. 18 Deposited into bank 5,000 Nov. 20 Drew cash for personal use 1,000 Nov. 22 Cash paid to Harish in full settlement of account 14,700 Nov. 25 Good sold to Nitesh 7,000 Nov. 26 Cartage paid 200 Nov. 27 Rent paid 1,500 Nov. 29 Received cash from Nitesh 6,800 Discount allowed 200 Nov. 30 Salary paid 3,000 17. Journalise the following transactions is the journal of M/s Goel Brothers and post them to the ledger. 2017 ` Jan. 01 Started business with cash 1,65,000 Jan. 02 Opened bank account in PNB 80,000 Jan. 04 Goods purchased from Tara 22,000 Jan. 05 Goods purchased for cash 30,000 Jan. 08 Goods sold to Naman 12,000 Jan. 10 Cash paid to Tara 22,000 2022-23 Recording of Transactions - I 95 Jan. 15 Cash received from Naman 11,700 Discount allowed 300 Jan. 16 Paid wages 200 Jan. 18 Furniture purchased for office use 5,000 Jan. 20 withdrawn from bank for personal use 4,000 Jan. 22 Issued cheque for rent 3,000 Jan. 23 goods issued for house hold purpose 2,000 Jan. 24 drawn cash from bank for office use 6,000 Jan. 26 Commission received 1,000 Jan. 27 Bank charges 200 Jan. 28 Cheque given for insurance premium 3,000 Jan. 29 Paid salary 7,000 Jan. 30 Cash sales 10,000 18 Give journal entries of M/s Mohit traders, Post them to the Ledger from the following transactions : August 2017 ` 1. Commenced business with cash 1,10,000 2. Opened bank account with H.D.F.C. 50,000 3. Purchased furniture 20,000 7. Bought goods for cash from M/s Rupa Traders 30,000 8. Purchased good from M/s Hema Traders 42,000 10. Sold goods for cash 30,000 14. Sold goods on credit to M/s. Gupta Traders 12,000 16. Rent paid 4,000 18. Paid trade expenses 1,000 20. Received cash from Gupta Traders 12,000 22. Goods return to Hema Traders 2,000 23. Cash paid to Hema Traders 40,000 25. Bought postage stamps 100 30. Paid salary to Rishabh 4,000 19. Journalise the following transaction in the Books of the M/s Bhanu Traders and Post them into the Ledger. December, 2017 ` 1. Started business with cash 92,000 2. Deposited into bank 60,000 4. Bought goods on credit from Himani 40,000 6. Purchased goods from cash 20,000 8. Returned goods to Himani 4,000 10. Sold goods for cash 20,000 14. Cheque given to Himani 36,000 2022-23 96 Accountancy 17. Goods sold to M/s Goyal Traders. 3,50,000 19. Drew cash from bank for personal use 2,000 21. Goyal traders returned goods 3,500 22. Cash deposited into bank 20,000 26. Cheque received from Goyal Traders 31,500 28. Goods given as charity 2,000 29. Rent paid 3,000 30. Salary paid 7,000 31. Office machine purchased for cash 3,000 20. Journalise the following transaction in the Book of M/s Beauti traders. Also post them in the ledger. Dec. 2017 ` 1. Started business with cash 2,00,000 2. Bought office furniture 30,000 3. Paid into bank to open an current account 1,00,000 5. Purchased a computer and paid by cheque 2,50,000 6. Bought goods on credit from Ritika 60,000 8. Cash sales 30,000 9. Sold goods to Karishna on credit 25,000 12. Cash paid to Mansi on account 30,000 14. Goods returned to Ritika 2,000 15. Stationery purchased for cash 3,000 16. Paid wages 1,000 18. Goods returned by Karishna 2,000 20. Cheque given to Ritika 28,000 22. Cash received from Karishna on account 15,000 24. Insurance premium paid by cheque 4,000 26. Cheque received from Karishna 8,000 28. Rent paid by cheque 3,000 29. Purchased goods on credit from Meena Traders 20,000 30. Cash sales 14,000 21. Journalise the following transaction in the books of Sanjana and post them into the ledger : January, 2017 ` 1. Cash in hand 6,000 Cash at bank 55,000 Stock of goods 40,000 Due to Rohan 6,000 Due from Tarun 10,000 2022-23 Recording of Transactions - I 97 3. Sold goods to Karuna 15,000 4. Cash sales 10,000 6. Goods sold to Heena 5,000 8. Purchased goods from Rupali 30,000 10. Goods returned from Karuna 2,000 14. Cash received from Karuna

13,000 15. Cheque given to Rohan 6,000 16. Cash received from Heena 3,000 20. Cheque received from Tarun 10.000 22. Cheque received from to Heena 2,000 25. Cash given to Rupali 18,000 26. Paid cartage 1,000 27. Paid salary 8,000 28. Cash sale 7,000 29. Cheque given to Rupali 12,000 30. Sanjana took goods for Personal use 4,000 31. Paid General expense 500 22. Record journal entries for the following transactions in the books of Anudeep of Delhi: (a) Bought goods ` 2,00,000 from Kanta of Delhi (CGST @ 9%, SGST @ 9%) (b) Bought goods ` 1,00,000 for cash from Rajasthan (IGST @ 12%) (c) Sold goods ` 1,50,000 to Sudhir of Punjab (IGST @ 18%) (d) Paid for Railway Transport ` 10,000 (CGST @ 5%, SGST @ 5%) (e) Sold goods ` 1,20,000 to Sidhu of Delhi (CGST @ 9%, SGST @ 9%) (f) Bought Air-Condition for office use ` 60,000 (CGST @ 9%, SGST @ 9%) (g) Sold goods ` 1,50,000 for cash to Sunil to Uttar Pradesh (IGST 18%) (h) Bought Motor Cycle for business use ` 50,000 (CGST 14%, SGST @ 14%) (i) Paid for Broadband services ` 4,000 (CGST @ 9%, SGST @ 0%) (j) Bought goods ` 50,000 from Rajesh, Delhi (CGST @ 9%, SGST @ 9%) Checklist to Test Your Understanding Test Your Understanding - I 1. (iii), 2 (Capital increases by net profit and fresh capital introduced, decreases by drawings and net loss), 3 (No), 4 (ii) Test Your Understanding - II 1. Cash account and capital account, Assets and Liabilities, Assest increase and capital increase. 2. Purchase account and Remesh account, Expenses and Liabilities, Expenses and Liabilities increases. 2022-23 98 Accountancy 3. Cash account and sales account, Assets and Revenues, Assets and Revenues increases. 4. Salaries account and cash account, Expense and Assets, Expenses increasesAssets decreases. 5. Furniture account and Cash account, Asset increases Asset decreases. 6. Loan account and Bank, Liability and Asset, Liabilities increases Asset decreases. 7. Sarita account and Sales account, Asset and Revenue, Assets decreases Revenue decreases. 8. Ramesh account and Cash, liabilities and Assets, Liabilities decreases Assets increases. 9. Rent account and Cash account, Expense and Assets, Expenses increases Assets decreases. Test Your Understanding - III 1(d), 2(d), 3(b), 4(b), 5(d), 6(c), 7(a) Test your understanding - IV 1. Rent 2. Debtors 3. Cash 4. Machine 5. Creditors 6. Office stationary 7. Debtors Test Your Understanding - V 1 (iv), 2 (i), 3 (i), 4 (ii), 5 (iii), 6 (iv), 7 (iv), 8 (iv), 9 (iii). 2022-23I n chapter 3, you learnt that all the business transactions are first recorded in the journal and then they are posted in the ledger accounts. A small business may be able to record all its transactions in one book only, i.e., the journal. But as the business expands and the number of transactions becomes large, it may become cumbersome to jour-nalise each transaction. For quick, efficient and accurate recording of business transactions, Journal is sub-divided into special journals. Many of the business transactions are repetitive in nature. They can be easily recorded in special journals, each meant for recording all the transactions of a similar nature. For example, all cash transactions may be recorded in one book, all credit sales transactions in another book and all credit purchases transactions in yet another book and so on. These special journals are also called daybooks or subsidiary books. Transactions that cannot be recorded in any special journal are recorded in journal called the Journal Proper. Special journals prove economical and make division of labour possible in accounting work. In this chapter we will discuss the following special purpose books: • Cash Book • Purchases Book • Purchases Return (Return Outwards) Book • Sales Book • Sales Return (Return Inwards) Book • Journal Proper Recording of Transactions-II 4 LEARNING OBJECTIVES After studying this chapter, you will be able to : • state the need for special purpose books; • record the transactions in cash book and post them in the ledger; • prepare the petty cash book; • record the transactions in the special purpose books; • post the entries in the special purpose book and to the ledger; • balance the ledger accounts. 2022-23 100 Accountancy 4.1 Cash Book Cash book is a book in which all transactions relating to cash receipts and cash payments are recorded. It starts with the cash or bank balances at the beginning of the period. Generally, it is made on monthly basis. This is a very popular book and is maintained by all organisations, big or small, profit or not-forprofit. It serves the purpose of both journal as well as the ledger (cash) account. It is also called the book of original entry. When a cashbook is maintained, transactions of cash are not recorded in the journal, and no separate account for cash or bank is required in the ledger. 4.1.1 Single Column Cash Book The single column cash book records all cash transactions of the business in a chronological order, i.e., it is a complete record of cash receipts and cash payments. When all receipts and payments are made in cash by a business organisation only, the cash book contains only one amount column on each (debit and credit) side. The format of single column cash book is shown in figure 4.1. Cash Book Dr. Cr. Date Receipts L.F. Amount Date Payments L.F. Amount ` ` Fig. 4.1 : Format of single column cash book Recording of entries in the single column cash book and its balancing is illustrated by an example. Consider the following transactions of M/s Roopa Traders observe how they are recorded in a single column cash book. Date Details Amount ` 2017 Nov. 01 Cash in hand 30,000 Nov. 04 Cash received from Gurmeet 12,000 Nov. 08 Insurance paid (Annual Instalment) 6,000 Nov. 13 Purchased furniture 13,800 Nov. 16 Sold goods for cash 28,000 Nov. 17 Purchased goods from Mudit in cash 17,400 Nov. 20 Purchase stationery 1,100 Nov. 24 Cash paid to Rukmani in full settlement of account 12,500 2022-23 Recording of Transactions - II 101 Nov. 27 Sold goods to Kamal for cash 18,200 Nov. 30 Paid monthly rent 2,500 Nov. 30 Paid salary 3,500 Nov. 30 Deposited in bank 8,000 Roopa Traders Cash Book Dr. Cr. Date Receipts L.F. Amount Date Payments L.F. Amount ` ` 2017 2017 Nov. 01 Balance b/d 30,000 Nov. 08 Insurance 6,000 Nov. 04 Gurmeet 12,000 Nov. 13 Furniture 13,800 Nov. 16 Sales 28,000 Nov. 17 Purchases 17,400 Nov. 27 Sales 18,200 Nov. 20 Stationery 1,100 Nov. 24 Rukmani 12,500 Nov. 30 Rent 2,500 Nov. 30 Salary 3,500 Nov. 30 Bank 8,000 Nov. 30 Balance c/d 23,400 88,200 88,200 Dec.01 Balance b/d 23,400 Posting of the Single Column Cash Book As evident from figure 4.1, the left side of the cash book shows the receipts of the cash whereas the right side of the cash book shows all the payments made in cash. The accounts appearing on then debit side for the cash book are credited in the respective ledger accounts because cash has been received in respect of them. Thus, in our example, an entry 'cash received from Gurmeet' appears on the debit side of the cash book conveys that the cash has been received from Gurmeet. Therefore, in the ledger, Gurmeet's account will be credited by writing 'Cash' in the particulars column on the credit side. Similarly, all the account names appearing on the credit side of the cash book are debited as cash/cheque has been paid in respect of them. Now, notice, how the transactions in our example are posted to the related ledger accounts: 2022-23 102 Accountancy Books of Roopa Traders Gurmeet's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Nov.04 Cash 12,000 Sales Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Nov. 16 Cash 28,000 Nov. 27 Cash 18,200 Insurance Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Nov. 08 Cash 6,000 Furniture Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Nov. 13 Cash 13,800 Purchases Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Nov. 17 Cash 17,400 Stationery Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Nov. 20 Cash 1,100 2022-23 Recording of Transactions - II 103 Rukmani's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Nov.24 Cash 12,500 Rent Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Nov.30 Cash 2,500 Salary Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Nov. 30 Cash 3,500 Bank's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Nov.30 Cash 8,000 4.1.2 Double Column Cash Book In this type of cash book, there are two columns of amount on each side of the cash book. In fact, now-a-days bank transactions are very large in number. In many organisations, as far as possible, all receipts and payments are affected through bank. A businessman generally opens a current account with a bank. Bank, do not allow any interest on the balance in current account but charge a small amount, called incidental charges, for the services rendered. For depositing cash/cheques in the bank account, a form has to be filled, which is called a pay-in-slip. (refer figure 4.2) It contains a counterfoil also which is returned to the customer (depositor) with the signature of the cashier, as receipt. The bank issues blank cheque forms, to the account holder for withdrawing money. (refer figure 4.3) The depositor writes the name of the party to whom payment is to be made after the words Pay printed on the cheque. Cheque 2022-23 104 Accountancy Fig. 4.2 : A pay-in-slip Fig. 4.3 : A cheque forms have the printed word bearer, which means payment is to be made to the person whose name has been written after the words “pay” or the bearer of the cheques. When the world ‘bearer’ is struck off by drawing a line, the cheque becomes an order cheque. It means payment is to be made to the person whose name is written on the cheque or to his order after proper identification. Cheques are generally crossed in practice. The payment of a crossed cheque cannot be made direct to the party on the counter. It is to be paid only through a bank. When two parallel lines are drawn across the cheque, it is said to be crossed. The various types of crossing providing different degrees of safety to the payment are shown in figure 4.4. 2022-23 Recording of Transactions - II 105 In case of an A/c payee only crossing, the amount of the cheque can be deposited only in the account of the person whose name appears on the cheque. When the name of the bank is written between two parallel lines, it becomes a special crossing and the payment can be made only to the bank whose name has been written between the two lines. Though this is rarely done, a cheque can be transferred by the payee (the person in whose favour the cheque has been drawn) to another person, if it is not crossed A/c payee only. A bearer cheque can be passed on by mere delivery. An order cheque can be transferred by endorsement and delivery. Endorsement means the writing of instructions to pay the cheque to a particular person and then singing it on the back of the cheque. When the number of bank transactions is large; it is convenient to have a separate amount column for bank transactions in the cash book itself instead of recording them in the journal. This helps in getting information about the position of the bank account from time to time. Just like cash transactions, all payments into the bank are recorded on the left side and all withdrawals/payments through the bank are recorded on the right side. When cash is deposited in the bank or cash is withdrawn from the bank, both the entries are recorded in the cash book. This is so because both aspects of the transaction appear in the cash book itself. When cash is paid into the bank, the amount deposited is written on the left side in the bank column and at the same time the same amount is entered on the right side in the cash column. The reverse entries are recorded when cash is withdrawn from the bank for use in the office. Against such entries the word C, which stands for contra is written in the L.F. column indicating that these entries are not to be posted to the ledger account. Fig. 4.4 : Types of crossing & Co. Not Negotiable A/c Payee Only State Bank of India, New Delhi 2022-23 106 Accountancy The bank column is balanced in the same way as the cash column. However, in the bank column, there can be credit balance also because of overdraft taken from the bank. Overdraft is a situation when cash withdrawn from the bank exceeds the amount of deposit. Entries in respect of cheques received should be made in the bank column of the cash book. When a cheque is received, it may be deposited into the bank on the same day or it may be deposited on another day. In case, it is deposited on the same day the amount is recorded in the bank column of the cash book on the receipts side. If the cheque is deposited on another day, in that case, on the date of receipt it is treated as cash received and hence recorded in the cash column on the receipts side. On the day of deposit to the bank, it is shown in the Bank Column on receipt (Dr.) side and in the Cash Column on the payment (Cr.) side. This is a contra entry. If a cheque received from a customer is dishonoured, the bank will return the dishonoured cheque and debit the firm’s account. On receipt of such cheque or intimation from the bank, the firm will make an entry on the credit side of the cash book by entering the amount of the dishonoured cheque in the bank column and the name of the customer in the particulars column. This entry will restore the position prevailing before the receipt of the cheque form the customer and its deposit in the bank. Dishonour of a cheque means return of the cheque unpaid, generally due to insufficient funds in the customer’s account with the bank. If the bank debits the firm on account of interest, commission or other charges for bank services, the entry will be made on the credit side in bank column. If the bank credits the firm’s account, the entry will be made on the debit side of the cash book in the appropriate column. The format of double column cash book is shown in figure 4.5. Cash Book Dr Cr Date Receipts L.F. Cash Bank Date Payments L.F. Cash Bank ` ` ` ` Fig. 4.5 : Format of a double column cashbook 2022-23 Recording of Transactions - II 107 We will now learn how the transactions are recorded in the double column cash book. Consider the following example: The following transactions related to M/s Tools India : Date Details Amount ` 2017 Sept. 01 Bank balance 42,000 Sept. 01 Cash balance 15,000 Sept. 04 Purchased goods by cheque 12,000 Sept. 08 Sales of goods for cash 6,000 Sept. 13 Purchased machinery by cheque 5,500 Sept. 16 Sold goods and received cheque (deposited same day) 4,500 Sept. 17 Purchase goods from Mriaula in cash 17,400 Sept. 20 Purchase stationery by cheque 1,100 Sept. 24 Cheque given to Rohit 1,500 Sept. 27 Cash withdrawn from bank 10,000 Sept. 30 Rent paid by cheque 2,500 Sept. 30 Paid salary 3,500 The double column cash book based upon above business transactions will prepared as follows : Cash Book Dr. Cr. Date Receipts L.F. Cash Bank Date Payments L.F. Cash Bank ` ` ` ` 2017 2017 Sept. Sept. 01 Balance b/d 15,000 42,000 04 Purchases 12,000 08 Sales 6,000 13 Machine 5,500 16 Sales 4,500 17 Purchase 17,400 27 Bank C 10,000 20 Stationery 1,100 24 Rohit 1,500 27 Cash C 10,000 30 Rent 2,500 30 Salary 3,500 30 Balance c/d 10,100 13,900 31,000 46,500 31,000 46,500 Oct. 01 Balance b/d 10,100 13,900 2022-23 108 Accountancy When the bank column is maintained in the cash book, the bank account also is not opened in the ledger. The bank column serves the purpose of the bank account. Entries marked C (being contra entries as explained earlier) are ignored while posting from the cash book to the ledger. These entries represent debit or credit of cash account against the bank account or vice-versa. We will now see how the transactions recorded in double column cash book are posted to the individual accounts. Purchases Account Receipts Payments Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Sept.04 Bank 12,000 Sept. 17 Cash 17,400 Sales Account Receipts Payments Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Sept. 08 Cash 6,000 Sept. 16 Bank 4,500 Machinery Account Receipts Payments Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Sept. 13 Bank 5,500 Stationery Account Receipts Payments Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Sept.20 Bank 1,100 2022-23 Recording of Transactions - II 109 Rohit's Account Receipts Payments Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Sept.24 Bank 1,500 Rent Account Receipts Payments Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Sept.30 Bank 2,500 Salary Account Receipts Payments Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Sept.30 Cash 3,500 4.1.3 Petty Cash Book In every organisation, a large number of small payments such as conveyance, cartage, postage, telegrams and other expenses (collectively recorded under miscellaneous expenses) are made. These are generally repetitive in nature. If all these payments are handled by the cashier and are recorded in the main cash book, the procedure is found to be very cumbersome. The cashier may be overburdened and the cash book may become very bulky. To avoid this, large organisations normally appoint one more cashier (petty cashier) and maintain a separate cash book to record these transactions. Such a cash book maintained by petty cashier is called petty cash book. The petty cashier works on the Imprest system. Under this system, a definite sum, say ` 2,000 is given to the petty cashier at the beginning of a certain period. This amount is called imprest amount. The petty cashier goes on making all small payments out of this imprest amount and when he has spent the substantial portion of the imprest amount say `1,780, he gets reimbursement of the amount spent from the head cashier. Thus, he again has the full imprest amount in the beginning of the next period. The reimbursement may be made on a weekly, fortnightly or monthly basis, depending on the frequency of small payments. (In certain cases, the petty cash system is operated through the 2022-23 110 Accountancy main cash book itself. In such instances, the petty cash book is not maintained independently.) The petty cash book generally has a number of columns for the amount on the payment side (credit) besides the first other amount column. Each of the amount columns is allotted for items of specific payments, which are most common. The last amount column is designated as 'Miscellaneous' followed by a

‘Remarks’ column. In the miscellaneous column those payments are recorded for which a separate column does not exist. In the ‘Remarks’ the nature of payment is recorded. At the end of the period, all amount columns are totaled. The total amount column l shows the total amount spent and to be reimbursed. On the receipt (debit) side, there is only one amount column. Columns for the date, voucher number and particulars are common for both receipts and payments. Box 1 Advantages of Maintaining Petty Cash Book 1. Saving of Time and efforts of chief cashier: The chief cashier is not required to deal with petty disbursements. He can concentrate on cash transactions involving large amount of cash. It saves time and labour and helps chief cashier to discharge his duties more effectively 2. Effective control over cash disbursements: Cash control becomes easy because of division of work. The head cashier can control big payments directly and petty payments by keeping a proper check on the petty cashier. This way the chances of making frauds and embezzlements become very difficult. 3. Convenient recording: Recording of petty disbursements in the main cash book makes it bulky and unmanageable. Further, the materiality principle requires that insignificant details need not be given in the main cashbook. This way the cash book reveals only material and useful information. Recording of such small payments becomes easy as the totals of different types of expenses are posted to ledger. It also saves time and effort of posting individual items in the ledger. In nutshell it can be stated that preparation of petty cash book is a cost reduction control measure. For example, Mr. Mohit, the petty cahier of M/s Samaira Traders received Rupees 2,000 on May 01, 2017 from the Head Cashier. For the month, details of petty expenses are listed here under: 2022-23 Recording of Transactions - II 111 Date Details Amount ` 2017 May 02 Auto fare 55 03 Courier services 40 04 Postal stamps 105 05 Erasers/Sharpeners/Pencils/Pads 225 06 Speed post charges 98 08 Taxi fare (`105 + `90) 195 08 Refreshments 85 10 Auto fare 60 12 Registered postal charges 42 13 Telegram 34 14 Cartage 25 16 Computer stationery 165 19 Bus fare 24 19 STD call charges 87 20 Office sanitation including disinfectant (` 36 + ` 24) 60 22 Refreshment 45 23 Photo stating charges 47 28 Courier services 40 29 Unloading charges 40 30 Bus fare 15 Posting from the Petty Cash Book The petty cash book is balanced periodically. The difference between the total receipts and total payments is the balance with the petty cashier. The balance is carried to the next period and the petty cashier is paid the amount actually spent. A petty cash account is opened in the ledger. It is debited with the amount given to petty cashier. Each expense account is individually debited with the periodic total as per the respective column by writing “petty cash account” and the petty cash account is credited with the total expenditure incurred during the period by writing sundries as per petty cash book. The petty cash account is balanced. It reflect the actual cash with the petty cashier. 2022-23 112 Accountancy The petty cash book for the month will be prepared as follows : Book of Samaira Traders Petty Cash Book Amount Date Particulars Voucher Amount Analysis of Payments Received No. paid ` 2017 ` Postage Telephone Conveyance Stationery Misc. May & Telegram 2,000 01 Cash received 02 Auto fare 55 55 03 Courier services 40 40 04 Postal stamps 105 105 05 Erasers/Sharpeners 225 225 /Pencils 06 Speed post charges 98 98 08 Taxi fare (105 + 90) 195 195 08 Refreshments 85 85 10 Auto fare 60 60 12 Registered postal 42 42 charges 13 Telegram 34 34 14 Cartage 25 25 16 Computer stationery 165 165 19 Bus fare 24 24 19 STD call charges 87 87 20 Office sanitation 60 60 including disinfectant (36+24) 22 Refreshment 45 45 23 Photo stating charges 47 47 28 Courier services 40 40 29 Unloading charges 40 40 30 Bus fare 15 15 1,487 325 121 349 390 302 31 Balance c/d 513 2,000 2,000 Jun. 513 01 Balance b/d 1,487 01 Cash received 2022-23 Recording of Transactions - II 113 Books of Samaira Traders Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 May 01 Petty cash A/c Dr. 2,000 To Cash A/c 2,000 (Cash paid to petty cashier) May 31 Postage A/c Dr. 325 Telephone & Telegram A/c Dr. 121 Conveyance A/c Dr. 349 Stationary A/c Dr. 390 Miscellaneous expenses A/c Dr. 302 To Petty cash A/c 1,487 (Petty expenses posted to petty cash account) Petty cash A/c Dr. 1,487 To Cash A/c 1,487 (Cash paid to petty cashier) Petty Cash Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 May

01 Cash 2,000 May 31 Sundries as 1,487 per petty cash book May 31 Balance c/d 513 2,000 2,000 Jun. 01 Balance b/d 513 Jun. 01 Cash 1,487 Books of Samaria Traders Postage Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 May 31 Petty cash 325 Telephone and Telegram Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 May 31 Petty cash 121 2022-23 114 Accountancy Conveyance Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 May 31 Petty cash 349 Stationery Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 May 31 Petty cash 390 Miscellaneous Expenses Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 May 31 Petty cash 302 4.1.4 Balancing of Cash Book On the left side, all cash transactions relating to cash receipts (debits) and on the right side all transactions relating to cash payments (credits) are entered date-wise. When a cash book is maintained, a separate cash book in the ledger is not opened. The cash book is balanced in the same way as an account in the ledger. But it may be noted that in the case of the cash book, there will always be debit balance because cash payments can never exceed cash receipts and cash in hand at the beginning of the period. The source document for cash receipts is generally the duplicate copy of the receipt issued by the cashier. For payment, any document, invoice, bill, receipt, etc., on the basis of which payment has been made, will serve as a source document for recording transactions in the cash book. When payment has been made, all these documents, popularly known as vouchers, are given a serial number and filed in a separate file for future reference and verification. Illustration 1 From the following transactions made by M/s Kuntia Traders, prepare the single column cashbook. 2022-23 Recording of Transactions - II 115 Date Details Amount ` 2017 Sept. 01 Cash in hand 40,000 Sept. 02 Deposited in bank 16,000 Sept. 04 Received from Puneet in full settlement of claim 11,700 of ` 12,000. Sept. 05 Cash paid to Rukmani in full settlement of claim of 6,850 `7,000 Sept. 06 Sold goods to Sudhir for cash 14,800 Sept. 06 Paid quarterly insurance premium on policy for 2,740 proprietor's wife Sept. 07 Purchased office furniture 8,000 Sept. 07 Purchased stationery 1,700 Sept. 07 Paid cartage 120 Sept. 10 Paid Kamal, discount allowed by him ` 200 6,800 Sept. 11 Received from Gurmeet, discount allowed to him `500 14,500 Sept. 12 Amount withdrawn for house hold use 5,000 Sept. 14 Electricity bill paid 1,160 Sept. 17 Goods sold for cash 23,000 Sept. 21 Bought goods from Kamal on cash basis 17,000 Sept. 24 Paid telephone charges 2,300 Sept. 26 Paid postal charges 520 Sept. 28 Paid monthly rent 4,200 Sept. 29 Paid monthly wages and salary 8,250 Sept. 29 Bought goods for cash 11,000 Sept. 30 Sold goods for cash 15,600 Solution Books of Kuntia Traders Cash Book Dr Cr Date Receipts L.F. Amount Date Payments L.F. Amount ` ` 2017 2017 Sept. 01 Balance b/d 40,000 Sept. 02 Bank 16,000 Sept. 04 Puneet 11,700 Sept. 05 Rukmani 6,850 Sept. 06 Sales 14,800 Sept. 06 Drawings 2,740 Sept. 11 Gurmeet 14,500 Sept. 07 Office furniture 8,000 Sept. 17 Sales 23,000 Sept. 07 Stationery 1,700 Sept. 30 Sales 15,600 Sept. 07 Cartage 120 Sept. 10 Kamal 6,800 Sept. 12 Drawings 5000 Sept. 14 Electric charges 1,160 Sept. 21 Purchases 17,000 2022-23 116 Accountancy Sept. 24 Telephone 2,300 charges Sept. 28 Postal charges 520 Sept. 29 Rent 4,200 Sept. 29 Wages & Salary 8,250 Sept. 30 Purchases 11,000 Sept. 30 Balance c/d 27,960 1,19,600 1,19,600 Oct. 01 Balance b/d 27,960 Illustration 2 Record the following transactions in double column cash book and balance it. Date Details Amount ` 2017 Aug. 01 Cash balance 15,000 Bank balance 10,000 Aug. 03 Paid insurance premium by cheque 4,200 Aug. 08 Cash sales 22,000 Cash discount 750 Aug. 09 Payment for cash purchases 21,000 Cash discount 700 Aug. 09 Cash deposited in bank 15,000 Aug. 10 Telephone bill paid by cheque 2,300 Aug. 14 Withdrawn from bank for personal use 6,000 Aug. 16 Withdrawn from bank office use 14,500 Aug. 20 Received cheque from John in full and final settlement 10,700 and deposited the same in the bank Aug. 23 Received cash from Michael 6,850 Discount allowed 150 Aug. 24 Stationery purchased for cash 1,800 Aug. 25 Cartage paid in cash 350 Aug. 25 Cheque received from Kumar 4,500 Aug. 28 Cheque received from Kumar deposited in Bank 4,500 Aug. 31 Cheque deposited on Aug. 28 dishonoured and returned by the bank Aug. 31 Rent paid by cheque 4,000 Aug. 31 Paid

wages to the watchman in cash 3,000 Aug. 31 Paid cash for postage 220 2022-23 Recording of Transactions - II 117 Solution Cash Book Dr. Cr. Date Receipts L.F. Cash Bank Date Payments L.F. Cash Bank ` ` ` ` 2017 2017 Aug. Aug. 01 Balance b/d 15,000 10,000 03 Insurance 4,200 08 Sales 22,000 09 Purchases 21,000 09 Cash C 15,000 09 Bank C 15,000 16 Bank C 14,500 10 Telephone 2,300 expenses 20 John 10,700 14 Drawings 6,000 23 Michael 6,850 16 Cash C 14,500 25 Kumar 4,500 24 Printing and 1,800 stationery 28 Cash C 4,500 25 Cartage 350 31 Balance c/d 6,000 28 Bank C 4,500 31 Kumar 4,500 31 Rent 4,000 31 Wages 3,000 31 Postage 220 31 Balance c/d 16,980 4,700 62,850 40,200 62,850 40,200 Sept. 01 Balance b/d 16,980 4,700 Illustration 3 Prepare bank column cash book from the following tansactions of M/s Laser Zone for the month of January 2014 and post them to the related ledger accounts : Date Details Amount ` 2017 Jan. 01 Cash in hand 4,000 Bank overdraft 3,200 Jan. 04 Wage paid 400 Jan. 05 Cash sales 7,000 Jan. 07 Purchased goods by cheque 2,000 Jan. 09 Purchased furniture for cash 2,200 Jan. 11 Cash paid to Rohit 2,000 Jan. 13 Cash sales 4,500 Jan. 14 Deposited into bank 7,000 Jan. 16 Bank charged interest on overdraft 200 2022-23 118 Accountancy Jan. 20 Paid telephone bill by cheque 600 Jan. 25 Sale of goods and received cheque 3,000 (deposited same day) Jan. 27 Paid rent 800 Jan. 29 Drew cash for personal use 500 Jan. 30 Paid salary 1,000 Jan. 31 Interest collected by bank 1,700 Solution Books of Laser Zone Cash Book Dr. Cr. Date Receipts L.F. Cash Bank Date Payments L.F. Cash Bank ` ` ` ` 2017 2017 Jan. Jan. 01 Balance b/d 4,000 01 Balance b/d 3,200 05 Sales 7,000 04 Wages 400 13 Sales 4,500 07 Purchase 2,000 14 Cash C 7,000 09 Furniture 2,200 25 Sales 3,000 11 Rohit 2,000 31 Interest 1,700 14 Bank C 7,000 16 Overdraft 200 interest 20 Telephone 600 27 Rent 800 29 Drawings 500 30 Salary 1,000 01 Balance c/d 1,600 5,700 15,500 11,700 15,500 11,700 Oct. 01 Balance b/d 1,600 5,700 Wages Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Jan.04 Cash 400 2022-23 Recording of Transactions - II 119 Sales Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Jan. 05 Cash 7,000 Jan.13 Cash 4,500 Jan.25 Bank 3,000 Purchases Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Jan.07 Bank 2,000 Furniture Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Jan. 09 Cash 2,200 Rohit Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Jan. 11 Cash 2,000 Ovedraft Interest (Paid) Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Jan.16 Bank 200 Telephone Expenses Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Jan.20 Bank 600 2022-23 120 Accountancy Rent Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Jan.27 Cash 800 Drawings Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Jan.29 Cash 500 Salary Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Jan.30 Cash 1,000 Interest (Received) Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Jan.31 Bank 1,700 Illustration 4 Prepare double column cash book of M/s Advance Technology Pvt. Ltd. for the month of December 2014 from the following transactions : Date Details Amount ` 2017 Dec. 01 Cash in hand 3,065 Cash at bank 6,780 Dec. 02 Cash paid to petty cashier 1,000 Dec. 03 Received cheque from Priya 3,000 Dec. 04 Cash sales 2,000 Dec. 05 Deposited into bank 1,200 Dec. 06 Priya's cheque deposited into bank 3,000 Dec. 08 Purchased furniture by cheque 6,500 Dec. 10 Paid trade expenses 400 Dec. 12 Cash sales 9,000 2022-23 Recording of Transactions - II 121 Dec. 13 Bank charges 300 Dec. 15 Dividend collected by bank 1,200 Dec. 16 Paid electric bill by cheque 600 Dec. 17 Cash purchases 2,000 Dec. 19 Paid for advertising 1,000 Dec. 21 Goods sold and received a cheque 6,000 (deposited same day) Dec. 22 Paid legal charges 500 Dec. 23 Drew from bank for personal use 2,000 Dec. 24 Paid establishment expenses 340 Dec. 25 Paid for printing of bill book 850 Dec. 26 Paid insurance premium by cheque 2,150 Dec. 27 Cash sales 7,200 Dec. 28 Paid salary by cheque 4,000 Dec. 29 Rent paid 3,000 Dec. 30 Commission received by cheque 2,500 (deposited same day) Dec. 31 Paid for charity by cheque 800 Solution Books of Advance Technology Cash Book Dr. Cr. Date Receipts L.F. Cash Bank Date Payments L.F. Cash Bank ` ` ` ` 2016 2016 Dec. Dec. 01 Balance b/d 3,065 6,780

02 Petty Cashier 1,000 03 Priya 3,000 05 Bank C 1,200 04 Sales 2,000 06 Bank C 3,000 05 Cash C 1,200 08 Furniture 6,500 06 Cash C 3,000 10 Trade expenses 400 12 Sales 9,000 13 Bank charges 300 15 Dividend 1,200 16 Electric charges 600 21 Sales 6,000 17 Purchases 2,000 27 Sales 7,200 19 Advertisement 1,000 30 Commission 2,500 22 Legal charges 500 23 Drawings 2,000 24 Establishment 340 expenses 25 Printing 850 26 Insurance 2,150 premium 28 Salary 4,000 29 Rent 3,000 2022-23 122 Accountancy 31 Charity 800 31 Balance c/d 10,975 4,330 24,265 20,680 24,265 20,680 2017 Jan. 01 Balance b/d 10,975 4,330 (ii) Ledger Posting Petty Cashier's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec.02 Cash 1,000 Priya's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec. 03 Cash 3,000 Sales Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec.04 Cash 2,000 Dec.12 Cash 9,000 Dec.21 Bank 6,000 Dec.27 Cash 7,200 Furniture Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec.08 Bank 6,500 2022-23 Recording of Transactions - II 123 Trade Expenses Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec.10 Cash 400 Bank Charges Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec.13 Bank 300 Dividend Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec.15 Bank 1,200 Electric Charges Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec.16 Bank 600 Purchases Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec. 17 Cash 2,000 Advertisement Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec. 19 Cash 1,000 2022-23 124 Accountancy Legal Charges Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec. 22 Cash 500 Drawings Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec. 23 Bank 2,000 Establishment Expenses Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec. 24 Cash 340 Printing Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec. 25 Cash 850 Insurance Premium Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec. 26 Bank 2,150 Salary Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec. 28 Bank 4,000 2022-23 Recording of Transactions - II 125 Rent Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec. 29 Cash 3,000 Commission Received Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec. 30 Bank 2,500 Charity Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 Dec. 31 Bank 800 4.2 Purchases (Journal) Book All credit purchases of goods are recorded in the purchases journal whereas cash purchases are recorded in the cash book. Other purchases such as purchases of office equipment, furniture, building, are recoded in the journal proper if purchased on credit or in the cash book if purchased for cash. The source documents for recording entries in the book are invoices or bills received by the firm from the supplies of the goods. Entries are made with the net amount of the invoice. Trade discount and other details of the invoice need not be recorded in this book. The format of the purchases journal is shown in figure 4.6. Purchases (Journal) Book Date Invoice Name of Supplier L.F. Amount No. (Account to be credited) ` Fig. 4.6 : Format of purchases (journal) book The monthly total of the purchases book is posted to the debit of purchases account in the ledger. Individual suppliers accounts may be posted daily. Consider the following details obtained from M/s Kanika Traders and observe how the entries are recorded in the purchase journal. 2022-23 126 Accountancy Date Details 2017 Aug. 04 Purchased from M/s Neema Electronics (invoice no. 3250): 20 Mini-size T.V. @ `2,000 per piece, 15 Tape recorders @ ` 12,500 per piece. Trade discount on all items @ 20%. Aug. 10 Bought from M/s Pawan Electronics (invoice no. 8260): 10 Video cassettes @ ` 150 per piece, 20 Tape recorders @ ` 1,650 per piece. Trade discout @ 10% on purchases. Aug. 18 Purchased from M/s. Northern Electronics (invoice no. 4256): 15 Northern stereos @ ` 4,000 per piece, 20 Northern colour T.V. @ ` 14,500 per piece. Trade discount @ 12.5%. Aug. 26 Purchased from M/s Neema Electronics (Invoice No. 3294): 10 Mini-size T.V. @ ` 1,000 per piece, 5 Colour T.V. @

` 12,500 per piece. Trade discount @ 20%. Aug. 29 Bought from M/s Pawan Electronics: (Invoice No. 8281) 20 Video cassettes @ 150 per piece 25 Tape recorders @ ` 1,600 per piece. Trade discount @ 10% on purchases. Books of Kanika Traders Purchases (Journal) Book Date Invoice Name of Supplier L.F. Amount No. (Account to be credited) ` 2017 Aug.04 3250 Neema Electronics 1,82,000 Aug.10 8260 Pawan Electronics 31,050 Aug.18 4256 Northern Electronics 3,06,250 Aug.26 3294 Neema Electronics 54,000 Aug.29 8281 Pawan Electronics 38,700 Aug.31 6,12,000 Posting from the purchases journal is done daily to their respective accounts with the relevant amounts on the credit side. The total of the purchases journal is periodically posted to the debit of the purchases account normally on the monthly basis. However, if the number of transactions is very large, this total may be done and posted at some other convenient time interval such as daily, weekly or fortnightly. The posting from the purchases journal to the ledger from is illustrated as follows: Books of Kanika Electronics Neema Electronics Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Aug.04 Purchases 1,82,000 Aug. 26 Purchases 54,000 2022-23 Recording of Transactions - II 127 Pawan Electronics Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Aug. 10 Purchases 31,050 Aug. 29 Purchases 38,700 Northern Electronics Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Aug.18 Purchases 3,06,250 Purchases Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Aug. 31 Sundries as 6,12,000 per Purchases Journal 4.3 Purchases Return (Journal) Book In this book, purchases return of goods are recorded. Sometimes goods purchased are returned to the supplier for various reasons such as the goods are not of the required quality, or are defective, etc. For every return, a debit note (in duplicate) is prepared and the original one is sent to the supplier for making necessary entries in his book. The supplier may also prepare a note, which is called the credit note. The source document for recording entries in the purchases return journal is generally a debit note. A debit note will contain the name of the party (to whom the goods have been returned) details of the goods returned and the reason for returning the goods. Each debit note is serially numbered and dated. The format of the purchases return journal is shown in figure 4.7(a). Purchases Return (Journal) Book Date Debit Name of the Supplier L.F. Amount Note No. (Account to be debited) ` Fig 4.7(a) : Format of Purchases return (journal) book 2022-23 128 Accountancy Box 2 Debit and Credit Notes A Debit note is a document evidencing a debit to be raised against a party for reasons other than sale on credit. On finding that goods supplied are not as per the terms of the order placed, the defective goods are returned to the supplier of the goods and a note is prepared to debit the supplier; or when an additional sum is recoverable from a customer such a note is prepared to debit the customer with the additional dues. In these two situations the note is called a debit note (refer figure 4.7(b)). A Credit note is prepared, when a party is to be given a credit for reasons other than credit purchase. It is a common practice to make it in red ink. When goods are received back from a customer, a credit note should be sent to him. The suggested proforma of credit note is shown in figure 4.7(c). Name of the Firm Issuing the Note Address of the Firm No. Date of Issue .... DEBIT NOTE Against : Supplier's Name Goods returned as per delivery Amount (`) Challan No. (Details of goods returned) (Rupees ....only) Signature of the Manager with date Fig. 4.7(b) : Showing a specimen of debit note Name of the Firm Issuing the Note Address of the Firm No. Date of Issue .... CREDIT NOTE Against : Customer's Name Goods returned by the customer Amount (`) Challan No. (Details of goods returned) (Rupees ....only) Signature of the Manager with date Fig. 4.7(c) : Showing a specimen credit note 2022-23 Recording of Transactions - II 129 Refer to the purchases (journal) book of Kanika Traders you will notice that 20 mini size T.V.'s and 15 tape- recorders were bought from Neema Electronics for ` 1,82,000 However, on delivery 2 mini T.V.'s and tape recorders were found defective and were returned back vide debit note no. 03/2017. In this case, the purchases return books will be prepared as follows : Purchases Return (Journal) Book Date Debit Name of the Supplier L.F. Amount Note (Account to be debited) ` No. 03/2017 Neema Electronics 13,200 13,200 Posting from the purchases returns journal requires that the supplier’s individual accounts are debited with the amount of returns and the purchases returns account is credited with the periodical total. Neema Electronics Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Purchases 13,200 Return Purchases Return Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Sundries as 13,200 per purchase returns book 4.4 Sales (Journal) Book All credit sales of merchandise are recorded in the sales journal. Cash sales are recorded in the cash book. The format of the sales journal is similar to that of the purchases journal explained earlier. The source document for recording entries in the sales journal are sales invoice or bill issued by the firm to the customers. The date of sale, invoice number, name of the customer and amount of the invoice are recorded in the sales journal. Other details about the sales transaction including terms of payment are available in the invoice. In fact, two or more than two copies of a sales invoice are prepared for each sale. The book 2022-23 130 Accountancy keeper makes entries in the sales journal from one copy of the sales invoice. The format of the sales joournal is shown in figure 4.8. In the sales journal, one additional column may be added to record sales tax recovered from the customer and to be paid to the government within the stipulated time. Periodically, at the end of each month the amount column is total led and posted to the credit of sales account in the ledger. Posting to the debit side of individual customer’s accounts may be made daily. Sales (Journal) Book Date Invoice Name of the Customer L.F. Amount No. (Account to be debited) ` Fig. 4.8 : Format of sales (journal) cash book For example M/s Koina Supplies sold on credit: (i) Two water purifiers @ ` 2,100 each and five buckets @ ` 130 each to M/s Raman Traders (Invoice no. 178 dated April 06, 2017). (ii) Five road side containers @ ` 4,200 each to M/s Nutan enterprises (Invoice no 180 dated April 09, 2017) . (iii) 100 big buckets @ ` 850 each to M/s Raman traders (Invoice no. 209, dated April 28, 2017). The above stated transactions will be entered in a sales journal as follows: Books of Koina Suppliers Sales (Journal) Book Date Invoice Name of the customer L.F. Amount No. (Account to be debited) ` 2017 April 06 178 Raman Traders 4,850 April 09 180 Nutan Enterprises 21,000 April 28 209 Raman Traders 85,000 April 30 1,10,850 Posting from the sales journal are done to the debit of customer’s accounts kept in the ledger. Like the purchases journal, individual customer’s accounts are generally posted daily, with the amount involved. The sales journal is also totaled periodically (generally monthly), and this total is credited to sales account in the ledger. The sales (journal) book illustrated above will be posted in the related ledger account in the following manner: 2022-23 Recording of Transactions - II 131 Raman Traders Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Apr. 06 Sales 4,850 Apr. 28 Sales 85,000 Nutan Enterprises Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Apr.01 Sales 21,000 Sales Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Apr. 30 Sundries as 1,10,850 per sales book 4.5 Sales Return (Journal) Book This journal is used to record return of goods by customers to them on credit. On receipt of goods from the customer, a credit note is prepared, like the debit note referred to earlier. The difference between the credit not and the debit note is that the former is prepared by the seller and the latter is prepared by the buyer. Like the debit note, the credit note is also prepared in duplicate and contains detail relating to the name of the customer, details of the merchandise received back and the amount. Each credit note is serially numbered and dated. The source document for recording entries in the sales return book is generally the credit note. The format of the sales return book is shown in figure 4.9 Sales Return (Journal) Book Date Credit Name of the customer L.F. Amount No. (Account to be credited) ` Fig. 4.9 : Format of sales return (journal) book 2022-23 132 Accountancy Refer to the sales (journal) book of Koina Supplier of you will find that two water purifiers were sold to Raman Traders for ` 2,100 each, out of which one purifier was returned back due to the manufacturing defect (credit note no. 10/2017). In this case, the sales return (Journal) book will be prepared as follows : Sales Return (Journal) Book Date Credit Name of the customer L.F. Amount No. (Account to be credited) ` 10/2017 Raman Traders 2,100 2,100 Posting to the sales return journal requires that the customer’s account be credited with the amount of returns and the sales return account be debited with the periodical total in the same way as is done in case of posting from the purchases journal. Raman Traders Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Sales Return 2,100 Sales Return Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Sundries 2,100 as per sales return book Illustration 5 Enter the following transactions of M/s Hi-Life Fashions in purchases and purchases return book and post them to the ledger accounts for the month of September 2014: Date Details 2017 Purchase of following goods on credit from M/s Ratna Traders, Sept. 01 as per Invoice No.714: 25 Shirts @ `300 per shirt 20 Pants @ `700 per pant Less 10% trade discount Sept. 08 Purchase of following goods on credit from M/s Bombay Fashion House, as per Invoice No.327 ; 2022-23 Recording of Transactions - II 133 10 Fancy Trousers @ `500 per trouser 20 Fancy Hat @ ` 100 per hat Less 5% trade discount Sept. 10 Goods returned to M/s Ratana Traders, as per debit note No.102 : 3 shirts @ `300 per shirt 1 Pant @ `700 per pant Less 10% trade discount Sept. 15 Purchase of following goods on credit from M/s Zolta Fashions, as per Invoice No.6781 : 10 Jackets @ `1000 per jacket 5 Plain shirts `200 per shirts Less 15% trade discount. Sept. 20 Purchase of following goods on credit from M/s Bride Palace, as per Invoice No.1076 : 10 Fancy Lengha @ `2,000 per lengha Less 5% trade discount. Sept. 24 Goods returned to M/s Bombay Fashion House as per debit note No.103 : 2 Fancy Trousers @ `500 per trouser 4 Fancy Hat @ `100 per hat Less 5% trade discount. Sept. 28 Goods returned to M/s Bride Palace as per debit note No.105 : 1 Fancy Lengha @ `2,000 per lengha Less 5% trade discount. Solution Books of Hi-life Fashions Purchases (Journal) Book Date Invoice Name of the Supplier L.F. Amount No. (Account to be credited) ` 2017 Sept.01 714 Ratana Traders 19,350 Sept.08 327 Bombay Fashion House 6,650 Sept.15 6781 Zolta Fashions 9,350 Sept.20 1076 Bride Palace 19,000 Sept.30 54,350 Purchases Return (Journal) Book Date Invoice Name of the Supplier L.F. Amount No. (Account to be debited) ` 2017 Sept. 10 102 Ratana Traders 1,440 Sept. 24 103 Bombay Fashion House 1,330 Sept. 28 106 Bride Palace 1,900 Sept. 30 4,670 2022-23 134 Accountancy (ii) Ledger Posting Books of M/s Hi-Life Fashions Ratana Traders Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Sept. 10 Purchases 1,440 Sept.01 Purchases 19,350 return Bombay Fashion House Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Sept. 24 Purchases 1,330 Sept. 08 Purchases 6,650 return Zolta Fashions Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Sept. 15 Purchases 9,350 Bride Palace Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Sept. 28 Purchases 1,900 Sept. 20 Purchases 19,000 return Purchases Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Sept. 30 Sundries as 54,350 per purchases journal 2022-23 Recording of Transactions - II 135 Purchases Return Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Sept. 30 Sundries as 4,670 per purchases return book Illustration 6 Enter the following transactions in the Sales and Sales Return book of M/s Vineet Stores: Date Details 2017 Sold goods on credit to M/s Rohit Stores as per invoice no.325 : Dec.01. 30 Kids Books @ ` 60 each. 20 Animal Books @ ` 50 each Dec. 05 Sold goods on credit to M/s Mera Stores as per invoice no.328 : 100 Greeting Cards @ `12 each. 50 Musical Cards @ ` 50 each Less 5% trade discount. Dec. 10 Sold Goods on credit to M/s Mega Stationers as per invoice no.329 : 50 Writing Pads @ ` 20 each. 50 Colour Books @ ` 30 each 20 Ink Pads @ 16 each Dec. 15 Goods Returned from M/s Rohit Stores as per credit note no.201: 2 Kids Books @ ` 60 each 1 Animal Book @ ` 50 each Dec. 19 Sold goods on credit to M/s Abha Traders as per invoice no.355 : 100 Cards Books @ ` 10 each. 50 Note Books @ ` 35 each Less 5% trade discount. Dec. 22 Goods returned from M/s Mega Stationers as per credit note no.204: 2 Colour Books @ ` 30 each Dec. 26 Sold goods on credit to M/s Bharti Stores as per invoice no.325 : 100 Greeting Cards @ ` 20 each. 100 Fancy Envelopes @ ` 5 each Dec. 30 Goods returned from M/s Abha Traders as per credit note no.207 : 20 Cards Books @ ` 10 each 5 Note Book@ ` 35 each Less 5% trade discount 2022-23 136 Accountancy Solution Books of Veneet Stores Sales

(Journal) Book Date Invoice Name of the Customer J.F. Amount No. (Account to be debited) ` 2017 Dec.01 325 Rohit Stores 2,800 Dec.05 328 Mera Stores 3,515 Dec.10 329 Mega Stationers 2,820 Dec.19 335 Abha Traders 2,375 Dec.26 340 Bharti Stores 2,500 Dec. 31 14,010 Sales Return (Journal) Book Date Credit Name of the Customer L.F. Amount Note No. (Account to be credited) ` 2017 Dec. 15 201 Rohit Stores 170 Dec. 22 204 Mega Stationers 150 Dec. 30 206 Abha Traders 333 Dec. 31 653 (ii) Ledger Posting Rohit Stores Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Dec. 01 Sales 2800 Dec.15 Sales return 170 Mera Stores Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Dec. 05 Sales 3,515 Mega Stationers Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Dec.10 Sales 2,820 Dec.22 Sales return 150 2022-23 Recording of Transactions - II 137 Abha Traders Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Dec.19 Sales 2,375 Dec.30 Sales return 333 Bharti Stores Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Dec.26 Sales 2,500 Sales Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Dec. 31 Sundries as 14,010 per sales book Sales Return Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Sundries as 653 Dec.31 per sales return book Illustration: 7 Prepare Purchases book and Purchases Return Book firm the following transactions: 2017 Aug. 05 Purchased from M/s Ramakant, Delhi (Invoice No. 6780) 20 Television @ `15,000 each, 05 DVD Players @ ` 10,000 each, trade discount @ 10%. Aug. 07 02 Television returned to M/s Ramakant, Delhi (found defective) Debit Note No. 211 Aug. 20 Bought from M/s Samay Electronics, Haryana (Invoice No. 1011) 10 Washing Machines @ 5,000 each and 5 Television @ 25,000 each trade discount @ 5% Rate of GST applicable on above purchase are: CGST @ 9% SGST @ 9% IGST @ 18% 2022-23 138 Accountancy Illustration : 8 Prepare Sales book and Sales Return Book of M/s Akash of Rajasthan from the following transactions : 2017 Aug. 07 Sold to M/s Rahul Bros., Delhi (Invoice No. 3620) 25 shirts @ 300 per shirt 20 pants @ ` 700 per pant Trade Discount @ 8% Aug. 10 Returned 05 Shirts to M/s Rahul Bros., Delhi (Credit Note No. 612) Aug. 18 Sold to M/s Kishan Traders, Jaipur (Invoice No.-3621 10 jackets @ ` 900 per 05 plain shirts @ ` 400 per shirt Trade Discount @ 8% GST Rates applicable on Readymade Clothes CGST @ 2.5% SGST @ 2.5% IGST @ 5% Purchases Book (Analytical) Date Invoice Name of Supplier L.F. Detail Total Pur- CGST SGST IGST (`) chases 2017 6780 M/s Ramakant, Delhi Aug. 20 T.V. @ ` 15,000 3,00,000 05 each 05 DVD Players @ 10,000 50,000 each 3,50,500 Less : Trade Discount 35,000 @ 10% 3,15,000 Add : CGST @ 9% 28,350 SGST @ 9% 28,350 3,71,700 3,15,000 28,350 28,350 —— Aug. 1011 M/s Samay Electronics, 20 Haryana 10 Washing Machines @ 5,000 each 50,000 5 T.V. @ ` 25,000 each 1,25,000 1,75,000 Less : Trade Discount 8,750 @ 5% 1,66,250 Add : IGST @ 18% 29,925 1,96,175 1,66,250 —— —— 29,925 Aug. 31 Total 5,67,875 4,81,250 28,350 28,350 29,925 Purchases Return Book Date Debit Name of Supplier L.F. Detail Total Pur- CGST SGST IGST Note No. (`) chases Return 2017 311 M/s Ramakant, Delhi Aug. 02 T.V. @ ` 15,000 each 30,000 05 Less : Trade Discount @10% 3,000 27,000 Add : CGST @ 9% 2,430 SGST @ 9% 2,430 31,860 27,000 2,430 2,430 — Aug. 31 Total 31,860 27,000 2,430 2,430 – 2022-23 Recording of Transactions - II 139 Sales Book (Analytical) Date Invoice Name of Customer L.F. Detail Total Sales CGST SGST IGST (`) 2017 3620 M/s Rahul Bros., Delhi Aug. 25 Shirt @ ` 300 Per Shirts 7,500 07 20 Pants @ ` 700 Per Pant 14,000 21,500 Less : Trade Discount @ 8% 1,720 19,780 Add : IGST @ 5% 989 10,626 10,120 253 253 —— Aug. 3621 M/s Kishan Traders, Jaipur 18 10 Jackets @ ` 900 Per 9,000 5 Plain Shirt @ ` 700 Per Pant 2,000 11,000 Less : Trade Discount @ 8% 880 10,120 Add : CGST @ 2.5% 253 20,769 19,780 —— —— 987 CGST @ 2.5% 253 Aug. 31 Total 31,395 29,900 253 253 989 Sales Return Book Date Credit Name of Supplier L.F. Detail Total Sales CGST SGST IGST Note No. (`) Return 2017 612 M/s Rahul Bros., Delhi Aug. 05 Shirt @ ` 300 each 1,500 10 Less : Trade Discount @ 8% 120 1,380 Add : CGST @ 9% 69 1,449 1,380 —— —— 69 Aug. 31 Total 1,449 1,380 —— —— 69 4.6 Journal Proper A book maintained to record transactions, which do not find place in special journals, is known as Journal Proper or Journal Residual. Following transactions are recorded in this journal: 1. Opening Entry: In order to open new set of books in the beginning of new accounting year and record therein opening balances of assets, liabilities and capital, the opening entry is made in the journal. 2. Adjustment Entries: In order to update ledger account on accrual basis, such entries are made at the end of the accounting period. Such as Rent outstanding, Prepaid insurance, Depreciation and Commission received in advance. 2022-23 140 Accountancy 3. Rectification entries: To rectify errors in recording transactions in the books of original entry and their posting to ledger accounts this journal is used. 4. Transfer entries: Drawing account is transferred to capital account at the end of the accounting year. Expenses accounts and revenue accounts which are not balanced at the time of balancing are opened to record specific transactions. Accounts relating to operation of business such as Sales, Purchases, Opening Stock, Income, Gains and Expenses, etc., and drawing are closed at the end of the year and their Total/balances are transferred to Trading and Profit and Loss account by recording the journal entries. These are also called closing entries. 5. Other entries: In addition to the above mentioned entries in the points number 1 to 4, recording of the following transaction is done in the journal proper : (i) At the time of a dishonour of a cheque the entry for cancellation for discount received or discount allowed earlier. (ii) Purchase/sale of items on credit other than goods. (iii) Goods withdrawn by the owner for personal use. (iv) Goods distributed as samples for sales promotion. (v) Endorsement and dishonour of bills of exchange. (vi) Transaction in respect of consignment and joint venture, etc. (vii) Loss of goods by fire/theft/spoilage. Test Your Understanding - I Select the Correct Answer (a) When a firm maintains a cash book, it need not maintain ; (i) Journal Proper (ii) Purchases (journal) book (iii) Sales (journal) book (iv) Bank and cash account in the ledger (b) Double column cash book records: (i) All transactions (ii) Cash and bank transactions (iii) Only cash transactions (iv) Only credit transactions (c) Goods purchased on cash are recorded in the : (i) Purchases (journal) book (ii) Sales (journal) book (iii) Cash book (iv) Purchases return (journal) book 2022-23 Recording of Transactions - II 141 (d) Cash book does not record transaction of : (i) Cash nature (ii) Credit nature (iii) Cash and credit nature (iv) None of these (e) Total of these transactions is posted in purchase account : (i) Purchase of furniture (ii) Cash and credit purchase (iii) Purchases return (iv) Purchase of stationery (f) The periodic total of sales return journal is posted to : (i) Sales account (ii) Goods account (iii) Purchases return account (iv) Sales return account (g) Credit balance of bank account in cash book shows : (i) Overdraft (ii) Cash deposited in our bank (iii) Cash withdrawn from bank (iv) None of these (h) The periodic total of purchases return journal is posted to : (i) Purchase account (ii) Profit and loss account (iii) Purchase returns account (iv) Furniture account (i) Balancing of account means : (i) Total of debit side (ii) Total of credit side (iii) Difference in total of debit & credit (iv) None of these 4.7 Balancing the Accounts Accounts in the ledger are periodically balanced, generally at the end of the accounting period, with the object of ascertaining the net position of each amount. Balancing of an account means that the two sides are totaled and the difference between them is shown on the side, which is shorter in order to make their totals equal. The words ‘balance c/d’ are written against the amount of the difference between the two sides. The amount of balance is brought (b/d) down in the next accounting period indicating that it is a continuing account, till finally settled or closed. In case the debit side exceeds the credit side, the difference is written on the credit side, if the credit side exceeds the debit side, the difference between the two appears on the debit side and is called debit and credit balance respectively. The 2022-23 142 Accountancy accounts of expenses losses and gains/revenues are not balanced but are closed by transferring to trading and profit and loss account. The balancing of the an account is illustrated below with the help of an example explaining the complete process of recording the transactions, posting to ledger and balancing there of. Date Details 2017 Apr. 01 Commenced business with cash ` 1,00,000. Apr.02 Deposited in bank ` 40,000. Apr. 02 Purchased for cash furniture ` 6,000; Land ` 42,000. Apr.l 03 Paid cheque to M/s Malika & Brothers for purchase of electric wires and plugs ` 17,000. Apr. 04 Bought of M/s Handa Co. vide invoice no.

544: (i) 28 Immersion Heaters 1,000 Watt of Smg. Ltd. @ ` 50, and (ii) 40 Tube lights @ `35. trade discount @ 12.5%. Apr.l 04 Purchased stationery for cash ` 2,300. Apr. 05 Loan from M/s Dayal Traders. @ 6% ` 25,000 and deposited money in the bank on the next day. Apr. 05 Paid cartage ` 80 and other charges ` 20. Apr. 06 Bought of M/s Burari. Ltd. on account vide Invoice No. 125: (i) 50 Table lamps (Universal) @ ` 80 : (ii) 20 Electric kettles (General) @ ` 125. (iii) 5 Electric iron@ ` 300. trade discount 20%. Apr. 07 Sales to M/s Ramneek on account vide invoice no. 871: (i) 10 Immersion heaters1000 watt @ ` 60. (ii) 5 Table lamps @ ` 100: (iii) 2 Electric irons @ 320. Apr. 08 Sales to M/s Kapadia on credit vide invoice no. 880 (i) 15 Immersion heaters @ 60: (ii) 15 Tube lights @ ` 38. Apr. 10 Return inwards from Ramneek : (i) 2 Immersion heaters, (ii) 1 Electric iron. Apr. 11 Paid rent by cheque ` 4,000. Apr. 11 Purchased from M/s Rungta for cash: (i) 5 Immersion heaters 1000 watt @ ` 45. Apr. 12 Returned goods to Burari Ltd. : (i) 3 Table lamps (Universal) (ii) 2 Electric kettles (iii) 1 Electric iron. Apr. 15 Purchased on account furniture from quality Furniture Ltd. ` 8,000. Apr. 16 Paid for advertisement ` 1,200. 2022-23 Recording of Transactions - II 143 Apr. 18 Sales to M/s Daman on account vide invoice no. 902: (i) 10 Electric kettles (General) @ ` 130. Apr. 19 Purchased from M/s Kochhar Co. on credit vide invoice no.205: (i) 25 Electric Mixers @ ` 600. (ii) 40 Electric irons (Special) @ ` 540. trade discount 20%. Apr. 20 Sales to M/s Ramneek on account vide bill no.925: 4 Electric Mixers @ ` 600. Apr. 21 Received cheque of `3,700 from M/s Ramneek for full and final settlement of claim. The cheque deposited in bank after two days. Apr. 21 Purchased from M/s Burari Ltd. on credit vide invoice no.157: (i) 10 Electric kettles @ ` 125 (ii) 20 Electric lamps @ ` 80 trade discount @ 20%. Apr. 23 Sales to M/s Nutan on account vide invoice no.958: (i) 2 Electric Mixers @ ` 600. Apr. 23 Cash sales of Electric wires and plugs ` 14,500, cash discount allowed ` 200. Apr. 24 Cash purchases from M/s Hitesh: (i) 5 Electric fans @ ` 740. Apr. 25 Paid electricity bill ` 1,320. Apr. 25 Made full and final payment to M/s Burari Ltd. by cheque discount allowed by them ` 320. Apr. 26 Purchased stationery on account from M/s Mohit Mart ` 3,200. Apr. 27 Sales to M/s Daman on account vide Invoice No. 981: (i) 15 Table lamps @ ` 100 (ii) 10 Immersion heaters 1000 watt @ ` 80. Apr. 28 Deposited in bank ` 5,000. Apr. 30 Withdrew ` 8,000 for personal use. Apr. 30 Paid telephone bill ` 2700 by cheque. Apr. 30 Paid insurance ` 1,600 by cheque. Apr. 30 Paid to M/s Handa Co. `2,450 by cheque; and ` 28,000 to M/s Kochhar and co. by cheque who allowed ` 1,280 as discount. Purchases (Journal) Book Date Invoice Name of the Supplier L.F. Amount No. (Account to be credited) ` 2017 Apr. 04 544 Handa Co. 2,450 Apr. 06 125 Burari Ltd. 6,400 Apr. 19 205 Kochhar Co. 29,280 Apr. 21 157 Burari Ltd. 2,280 Apr. 30 40,410 2022-23 144 Accountancy Sales (Journal) Book Date Invoice Name of the Customer L.F. Amount No. (Account to be debited) ` 2017 Apr. 07 871 Ramneek 1,740 Apr. 08 880 Kapadia 1,470 Apr. 18 902 Daman 1,300 Apr. 20 925 Ramneek 2,400 Apr. 23 958 Nutan 1,200 Apr. 27 981 Daman 2,300 Apr. 30 10,410 Purchases Return (Journal) Book Date Debit Name of the Supplier L.F. Amount (Account to be debited) ` 2017 Apr. 12 Burari Ltd. 632 Apr. 30 632 Sales Return (Journal) Book Date Credit Name of the customer L.F. Amount (Account to be credited) ` 2017 Apr. 10 Ramneek 440 Apr. 30 440 Journal Proper Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Apr. 15 Furniture A/c Dr. 8,000 To Quality Furniture A/c 8,000 (Purchase of furniture on credit) Apr. 25 Burari Ltd. A/c Dr. 320 To Discount A/c 320 (Discount received) Apr. 26 Stationery A/c Dr. 3,200 To Mohit Mart A/c 3,200 (Purchase of Stationery items on credit) Apr. 30 Kochhar A/c 1,280 To Discount A/c 1,280 (Discount received) Total 12,800 12,800 2022-23 Recording of Transactions - II 145 Cash Book Date Particulars L.F. Cash Bank Date Particulars L.F. Cash Bank ` ` ` ` 2017 2017 Apr. April 01 Capital 1,00,000 02 Bank C 40,000 02 Cash C 40,000 02 Furniture 6,000 05 6% Loan 25,000 02 Land 42,000 06 Cash C 25,000 03 Purchases 17,000 21 Ramneek 3,700 04 Stationery 2,300 23 Cash C 3,700 05 Miscellaneous 100 expenses 23 Sales 14,500 06 Bank C 25,000 28 Cash C 5,000 11 Rent 4,000 11 Purchases 225 16 Advertisement 1,200 23 Bank C 3,700 24 Purchases 3,700 25 Electric 1,320 charges 25 Burari Ltd. 7,728 28 Bank C 5,000 30 Drawings 8,000 30 Telephone 2,700 charges 30 Insurance 1,600 30 Handa Co. 2,450 30 Kochhar & Co. 28,000 30 Balance c/d 4,655 10,222 1,43,200 73,700

1,43,200 73,700 May 01 Balance b/d 4,655 10,222 The recorded transactions will be posted in the ledger. Capital Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2014 Apr. 30 Balance c/d 1,00,000 Apr. 01 Cash 1,00,000 1,00,000 1,00,000 2022-23 146 Accountancy 6% Loan Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Apr. 30 Balance c/d 25,000 April 05 Cash 25,000 25,000 25,000 Ramneek's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Apr. 07 Sales 1,740 April 10 Sales return 440 Apr. 20 Sales 2,400 April 21 Cash 3,700 4,140 4,140 Sales Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Apr. 23 Cash 14,500 Apr. 30 Sundries 10,410 24,910 Furniture Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Apr. 02 Cash 6,000 Apr. 30 Balance c/d 14,000 Apr. 15 Quality 8,000 Furniture 14,000 14,000 2022-23 Recording of Transactions - II 147 Land Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Apr. 02 Cash 42,000 Apr.30 Balance c/d 42,000 42,000 42,000 Purchases Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Apr. 03 Bank 17,000 Apr. 11 Bank 225 Apr. 24 Cash 3,700 Apr. 30 Sundries 40,410 61,335 Stationery Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Apr. 04 Cash 2,300 Apr. 26 Mohit mart 3,200 5,500 Miscellaneous Expenses Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Apr. 05 Cash 100 100 2022-23 148 Accountancy Rent Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Apr. 04 Bank 4,000 4,000 Advertisement Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Apr.16 Cash 1,200 1,200 Electric Charges Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Apr. 25 Cash 1,320 1,320 Drawings Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Apr. 30 Cash 8,000 8,000 Telephone Charges Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Apr. 30 Bank 2,700 2,700 2022-23 Recording of Transactions - II 149 Insurance Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Apr. 30 Bank 1,600 1,600 Quality Furniture Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Apr. 30 Balance c/d 8,000 Apr. 15 Furniture 8,000 8,000 8,000 Mohit Mart Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Apr. 30 Balance c/d 3,200 Apr. 26 Stationery 3,200 3,200 3,200 Purchases Return Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Apr. 30 Sundries 632 632 Handa Company Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Apr. 30 Bank 2,450 Apr. 04 Purchases 2,450 2,450 2,450 2022-23 150 Accountancy Burari Ltd. Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Apr. 12 Purchases 632 Apr. 06 Purchases 6,400 return Apr. 25 Bank 7,728 Apr. 21 Purchases 2,280 Discount 320 8,680 8,680 Kochhar Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Apr. 30 Bank 28,000 Apr. 19 Purchases 29,280 Discount 1,280 29,280 29,280 Sales Return Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Apr. 30 Sundries 440 . 440 Kapadia Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Apr. 08 Sales 1,470 Apr. 30 Balance c/d 1,470 1,470 1,470 Daman Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Apr. 18 Sales 1,300 Apr. 30 Balance c/d 3,600 Apr. 27 Sales 2,300 3,600 3,600 2022-23 Recording of Transactions - II 151 Nutan Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Apr. 23 Sales 1,200 Apr. 30 Balance c/d 1,200 1,200 1,200 Discount Received Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 Apr. 25 Burari Ltd 320 Apr. 30 Kochhar 1,280 1,600 Test Your Understanding - II 1. Fill in the Correct Words : (a) Cash book is a .... journal. (b) In Journal proper, only.........discount is recorded. (c) Return of goods purchased on credit to the suppliers will be entered in ...... Journal. (d) Assets sold on credit are entered in .... (e) Double column cash book records transaction relating to ....and .... (f) Total of the debit side of cash book is ....than the credit side. (g) Cash book does not record the ....transactions. (h) In double column cash book ....transactions are also recorded. (i)

Credit balance shown by a bank column in cash book is .... (j) The amount paid to the petty cashier at the beginning of a period is known as ....amount. (k) In purchase book goods purchased on ....are recorded. 2. State whether the following statements are True or False : (a) Journal is a book of secondary entry. (b) One debit account and more than one credit account in a entry is called compound entry. (c) Assets sold on credit are entered in sales journal. (d) Cash and credit purchases are entered in purchase journal. (e) Cash sales are entered in sales journal. (f) Cash book records transactions relating to receipts and payments. (g) Ledger is a subsidiary book. (h) Petty cash book is a book having record of big payments. 2022-23 152 Accountancy (i) Cash received is entered on the debit side of cash book. (j) Transaction recorded both on debit and credit side of cash book is known as contra entry. (k) Balancing of account means total of debit and credit side. (l) Credit purchase of machine is entered in purchase journal. Key Terms Introduced in the Chapter • Posting • Sales (Journal) Book • Day books • Balancing of Accounts • Cash book • Purchase (Journal) book • Petty Cash book • Purchases return (Journal) Book • Sales return (Journal) Book Summary with Reference to Learning Objectives 1. Journal : Basic book of original entry. 2. Cash book : A book used to record all cash receipts and payments. 3. Petty cash book : A book used to record small cash payments. 4. Purchase journal : A special journal in which only credit purchases are recorded 5. Sales journal : A special journal in which only credit sales are recorded 6. Purchases Return Book : A book in which return of merchandise purchased is recorded. 7. Sales Return Book : A special book in which returns of merchandise sold on credit are recorded. Questions For Practice Short Answers 1. Briefly state how the cash book is both journal and a ledger. 2. What is the purpose of contra entry? 3. What are special purpose books? 4. What is petty cash book? How it is prepared? 5. Explain the meaning of posting of journal entries? 6. Define the purpose of maintaining subsidiary journal. 7. Write the difference between return Inwards and return ouwards. 8. What do you understand by ledger folio? 9. What is difference between trade discount and cash discount? 10. Write the process of preparing ledger from a journal. 11. What do you understand by Imprest amount in petty cash book? Long Answers 1. Explain the need for drawing up the special purpose books. 2. What is cash book? Explain the types of cash book. 3. What is contra entry? How can you deal this entry while preparing double column cash book? 2022-23 Recording of Transactions - II 153 4. What is petty cash book? Write the advantages of petty cash book? 5. Describe the advantages of sub-dividing the Journal. 6. What do you understand by balancing of account? Numerical Questions Simple Cash Book 1. Enter the following transactions in a simple cash book for December 2016: ` 01 Cash in hand 12,000 05 Cash received from Bhanu 4,000 07 Rent Paid 2,000 10 Purchased goods Murari for cash 6,000 15 Sold goods for cash 9,000 18 Purchase stationery 300 22 Cash paid to Rahul on account 2,000 28 Paid salary 1,000 30 Paid rent 500 (Ans. Cash in hand ` 13,200) 2. Record the following transaction in simple cash book for November 2016: ` 01 Cash in hand 12,500 04 Cash paid to Hari 600 07 Purchased goods 800 12 Cash received from Amit 1,960 16 Sold goods for cash 800 20 Paid to Manish 590 25 Paid cartage 100 31 Paid salary 1,000 (Ans. Cash in hand ` 12,170) 3. Enter the following transaction in Simple cash book for December 2017: ` 01 Cash in hand 7,750 06 Paid to Sonu 45 08 Purchased goods 600 15 Received cash from Parkash 960 20 Cash sales 500 25 Paid to S.Kumar 1,200 30 Paid rent 600 (Ans. Cash in hand ` 6,765) Bank Column Cash Book 4. Record the following transactions in a bank column cash book for December 2016: ` 01 Started business with cash 80,000 04 Deposited in bank 50,000 2022-23 154 Accountancy 10 Received cash from Rahul 1,000 15 Bought goods for cash 8,000 22 Bought goods by cheque 10,000 25 Paid to Shyam by cash 20,000 30 Drew from Bank for office use 2,000 31 Rent paid by cheque 1,000 (Ans. Cash in hand ` 5,000: cash at bank ` 37,000) 5. Prepare a double column cash book with the help of following information for December 2016: ` 01 Started business with cash 1,20,000 03 Cash paid into bank 50,000 05 Purchased goods from Sushmita 20,000 06 Sold goods to Dinker and received a cheque 20,000 10 Paid to Sushmita cash 20,000 14 Cheque received on December 06, 2016 deposited into bank 18 Sold goods to Rani 12,000 20 Cartage paid in cash 500 22 Received cash from Rani 12,000 27 Commission received 5,000 30 Drew cash for personal use 2,000 (Ans. Cash in hand ` 64,500 : Cash at bank ` 70,000) 6. Enter the following transactions in double column cash book of M/s Ambica Traders for July 2017: ` 01 Commenced business with cash 50,000 03 Opened bank account with ICICI 30,000 05 Purchased goods for cash 10,000 10 Purchased office machine for cash 5,000 15 Sales goods on credit from Rohan and received chaeque 7,000 18 Cash sales 8,000 20 Rohan's cheque deposited into bank 22 Paid cartage by cheque 500 25 Cash withdrawn for personal use 2,000 30 Paid rent by cheque 1,000 (Ans. Cash in hand ` 11,000, Cash at bank ` 35,500) 7. Prepare double column cash book from the following information for July 2017: ` 01 Cash In hand 7,500 Bank overdraft 3,500 03 Paid wages 200 05 Cash sales 7,000 10 Cash deposited into bank 4,000 15 Goods purchased and paid by cheque 2,000 20 Paid rent 500 2022-23 Recording of Transactions - II 155 25 Drew from bank for personal use 400 30 Salary paid 1,000 (Ans. Cash in hand ` 8,800, Bank overdraft ` 1,900) 8. Enter the following transaction in a double column cash book of M/s.Mohit Traders for January 2017: ` 01 Cash in hand 3,500 Bank overdraft 2,300 03 Goods purchased for cash 1,200 05 Paid wages 200 10 Cash sales 8,000 15 Deposited into bank 6,000 22 Sold goods for cheque which was deposited into 2,000 bank same day 25 Paid rent by cheque 1,200 28 Drew from bank for personal use 1,000 31 Bought goods by cheque 1,000 (Ans. Cash in hand ` 4,100 Cash at bank ` 2,500) 9. Prepare double column cash book from the following transactions for the year August 2017: ` 01 Cash in hand 17,500 Cash at bank 5,000 03 Purchased goods for cash 3,000 05 Received cheque from Jasmeet 10,000 08 Sold goods for cash 7,000 10 Jasmeet's cheque deposited into bank 12 Purchased goods and paid by cheque 20,000 15 Paid establishment expenses through bank 1,000 18 Cash sales 7,000 20 Deposited into bank 10,000 24 Paid trade expenses 500 27 Received commission by cheque 6,000 29 Paid Rent 2,000 30 Withdrew cash for personal use 1,200 31 Salary paid 6,000 (Ans. Cash in hand ` 8,800 cash at bank ` 10,000) 10. M/s Ruchi trader started their cash book with the following balances on July 2017: cash in hand `1,354 and balance in bank current account `7,560. He had the following transaction in the month of July 2017: ` 03 Cash sales 2,300 05 Purchased goods, paid by cheque 6,000 08 Cash sales 10,000 12 Paid trade expenses 700 15 Sales goods, received cheque (deposited same day) 20,000 18 Purchased motor car paid by cheque 15,000 2022-23 156 Accountancy 20 Cheque received from Manisha (deposited same day) 10,000 22 Cash Sales 7,000 25 Manisha's cheque returned dishonoured 28 Paid Rent 2,000 29 Paid telephone expenses by cheque 500 31 Cash withdrawn for personal use 2,000 Prepare bank column cash book (Ans. Cash in hand ` 15,954 cash at bank ` 6,060) Petty Cash Book 11. Prepare petty cash book from the following transactions. The imprest amount is `2,000. 2017 ` January 01 Paid cartage 50 02 STD charges 40 02 Bus fare 20 03 Postage 30 04 Refreshment for employees 80 06 Courier charges 30 08 Refreshment of customer 50 10 Cartage 35 15 Taxi fare to manager 70 18 Stationery 65 20 Bus fare 10 22 Fax charges 30 25 Telegrams charges 35 27 Postage stamps 200 29 Repair on furniture 105 30 Laundry expenses 115 31 Miscellaneous expenses 100 (Ans. Cash balance ` 935) 12. Record the following transactions during the week ending Dec.30, 2014 with a weekly imprest ` 500. 2017 ` January 24 Stationery 100 25 Bus fare 12 25 Cartage 40 26 Taxi fare 80 27 Wages to casual labour 90 29 Postage 80 (Ans. Cash balance ` 98) Other Subsidiary Books 13. Enter the following transactions in the Purchase Journal (Book) of M/s Gupta Traders of July 2017: 2022-23 Recording of Transactions - II 157 01 Bought from Rahul Traders as per invoice no.20041 40 Registers @ `60 each 80 Gel Pens @ `15 each 50 note books @ `20 each Trade discount 10%. 15 Bought from Global Stationers as per invoice no.1132 40 Ink Pads @ `8 each 50 Files @ `10 each 20 Color Books @ ` 20 each Trade Discount 5% 23 Purchased from Lamba Furniture as per invoice no. 3201 2 Chairs @ 600 per chair 1 Table @ 1000 per table 25 Bought from Mumbai Traders as per invoice no.1111 10 Paper Rim @ `100 per rim 400 drawing Sheets @ `3 each 20 Packets waters colour @ `40 per packet (Ans: Total of purchases book ` 8,299) 14. Enter the following transactions in sales (journal) book of M/s.Bansal electronics: 2014 September 01 Sold to

Amit Traders as per bill no.4321 20 Pocket Radio @ 70 per Radio 2, T.V. set, B&W.(6") @ 800 Per T.V. 10. Sold to Arun Electronics as per bill no.4351 5 T.V. sets (20") B&W @ `3,000 per T.V. 2 T.V. sets (21") Colour @ ` 4,800 per T.V. 22 Sold to Handa Electronics as per bill no.4,399 10 Tape recorders @ ` 600 each 5 Walkman @ ` 300 each 28 Sold to Harish Trader as per bill no.4430 10 Mixer Juicer Grinder @ ` 800 each. (Ans. Total of sales book ` 43,100) 15. Prepare a purchases return (journal) book from the following transactions for April 2017. 2017 ` April 05 Returned goods to M/s Kartik Traders 1,200 10 Goods returned to Sahil Pvt. Ltd. 2,500 17 Goods returned to M/s Kohinoor Traders. for list price `2,000 less 10% trade discount. 28 Return outwards to M/s Handa Traders 550 (Ans. Total of purchases return book ` 6,150) 2022-23 158 Accountancy 16. Prepare Return Inward Journal (Book) from the following transactions of M/s Bansal Electronics for July 2017: 2017 ` July 04 M/s Gupta Traders returned the goods 1,500 10 Goods returned from M/s Harish Traders 800 18 M/s Rahul Traders returned the goods not as per 1,200 specifications 28 Goods returned from Sushil Traders 1,000 (Ans : Total of sales return ` 4,500) Recording, Posting and Balancing 17. Prepare proper subsidiary books and post them to the ledger from the following transactions for the month of February 2017: 2017 ` February 01 Goods sold to Sachin 5,000 04 Purchase from Kushal Traders 2,480 06 Sold goods to Manish Traders 2,100 07 Sachin returned goods 600 08 Returns to Kushal Traders 280 10 Sold to Mukesh 3,300 14 Purchased from Kunal Traders 5,200 15 Furniture purchased from Tarun 3,200 17 Bought of Naresh 4,060 20 Return to Kunal Traders 200 22 Return inwards from Mukesh 250 24 Purchased goods from Kirit & Co. for list price of 5,700 less 10% trade discount 25 Sold to Shri Chand goods 6600 less 5% trade discount 26 Sold to Ramesh Brothers 4,000 28 Return outwards to Kirit and Co. 1,000 less 10% trade discount 28 Ramesh Brothers returned goods ` 500. Ans : (Total of sales book `20,670, purchases book `16,870, Purchases return book `1,380, sales return book `1,350). 18. The following balances of ledger of M/s Marble Traders on April 01, 2017 2017 ` April Cash in hand 6,000 Cash at bank 12,000 Bills receivable 7,000 Ramesh (Cr.) 3,000 2022-23 Recording of Transactions - II 159 Stock (Goods) 5,400 Bills payable 2,000 Rahul (Dr.) 9,700 Himanshu (Dr.) 10,000 Transactions during the month were: April ` 01 Goods sold to Manish 3,000 02 Purchased goods from Ramesh 8,000 03 Received cash from Rahul in full settlement 9,200 05 Cash received from Himanshu on account 4,000 06 paid to Remesh by cheque 6,000. 08 Rent paid by cheque 1,200 10 Cash received from manish 3,000 12 Cash sales 6,000 14 Goods returned to Ramesh 1,000 15 Cash paid to Ramesh in full settlement 3,700 Discount received 300 18 Goods sold to Kushal 10,000 20 Paid trade expenses 200 21 Drew for personal use 1,000 22 Goods return from Kushal 1,200 24 Cash received from Kushal 6,000 26 Paid for stationery 100 27 Postage charges 60 28 Salary Paid 2,500 29 Goods purchased from Sheetal Traders 7,000 30 Sold goods to Kirit 6000 Goods purchased from Handa Traders 5,000 Journlise the above transactions and post them to the ledger. Checklist to Test Your Understanding Test Your Understanding - I a. (iv) b. (ii) c. (iii) d. (ii) e. (ii) f. (iv) g .(ii) h. (iii) i. (iii) Test Your Understanding - II 1. (a) subsidiary (b) cash (c) purchases return (d) journal proper (e) cash, bank (f) more (g) credit (h) bank (i) overdraft (j) imprest (k) credit 2. (a) False (b) True (c) False (d) False (e) False (f) True (g) True (h) False (i) True (j) True (k) False (l) False 2022-23160 Accountancy I n chapter 4, you have learnt that the business organisations keep a record of their cash and bank transactions in a cash book. The cash book also serves the purpose of both the cash account and the bank account and shows the balance of both at the end of the period. Once the cash book has been balanced, it is usual to check its details with the records of the firm's bank transactions as recorded by the bank. To enable this check, the cashier needs to ensure that the cash book is completely up to date and a recent bank statement (or a bank passbook) has been obtained from the bank. A bank statement or a bank passbook is a copy of a bank account as shown by the bank records. This enable the bank customers to check their funds in the bank regularly and update their own records of transactions that have occurred. An illustrative bank passbook of a current account is shown in figure 5.1. The amount of balance shown in the passbook or the bank statement must tally with the balance as shown in the cash book. But in practice, these are usually found to be different. Hence, we have to ascertain the causes for such difference. It will be observed that a bank statement/passbook shows all deposits in the credit column and withdrawals in the debit column. Thus, if deposits exceed withdrawals it shows a credit balance and if withdrawals exceed deposits it will show a debit balance (overdraft). LEARNING OBJECTIVES After studying this chapter, you will be able to : • state the meaning and need for the preparation of bank reconciliation statement; • identify causes of difference between bank balance as per cash book and pass book; • prepare the bank reconciliation statement; • ascertain the correct bank balance as per cash book; Bank Reconciliation Statement 5 2022-23 Bank Reconciliation Statement 161 5.1 Need for Reconciliation It is generally experienced that when a comparison is made between the bank balance as shown in the firm's cash book, the two balances do not tally. Hence, we have to first ascertain the causes of difference thereof and then reflect them in a statement called Bank Reconciliation Statement to reconcile (tally) the two balances. In order to prepare a bank reconciliation statement we need to have a bank balance as per the cash book and a bank statement as on a particular day along with details of both the books. If the two balances differ, the entries in both the books are compared and the items on account of which the difference has arisen are ascertained with the respective amounts involved so that the bank reconciliation statement may be prepared. Its format shown in figure 5.5. Particulars Amount ` Balance as per cash book .... Add: Cheques issued but not presented .... Interest credited by the bank .... Less: Cheques deposited but not credited by the bank .... Bank charges not recorded in the cash book .... Balance as per the passbook xxxx Fig. 5.2 : Proforma of bank reconciliation statement It can also be prepared with two amount columns one showing additions (+ column) and another showing deductions (-column). For convenience, we usually adopt this treatment. Particulars Amount Amount ` ` (+) (–) Balance as per cash book ...... Cheques issued but not presented ` ...... Interest credited by the bank ...... Cheque deposited but not credited by the bank ...... Bank charges not recorded in the cash book ...... Balance as per the passbook. xxxx Fig. 5.3 : Proforma of bank reconcitiation statement (table form) 2022-23 162 Accountancy DHERENDRA NATIONAL BANK MULTI-MODULE PACKAGE DATE : 30/09/2016 CONNAUGHT PLACE STATEMENT OF ACCOUNT OP.ID : GK FROM 01/08/2016 TO 30/09/2016 PAGE NO. : 1 ACCOUNT NO. 03355 NAME : DEV PANDIT KHADWAI, RUNAKUTA, DELHI-34 DATE PARTICULARS CHEQUE DEBIT CREDIT BALANCE +REMARKS No. ` P. ` P. ` P. Opening 50,782.30 + Balance : 04/08/2016 DELHI PLA 356376 35,000.00 15,782.30 + 07/08/2016 TO SELF 356377 10,000.00 5,782.30 + 13/08/2016 BY CLG 10,673,00 16,455,30 + 13/08/2016 BY CLG 9,143.00 25,598.30 + 17/08/2016 TO SELF 356378 20,000.00 5,598.30 + 21/08/2016 BY CLG 25,808.00 31,406.30 + 26/08/2016 BY CLG 32,949.00 64,355,30 + 02/09/2016 To SELF 356381 30,000.00 34,355.30 + 04/09/2016 DELHI PLASTIC 356382 10,000.00 24,355.30 + 08/09/2016 ICICI 657755 6,074.00 18,281.30 + 09/09/2016 BY CLG 3,146.00 21,427.30 + 13/09/2016 TO SELF 356380 9,500,00 11,927.30 + 15/09/2016 BY CLG 5,320.00 17,247.30 + 15/09/2016 BY CLG 18,564.00 35,811.30 + 16/09/2016 TO SERVICE CHARGES 120.00 35,691.30 + 21/09/2016 TO SELF 356383 20,000.00 15,691.30 + 25/09/2016 TO SELF 356385 10,000.00 5,691.30 + 27/09/2016 BY CLG 16,198.00 21,889.30 + FOR DHERENDRA NATIONAL BANK ACCOUNTANT/MANAGER Fig. 5.1 : Specimen of bank statement (current account) 2022-23 Bank Reconciliation Statement 163 Reconciliation of the cash book and the bank passbook balances amounts to an explanation of differences between them. The differences between the cash book and the bank passbook is caused by: • timing differences on recording of the transactions. • errors made by the business or by the bank. 5.1.1 Timing Differences When a business compares the balance of its cash book with the balance shown by the bank passbook, there is often a difference, which is caused by the time gap in recording the transactions relating either to payments or receipts. The factors affecting time gap includes : 5.1.1(a) Cheques issued by the bank but not yet presented for payment When cheques are issued by the firm to suppliers or creditors of the firm, these are immediately entered on the credit side of the cash book. However, the receiving party may not present the cheque to the bank for payment immediately. The bank will debit the firm's account only when these cheques are actually paid by the bank. Hence, there is a time lag between the issue of a cheque and its presentation to the bank which may cause the difference between the two balances. 5.1.1(b) Cheques paid into the bank but not yet collected When firm receives cheques from its customers (debtors), they are immediately recorded in the debit side of the cash book. This increases the bank balance as per the cash book. However, the bank credits the customer account only when the amount of cheques are actually realised. The clearing of cheques generally takes few days especially in case of outstation cheques or when the cheques are paid-in at a bank branch other than the one at which the account of the firm is maintained. This leads to a cause of difference between the bank balance shown by the cash book and the balance shown by the bank passbook. 5.1.1(c) Direct debits made by the bank on behalf of the customer Sometimes, the bank deducts amount for various services from the account without the firm's knowledge. The firm comes to know about it only when the bank statement arrives. Examples of such deductions include: cheque collection charges, incidental charges, interest on overdraft, unpaid cheques deducted by the bank – i.e., stopped or bounced, etc. As a result, the balance as per passbook will be less than the balance as per cash book. 2022-23 164 Accountancy 5.1.1(d) Amounts directly deposited in the bank account There are instances when debtors (customers) directly deposits money into firm's bank account. But, the firm does not receive the intimation from any source till it receives the bank statement. In this case, the bank records the receipts in the firm's account at the bank but the same is not recorded in the firm's cash book. As a result, the balance shown in the bank passbook will be more than the balance shown in the firm's cash book. 5.1.1(e) Interest and dividends collected by the bank When the bank collects interest and dividend on behalf of the customer, then these are immediately credited to the customers account. But the firm will know about these transactions and record the same in the cash book only when it receives a bank statement. Till then the balances as per the cash book and passbook will differ. 5.1.1(f) Direct payments made by the bank on behalf of the customers Sometimes the customers give standing instructions to the bank to make some payment regularly on stated days to the third parties. For example, telephone bills, insurance premium, rent, taxes, etc. are directly paid by the bank on behalf of the customer and debited to the account. As a result, the balance as per the bank passbook would be less than the one shown in the cash book. 5.1.1(g) Cheques deposited/bills discounted dishonoured If a cheque deposited by the firm is dishonoured or a bill of exchange drawn by the business firm is discounted with the bank is dishonoured on the date of maturity, the same is debited to customer's account by the bank. As this information is not available to the firm immediately, there will be no entry in the firm's cash book regarding the above items. This will be known to the firm when it receives a statement from the bank. As a result, the balance as per the passbook would be less than the cash book balance. 5.1.2 Differences Caused by Errors Sometimes the difference between the two balances may be accounted for by an error on the part of the bank or an error in the cash book of the business. This causes difference between the bank balance shown by the cash book and the balance shown by the bank statement. 2022-23 Bank Reconciliation Statement 165 5.1.2(a) Errors committed in recording transaction by the firm Omission or wrong recording of transactions relating to cheques issued, cheques deposited and wrong totalling, etc., committed by the firm while recording entries in the cash book cause difference between cash book and passbook balance. 5.1.2(b) Errors committed in recording transactions by the bank Omission or wrong recording of transactions relating to cheques deposited and wrong totalling, etc., committed by the bank while posting entries in the passbook also cause differences between passbook and cash book balance. Test Your Understanding - I I. Read the following transactions and identify the cause of difference on the basis of time gap or errors made by business firm/bank. Put a sign (ü) for the correct cause. S.No. Transactions Time Gap Errors made by business/ bank 1. Cheques issued to customers but not presented for payment. 2. Cheque amounting to ` 5,000 issued to M/s. XYZ but recorded as ` 500 in the cash book. 3. Interest credited by the bank but yet not recorded in the cash book. 4. Cheque deposited into the bank but not yet collected by the bank. 5. Bank charges debited to firm's current account by the bank. II. Fill in the blanks : (i) Passbook is a copy of............as it appears in the ledger of the bank. (ii) When money is with drawn from the bank, the bank .... the account of the customer. (iii) Normally, the cash book shows a debit balance, passbook shows ....balance. (iv) Favourable balance as per the cash book means ....balance in the bank column of the cash book. 2022-23 166 Accountancy (v) If the cash book balance is taken as starting point the items which make the cash book balance smaller than the passbook must be ....for the purpose of reconciliation. (vi) If the passbook shows a favourable balance and if it is taken as the starting point for the purpose of bank reconciliation statement then cheques issued but not presented for payment should be ....to find out cash balance. (vii) When the cheques are not presented for payment, favourable balance as per the cash book is ....than that of the passbook. (viii) When a banker collects the bills and credits the account passbook overdraft shows ....balance. (ix) If the overdraft as per the passbook is taken as the starting point, the cheques issued but not presented are to be ....in the bank reconciliation statement. (x) When the passbook balance is taken as the starting point items which makes the passbook balance ....than the balance in the cash book must be deducted for the purpose of reconciliation. 5.2 Preparation of Bank Reconciliation Statement After identifying the causes of difference, the reconciliation may be done in the following two ways: (a) Preparation of bank reconciliation statement without adjusting cash book balance. (b) Preparation of bank reconciliation statement after adjusting cash book balance. It may be noted that in practice, the bank reconciliation statement is prepared after adjusting the cash book balance, about which you will study later in the chapter. 5.2.1 Preparation of Bank Reconciliation Statement without adjusting Cash Book Balance To prepare bank reconciliation statement, under this approach, the balance as per cash book or as per passbook is the starting item. The debit balance as per the cash book means the balance of deposits held at the bank. Such a balance will be a credit balance as per the passbook. Such a balance exists when the deposits made by the firm are more than its withdrawals. It indicates the favourable balance as per cash book or favourable balance as per the passbook. On the other hand, the credit balance as per the cash book indicates bank overdraft. In other words, the excess amount withdrawn over the amount deposited in the bank. It is also known as unfavourable balance as per cash book or unfavourable balance as per passbook. 2022-23 Bank Reconciliation Statement 167 We may have four different situations while preparing the bank reconciliation statement. These are : 1. When debit balance (favourable balance) as per cash book is given and the balance as per passbook is to be ascertained. 2. When credit balance (favourable balance) as per passbook is given and the balance as per cash book is to be ascertained. 3. When credit balance as per cash book (unfavourable balance/overdraft balance) is given and the balance as per passbook is to ascertained. 4. When debit balance as per passbook (unfavourable balance/overdraft balance) is given and the cash book balance as per is to ascertained. 5.2.1(a) Dealing with favourable balances The following steps may be initiated to prepare the bank reconciliation statement: (i) The date on which the statement is prepared is written at the top, as part of the heading. (ii) The first item in the statement is generally the balance as shown by the cash book. Alternatively, the starting point can also be the balance as per passbook. (iii) The cheques deposited but not yet collected are deducted. (iv) All the cheques issued but not yet presented for payment, amounts directly deposited in the bank account are added. (v) All the items of charges such as interest on overdraft, payment by bank on standing instructions and debited by the bank in the passbook but not entered in cash book, bills and cheques dishonoured etc. are deducted. (vi) All the credits given by the bank such as interest on dividends collected, etc. and direct deposits in the bank are added. (vii) Adjustment for errors are made according to the principles of rectification of errors. (The rectification of errors has been discussed in detail in chapter 6.) (viii) Now the net balance shown by the statement should be same as shown by the passbook. It may be noted that treatment of all items shall be the reverse of the above if we adjust passbook balance as the starting point. (see illustration 3) The following solved illustrations will help you understand dealing with favourable balance as per cash book and passbook. 2022-23 168 Accountancy Illustration 1 From the following particulars of Mr. Vinod, prepare bank reconciliation statement as on March 31, 2017. 1. Bank balance as per cash book ` 50,000. 2. Cheques issued but not presented for payment ` 6,000. 3. The bank had directly collected dividend of ` 8,000 and credited to bank account but was not entered in the cash book. 4. Bank charges of ` 400 were not entered in the cash book. 5. A cheques for ` 6,000 was deposited but not collected by the bank. Solution Bank Reconciliation Statement of Mr. Vinod as on March 31, 2017 Particulars + – ` ` 1. Balance as per cash book 50,000 2. Cheques issued but not presented for payment 6,000 3. Dividends collected by the bank 8,000 4. Cheque deposited but not credited by the bank 6,000 5. Bank charges debited by the bank 400 6. Balance as per passbook. 57,600 64,000 64,000 Illustration 2 From the following particulars of Anil & Co. prepare a bank reconciliation statement as on August 31, 2017. 1. Balance as per the cash book ` 54,000. 2. ` 100 bank incidental charges debited to Anil & Co. account, which is not recorded in cash book. 3. Cheques for ` 5,400 is deposited in the bank but not yet collected by the bank. 4. A cheque for ` 20,000 is issued by Anil & Co. not presented for payment. Solution Bank Reconciliation Statement of Anil & Co. as on August 31, 2017 Particulars (+) (–) Amount Amount ` ` 1. Balance as per cash book 54,000 - 2. Cheqeus issued but not presented for payment 20,000 - 3. Cheques deposited but not credited by the bank - 5,400 4. Bank incidental charges debited by the bank - 100 5. Balance as per passbook - 68,500 74,000 74,000 2022-23 Bank Reconciliation Statement 169 Illustration 3 The bank passbook of M/s. Boss & Co. showed a balance of ` 45,000 on May 31, 2017. 1. Cheques issued before May 31, 2017, amounting to ` 25,940 had not been presented for encashment. 2. Two cheques of ` 3,900 and ` 2,350 were deposited into the bank on May 31 but the bank gave credit for the same in June, 2017. 3. There was also a debit in the passbook of ` 2,500 in respect of a cheque dishonoured on 31.5.2017. Prepare a bank reconciliation statement as on May 31, 2017. Solution Bank Reconciliation Statement of Bose & Co as on May 31, 2017 Particulars (+) (–) Amount Amount ` ` 1. Balance as per passbook 45,000 2. Cheques deposited but not collected by the bank 6,250 (` 3,900+ ` 2,350) 3. Cheque dishonoured recorded only in passbook 2,500 4. Cheques issued but not presented for payment 25,940 5. Balance as per cash book 27,810 53,750 53,750 5.2.1(b) Dealing with overdrafts So far we have dealt with bank reconciliation statement where bank balances has been positive – i.e., there has been money in the bank account. However, businesses sometimes have overdrafts at the bank. Overdrafts are where the bank account becomes negative and the businesses in effect have borrowed from the bank. This is shown in the cash book as a credit balance. In the bank statement, where the balance is followed by Dr. (or sometimes OD) means that there is an overdraft and called debit balance as per passbook. An overdraft is treated as negative figure on a bank reconciliation statement. The following solved illustration will help you understand the preparation of bank reconciliation statement when there is an overdraft. Illustration 4 On March 31, 2017, Rakesh had on overdraft of ` 8,000 as shown by his cash book. Cheques amounting to ` 2,000 had been paid in by him but were not collected by the bank. He issued cheques of ` 800 which were not presented to the bank for payment. There was a debit in his passbook of ` 60 for interest and ` 100 for bank charges. Prepare bank reconciliation statement. 2022-23 170 Accountancy Solution Bank Reconciliation Statement of Rakesh as on April 01, 2017 Particulars (+) (–) Amount Amount ` ` 1. Overdraft as per cash book 8,000 2. Cheques deposited but not yet collectedcharged by the bank 2,000 3. Bank charges 60 4. Cheques issued but not presented for payment 800 100 5. Balance as per bank passbook (overdraft) 9,360 10,160 10,160

Illustration 5 On March 31, 2017 the bank column of the cash book of Agrawal Traders showed a credit balance of ` 1,18,100 (Overdraft). On examining of the cash book and the bank statement, it was found that : 1. Cheques received and recorded in the cash book but not sent to the bank of collection ` 12,400. 2. Payment received from a customer directly by the bank ` 27,300 but no entry was made in the cash book. 3. Cheques issued for ` 1,75,200 not presented for payment. Interest of ` 8,800 charged by the bank was not entered in the cash book. Prepare bank reconciliation statement. Solution Bank Reconciliation Statement of Agarwal Traders as on March 31, 2017 Particulars (+) (–) Amount Amount ` ` 1. Overdraft as per cash book 1,18,100 2. Cheques received and recorded in the cash book but not 12,400 sent to the bank for collection 3. Interest on bank overdraft debited by the bank but not 8,800 entered in the cash book 4. Payment received from the customer directly 27,300 5. Credited in the bank a/c but not entered in the cash book 1,75,200 6. Cheques issued but not presented for payment 7. Balance as per the passbook (favourable balance) 63,200 2,02,500 2,02,500 2022-23 Bank Reconciliation Statement 171 Illustration 6 From the following particulars of Asha & Co. prepare a bank reconciliation statement on December 31, 2017. ` Overdraft as per passbook 20,000 Interest on overdraft 2,000 Insurance Premium paid by the bank 200 Cheque issued but not presented for payment 6,500 Cheque deposited but not yet cleared 6,000 Wrongly debited by the bank 500 Solution Bank Reconciliation Statement of Asha & Co as on December 31, 2017 Particulars (+) (–) Amount Amount ` ` 1. Overdraft as per passbook 20,000 2. Interest on overdraft 2,000 3. Insurance premium paid by the bank 200 4. Cheque issued but not presented for payment 6,500 5. Cheques deposited but not yet cleared 6,000 6. Wrongly debited by the bank 500 7. Balance as per the cash book (overdraft) 17,800 26,500 26,500 Illustration 7 From the following particulars, prepare a bank reconciliation statement as on March 31, 2017. (a) Debit balance as per cash book is ` 10,000. (b) A cheque for ` 1,000 deposited but not recorded in the cash book. (c) A cash deposit of ` 200 was recorded in the cash book as if there is not bank, column therein. (d) A cheque issued for ` 250 was recorded as ` 205 in the cash column. (e) The debit balance of ` 1,500 as on the previous day was brought forward as a credit balance. (f) The payment side of the cash book was under cast by ` 100. (g) A cash discount allowed of ` 112 was recorded as ` 121 in the bank column. (h) A cheque of ` 500 received from a debtor was recorded in the cash book but not deposited in the bank for collection. (i) One outgoing cheque of ` 300 was recorded twice in the cash book. 2022-23 172 Accountancy Solution Bank Reconciliation statement as on September 30, 2017 Particulars (+) (–) Amount Amount ` ` 1. Debit balance as per cash book 10,000 2. Error in carrying forward 3,000 3. Cheque recorded twice in cash book 300 4. Cheque deposit not record in bank column 200 5. Cheque deposit but not recorded 1,000 6, Under casting of payment side 100 7. Cheque issued but not entered 250 8. A cash discount wrongly recorded in bank column 121 9. Cheque recorded but not deposited 500 10. Credit balance as per passbook 13,529 14,500 14,500 Illustration 8 From the following particulars, prepare the bank reconciliation statement of Shri Krishan as on March 31, 2017. (a) Balance as per passbook is ` 10,000. (b) Bank collected a cheque of ` 500 on behalf of Shri Krishan but wrongly credited it to Shri Kishan's account. (c) Bank recorded a cash book deposit of ` 1,589 as ` 1,598. (d) Withdrawal column of the passbook under cast by ` 100. (e) The credit balance of ` 1,500 as on the pass-book was recorded in the debit balance. (f) The payment of a cheque of ` 350 was recorded twice in the passbook. (g) The pass-book showed a credit balance for a cheque of ` 1,000 deposited by Shri Kishan. Solution Bank Reconciliation Statement as on March 31, 2017 Particulars (+) (–) Amount Amount ` ` 1. Credit balance as per passbook 10,000 2. Cheque wrongly credited to another customer account 500 3. Error in carrying forward 3,000 4. Cheque recorded twice 350 5. Excess credit for cash deposit 9 6. Under casting of withdrawal column 100 7. Wrong credit 1,000 8. Debit balance as per cash book 12,741 13,850 13,850 2022-23 Bank Reconciliation Statement 173 Test Your Understanding - II Select the Correct Answer: 1. A bank reconciliation statement is prepared by: (a) Creditors (b) Bank (c) Account holder in a bank (d) Debtors 2. A bank reconciliation statement is prepared with the balance: (a) Passbook (b) Cash book (c) Both passbook and cash book (d) None of these 3. Passbook is a copy of: (a) Copy of customer Account (b) Bank column of cash book (c) Cash column of cash book (d) Copy of receipts and payments 4. Unfavourable bank balance means: (a) Credit balance in passbook (b) Credit balance in cash book (c) Debit balance in cash book (d) None of these 5. Favourable bank balance means: (a) Credit balance in the cash book (b) Credit balance in passbook (c) Debit balance in the cash book (d) Both (b) and (c) 6. A bank reconciliation statement is mainly prepared for: (a) Reconcile the cash balance of the cash book. (b) Reconcile the difference between the bank balance shown by the cash book and bank passbook (c) Both (a) and (b) (d) None of these Test your Understanding - III State whether each of the following statements is True or False 1. Passbook is the statement of account of the customer maintained by the bank. 2. A business firm periodically prepares a bank reconciliation statement to reconcile the bank balance as per the cash book with the passbook as these two show different balances for various reasons. 3. Cheques issued but not presented for payment will reduce the balance as per the passbook. 4. Cheques deposited but not collected will result in increasing the balance of the cash book when compared to passbook. 5. Overdraft as per the passbook is less than the overdraft as per cash book when there are cheques deposited but not collected by the banker. 6. The debit balance of the bank account as per the cash book should be equal to the credit balance of the account of the business in the books of the bank. 7. Favourable bank balance as per the cash book will be less than the bank passbook balance when there are unpresented cheques for payment. 8. Direct collections received by the bank on behalf of the customers would increase the balance as per the bank passbook when compared to the balance as per the cash book. 9. When payments made by the bank as per the standing instructions of the customer, the balance in the passbook will be more when compared to the cash book. 2022-23 174 Accountancy Key Terms Introduced in the Chapter 1. Bank Reconciliation Statement 2. Cash book and Passbook Summary with Reference to Learning Objectives 1. Bank Reconciliation Statement: A statement prepared to reconcile the bank balance as per cash book with the balance as per passbook or bank statement, by showing the items of difference between the two accounts. 2. Causes of difference: – timing of recoding the transaction. – error made by business or by the bank. 3. Correct cash balance: It may happen that some of the receipts or payments are missing from either of the books and errors, if any, need to be rectified. This arise the need to look at the entries/errors recorded in both statements and other information available and compute the correct cash balance before reconciling the statements. Questions for Practice Short Answers 1. State the need for the preparation of bank reconciliation statement? 2. What is a bank overdraft? 3. Briefly explain the statement 'wrongly debited by the bank' with the help of an example. 4. State the causes of difference occurred due to time lag. 5. Briefly explain the term 'favourable balance as per cash book'. 6. Enumerate the steps to ascertain the correct cash book balance. Long Answers 1. What is a bank reconciliation statement. Why is it prepared? 2. Explain the reasons where the balance shown by the bank passbook does not agree with the balance as shown by the bank column of the cash book. 3. Explain the process of preparing bank reconciliation statement with amended cash balance. Numerical Questions Favourable balance of cash book and passbook – 1. From the following particulars, prepare a bank reconciliation statement as at March 31, 2017. (i) Balance as per cash book ` 3,200 (ii) Cheque issued but not presented for payment ` 1,800 (iii) Cheque deposited but not collected upto March 31, 2014 ` 2,000 (iv) Bank charges debited by bank ` 150 (Ans: Balance as per passbook ` 2,850) 2022-23 Bank Reconciliation Statement 175 2. On March 31, 2017 the cash book showed a balance of ` 3,700 as cash at bank, but the bank passbook made up to same date showed that cheques for ` 700, ` 300 and ` 180 respectively had not presented for payment, Also, a cheque amounting to ` 1,200 deposited into the account had not been credited. Prepare a bank reconciliation statement. (Ans : Balance as per passbook ` 3,680) 3. The cash book shows a bank balance of ` 7,800. On comparing the cash book with passbook the following discrepancies were noted: (a) Cheque deposited in bank but not credited ` 3,000 (b) Cheque issued but not yet present for payment ` 1,500 (c) Insurance premium paid by the bank ` 2,000 (d) Bank interest credit by the bank ` 400 (e) Bank charges ` 100 (d) Directly deposited by a customer ` 4,000 (Ans: Balance as per passbook ` 8,600) 4. Bank balance of ` 40,000 showed by the cash book of Atul on December 31, 2016. It was found that three cheques of ` 2,000, ` 5,000 and ` 8,000 deposited during the month of December were not credited in the passbook till January 02, 2017. Two cheques of ` 7,000 and ` 8,000 issued on December 28, were not presented for payment till January 03, 2017. In addition to it bank had credited Atul for ` 325 as interest and had debited him with ` 50 as bank charges for which there were no corresponding entries in the cash book. Prepare a bank reconciliation statement as on December 31, 2016. (Ans: Balance as per passbook ` 40,275) 5. On comparing the cash book with passbook of Naman it is found that on March 31, 2014, bank balance of ` 40,960 showed by the cash book differs from the bank balance with regard to the following: (a) Bank charges ` 100 on March 31, 2017, are not entered in the cash book. (b) On March 21, 2017, a debtor paid ` 2,000 into the company's bank in settlement of his account, but no entry was made in the cash book of the company in respect of this. (c) Cheques totaling ` 12,980 were issued by the company and duly recorded in the cash book before March 31, 2017, but had not been presented at the bank for payment until after that date. (d) A bill for ` 6,900 discounted with the bank is entered in the cash book without recording the discount charge of ` 800. (e) ` 3,520 is entered in the cash book as paid into bank on March 31st , 2017, but not credited by the bank until the following day. (f) No entry has been made in the cash book to record the dishon or on March 15, 2017 of a cheque for ` 650 received from Bhanu. Prepare a reconciliation statement as on March 31, 201. (Ans: Balance as per passbook ` 50,870) 2022-23 176 Accountancy 6. Prepare bank reconciliation statement as on December 31, 2017. This day the passbook of Mr. Himanshu showed a balance of ` 7,000. (a) Cheques of ` 1,000 directly deposited by a customer. (b) The bank has credited Mr. Himanshu for ` 700 as interest. (c) Cheques for ` 3000 were issued during the month of December but of these cheques for ` 1,000 were not presented during the month of December. (Ans: Balance as per cash book ` 3,300). 7. From the following particulars prepare a bank reconciliation statement showing the balance as per cash book on December 31, 2016. (a) Two cheques of ` 2,000 and ` 5,000 were paid into bank in October, 2016 but were not credited by the bank in the month of December. (b) A cheque of ` 800 which was received from a customer was entered in the bank column of the cash book in December 2016 but was omitted to be banked in December, 2016. (c) Cheques for ` 10,000 were issued into bank in November 2016 but not credited by the bank on December 31, 2016. (d) Interest on investment ` 1,000 collected by bank appeared in the passbook. Balance as per Passbook was ` 50,000 (Ans: Balance as per cash book ` 47,800) 8. Balance as per passbook of Mr. Kumar is 3,000. (a) Cheque paid into bank but not yet cleared Ram Kumar ` 1,000 Kishore Kumar ` 500 (b) Bank Charges ` 300 (c) Cheque issued but not presented Hameed ` 2,000 Kapoor ` 500 (d) Interest entered in the passbook but not entered in the cash book ` 100 Prepare a bank reconciliation statement. (Ans: Balance as per cash book ` 2,200). 9. The passbook of Mr. Mohit current account showed a credit Balance of ` 20,000 on dated December 31, 2016. Prepare a Bank Reconciliation Statement with the following information. (i) A cheque of ` 400 drawn on his saving account has been shown on current account. (ii) He issued two cheques of ` 300 and ` 500 on of December 25, but only the Ist cheque was presented for payment. (iii) One cheque issued by Mr. Mohit of ` 500 on December 25, but it was not presented for payment whereas it was recorded twice in the cash book. (Ans: Balance as per cash book ` 18,900). 2022-23 Bank Reconciliation Statement 177 Unfavourable balance of cash book 10. On Ist January 2017, Rakesh had an overdraft of ` 8,000 as showed by his cash book. Cheques amounting to ` 2,000 had been paid in by him but were not collected by the bank by January 01, 2017. He issued cheques of ` 800 which were not presented to the bank for payment up to that day. There was a debit in his passbook of ` 60 for interest and ` 100 for bank charges. Prepare bank reconciliation statement for comparing both the balance. (Ans: Overdraft as per passbook ` 9,360) 11. Prepare bank reconciliation statement. (i) Overdraft shown as per cash book on December 31, 2017 ` 10,000. (ii) Bank charges for the above period also debited in the passbook ` 100. (iii) Interest on overdraft for six months ending December 31, 2017 ` 380 debited in the passbook. (iv) Cheques issued but not incashed prior to December 31, 2017 amounted to ` 2,150. (v) Interest on Investment collected by the bank and credited in the passbook ` 600. (vi) Cheques paid into bank but not cleared before December, 31, 2017 were ` 1,100. (Ans: overdraft as per passbook ` 8,830). 12. Kumar find that the bank balance shown by his cash book on December 31, 2017 is ` 90,600 (Credit) but the passbook shows a difference due to the following reason: A cheque (post dated) for ` 1,000 has been debited in the bank column of the cash book but not presented for payment. Also, a cheque for ` 8,000 drawn in favour of Manohar has not yet been presented for payment. Cheques totaling ` 1,500 deposited in the bank have not yet been collected and cheque for ` 5,000 has been dishonoured. (Ans: overdraft as per passbook ` 90,100). 13. On December 31, 2017, the cash book of Mittal Bros. Showed an overdraft of ` 6,920. From the following particulars prepare a Bank Reconciliation Statement and ascertain the balance as per passbook. (1) Debited by bank for ` 200 on account of Interest on overdraft and ` 50 on account of charges for collecting bills. (2) Cheques drawn but not encashed before December, 31, 2017 for ` 4,000. (3) The bank has collected interest and has credited ` 600 in passbook. (4) A bill receivable for ` 700 previously discounted with the bank had been dishonoured and debited in the passbook. (5) Cheques paid into bank but not collected and credited before December 31, 2017 amounted ` 6,000. (Ans: Overdraft as per passbook ` 9,170). 2022-23 178 Accountancy Unfavourable balance of the passbook 14. Prepare bank reconciliation statement of Shri Bhandari as on March 31, 2017 (i) The Payment of a cheque for ` 550 was recorded twice in the passbook. (ii) Withdrawal column of the passbook under cast by ` 200 (iii) A Cheque of ` 200 has been debited in the bank column of the Cash Book but it was not sent to bank at all. (iv) A Cheque of ` 300 debited to Bank column of the cash book was not sent to the bank. (v) ` 500 in respect of dishonoured cheque were entered in the passbook but not in the cash book. Overdraft as per passbook is ` 20,000. (Ans: Overdraft as per cash book ` 21,350). 15. Overdraft shown by the passbook of Mr. Murli is ` 20,000. Prepare bank reconciliation statement on dated March 31, 2017. (i) Bank charges debited as per passbook ` 500. (ii) Cheques recorded in the cash book but not sent to the bank for collection ` 2,500. (iii) Received a payment directly from customer ` 4,600. (iv) Cheque issued but not presented for payment ` 6,980. (v) Interest credited by the bank ` 100. (vi) LIC paid by bank ` 2,500. (vii) Cheques deposited with the bank but not collected ` 3,500. (Ans: Overdraft as per cash book ` 22,680). 16. Raghav & Co. have two bank accounts. Account No. I and Account No. II. From the following particulars relating to Account No. I, find out the balance on that account of March 31, 2017 according to the cash book of the firm. (i) Cheques paid into bank prior to March 31, 2017, but not credited for ` 10,000. (ii) Transfer of funds from account No. II to account no. I recorded by the bank on March 31, 2017 but entered in the cash book after that date for ` 8,000. (iii) Cheques issued prior to March 31, 2017 but not presented until after that date for ` 7,429. (iv) Bank charges debited by bank not entered in the cash book for ` 200. (v) Interest Debited by the bank not entered in the cash book ` 580. (vi) Overdraft as per Passbook ` 18,990. (Ans: Overdraft as per cash book ` 23,639). 17. Prepare a bank reconciliation statement from the following particulars and show the balance as per cash book. 2022-23 Bank Reconciliation Statement 179 (i) Balance as per passbook on March 31, 2017 overdrawn ` 20,000. (ii) Interest on bank overdraft not entered in the cash book ` 2,000. (iii) ` 200 insurance premium paid by bank has not been entered in the cash book. (iv) Cheques drawn in the last week of March 2017, but not cleared till date for ` 3,000 and ` 3,500. (v) Cheques deposited into bank on February 2017, but yet to be credited on dated March 31, 2017 ` 6,000. (vii) Wrongly debited by bank ` 500. (Ans: Overdraft as per cash book ` 17,800). 18. The passbook of Mr. Randhir showed an overdraft of ` 40,950 on March

31, 2017. Prepare bank reconciliation statement on March 31, 2017. (i) Out of cheques amounting to ` 8,000 drawn by Mr. Randhir on March 27 a cheque for ` 3,000 was encashed on April 2017. (ii) Credited by bank with ` 3,800 for interest collected by them, but the amount is not entered in the cash book. (iii) ` 10,900 paid in by Mr. Randhir in cash and by cheques on March, 31 cheques amounting to ` 3,800 were collected on April, 07. (iv) A Cheque of ` 780 credited in the passbook on March 28 being dishonoured is debited again in the passbook on April 01, 2017. There was no entry in the cash book about the dishonour of the cheque until April 15. (Ans: Overdraft as per cash book ` 43,170) Checklist to Test Your Understanding Test Your Understanding - I (I) 1. Time gap 2. Error 3. Time gap 4. Time gap 5. Time gap (II) (i) Customer account (ii) Debit (iii) Credit (iv) Debit (v) Added (vi) Deducted (vii) loss (viii) Loss (ix) Added (x) Higher Test Your Understanding - II 1. (b) 2. (c) 3. (a) 4. (a) 5. (c) 6. (b) Test Your Understanding - III 1. (T) 2. (T) 3. (F) 4. (T) 5. (F) 6. (T) 7. (T) 8. (T) 9. (F) 2022-23180 Accountancy I n the earlier chapters, you have learnt about the basic principles of accounting that for every debit there will be an equal credit. It implies that if the sum of all debits equals the sum of all credits, it is presumed that the posting to the ledger in terms of debit and credit amounts is accurate. The trial balance is a tool for verifying the correctness of debit and credit amounts. It is an arithmetical check under the double entry system which verifies that both aspects of every transaction have been recorded accurately. This chapter explains the meaning and process of preparation of trial balance and the types of errors and their rectification. 6.1 Meaning of Trial Balance A trial balance is a statement showing the balances, or total of debits and credits, of all the accounts in the ledger with a view to verify the arithmatical accuracy of posting into the ledger accounts. Trial balance is an important statement in the accounting process as it shows the final position of all accounts and helps in preparing the final statements. The task of preparing the statements is simplified because the accountant can take the balances of all accounts from the trial balance instead of going through the whole ledger. It may be noted that the trial balance is usually prepared with the balances of accounts. Trial Balance and Rectification of Errors 6 LEARNING OBJECTIVES After studying this chapter, you will be able to : • state the meaning of trial balance; • enumerate the objectives of preparing trial balance ; • prepare trial balance; • explain the types of errors; • state various process of locating errors ; • identify the errors which affect the agreement of trial balance and those which do not affect the agreement of trial balance; • rectify the errors without preparing suspense account; and • rectify the errors with suspense account. 2022-23 Trial Balance and Rectification of Errors 181 Trial Balance of ......as on March 31, 2014 Account Title L.F. Debit Credit Balance Balance ¯ ¯Total Fig. 6.1: Showing format of a trial balance It is normally prepared at the end of an accounting year. However, an organisation may prepare a trial balance at the end of any chosen period, which may be monthly, quarterly, half yearly or annually depending upon its requirements. In order to prepare a trial balance following steps are taken: • Ascertain the balances of each account in the ledger. • List each account and place its balance in the debit or credit column, as the case may be. (If an account has a zero balance, it may be included in the trial balance with zero in the column for its normal balance). • Compute the total of debit balances column. • Compute the total of the credit balances column. • Verify that the sum of the debit balances equal the sum of credit balances. If they do not tally, it indicate that there are some errors. So one must check the correctness of the balances of all accounts. It may be noted that all assets expenses and receivables account shall have debit balances whereas all liabilities, revenues and payables accounts shall have credit balances (refer figure 6.2). 6.2 Objectives of Preparing the Trial Balance The trial balance is prepared to fulfill the following objectives : 1. To ascertain the arithmetical accuracy of the ledger accounts. 2. To help in locating errors. 3. To help in the preparation of the financial statements. (Profit & Loss account and Balance Sheet). 2022-23 182 Accountancy Account Title L.F. Debit Credit Balance Balance ¯ ¯ • Capital ⎫ • Land and Buildings ⎫ • Plant and Machinery ⎫ • Equipment ⎫ • Furniture and Fixtures ⎫ • Cash in Hand ⎫ • Cash at Bank ⎫ • Debtors ⎫ • Bills

Receivable ⎫ • Stock of Raw Materials ⎫ • Stock of Finished Goods ⎫ • Purchases ⎫ • Carriage Inwards ⎫ • Carriage Outwards ⎫ • Sales ⎫ • Sales Return ⎫ • Purchases Return ⎫ • Interest Paid ⎫ • Commission/Discount Received ⎫ • Salaries ⎫ • Long Term Loan ⎫ • Bills Payable ⎫ • Creditors ⎫ • Advances from Customers ⎫ • Drawings ⎫ Total xxx xxx Fig. 6.2 : Illustrative trial balance 6.2.1 To Ascertain the Arithmetical Accuracy of Ledger Accounts As stated earlier, the purpose of preparing a trial balance is to asceitain whether all debits and credit are properly recorded in the ledger or not and that all accounts have been correctly balanced. As a summary of the ledger, it is a list of the accounts and their balances. When the totals of all the debit balances 2022-23 Trial Balance and Rectification of Errors 183 and credit balances in the trial balance are equal, it is assumed that the posting and balancing of accounts is arithmetically correct. However, the tallying of the trial balance is not a conclusive proof of the accuracy of the accounts. It only ensures that all debits and the corresponding credits have been properly recorded in the ledger. 6.2.2 To Help in Locating Errors When a trial balance does not tally (that is, the totals of debit and credit columns are not equal), we know that at least one error has occured. The error (or errors) may have occured at one of those stages in the accounting process: (1) totalling of subsidiary books, (2) posting of journal entries in the ledger, (3) calculating account balances, (4) carrying account balances to the trial balance, and (5) totalling the trial balance columns. It may be noted that the accounting accuracy is not ensured even if the totals of debit and credit balances are equal because some errors do not affect equality of debits and credits. For example, the book-keeper may debit a correct amount in the wrong account while making the journal entry or in posting a journal entry to the ledger. This error would cause two accounts to have incorrect balances but the trial balance would tally. Another error is to record an equal debit and credit of an incorrect amount. This error would give the two accounts incorrect balances but would not create unequal debits and credits. As a result, the fact that the trial balance has tallied does not imply that all entries in the books of original record (journal, cash book, etc.) have been recorded and posted correctly. However, equal totals do suggest that several types of errors probably have not occured. 6.2.3 To Help in the Preparation of the Financial Statements Trial balance is considered as the connecting link between accounting records and the preparation of financial statements. For preparing a financial statement, one need not refer to the ledger. In fact, the availability of a tallied trial balance is the first step in the preparation of financial statements. All revenue and expense accounts appearing in the trial balance are transferred to the trading and profit and loss account and all liabilities, capital and assets accounts are transferred to the balance sheet. (Preparation of the financial statements is explained in chapters, 9 and 10). 2022-23 184 Accountancy 6.3 Preparation of Trial Balance Theoritically spreading, a trial balance can be prepared in the following three ways: (i) Totals Method (ii) Balances Method (iii) Totals-cum-balances Method 6.3.1 Totals method Under this method, total of each side in the ledger (debit and credit) is ascertained separately and shown in the trial balance in the respective columns. The total of debit column of trial balance should agree with the total of credit column in the trial balance because the accounts are based on double entry system. However, this method is not widely used in practice, as it does not help in assuming accuracy of balances of various accounts and and preparation of the fianancial statements. 6.3.2 Balances Method This is the most widely used method in practice. Under this method trial balance is prepared by showing the balances of all ledger accounts and then totalling up the debit and credit columns of the trial balance to assure their correctness. The account balances are used because the balance summarises the net effect of all transactions relating to an account and helps in preparing the financial statements. It may be noted that in trial balance, normally in place of balances in individual accounts of the debtors, a figure of sundry debtors is shown, and in place of individual accounts of creditors, a figure of sundry creditors is shown. 6.3.3 Totals-cum-balances Method This method is a combination of totals method and balances method. Under this method four columns for amount are prepared. Two columns for writing the debit and credit totals of various accounts and two columns for writing the debit and credit balances of these accounts. However, this method is also not used in practice because it is time consuming and hardly serves any additional or special purpose. Let us now learn how will the trial balance be prepared using each of these methods with the help of the following example: Mr. Rawat's ledger shows the following accounts for his business. Help him in preparing the trial balance using: (i) Totals method, (ii) Balances method, (iii) Totals-cum-Balances method. 2022-23 Trial Balance and Rectification of Errors 185 Rawat's Capital Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount 2014 2014 Dec. 31 Balance c/d 60,000 Jan. 01 Balance b/d 40,000 Cash 20,000 60,000 2015 60,000 Jan. 01 Balance b/d 60,000 Rohan's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount 2014 2014 Cash 40,000 Jan. 01 Balance b/d 10,000 Dec. 31 Balance c/d 20,000 Purchases 50,000 60,000 2015 60,000 Jan. 1 Balance b/d 20,000 Machinery Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount 2014 2014 Dec. 31 Balance b/d 20,000 Depreciation 3,000 Dec. 31 Balance c/d 17,000 20,000 20,000 2015 Jan. 01 Balance b/d 17,000 Rahul's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount 2014 2014 Jan. 01 Balance b/d 15,000 Cash 55,000 Sales 60,000 Dec. 31 Balance c/d 20,000 2015 75,000 75,000 Jan. 01 Balance b/d 20,000 2022-23 186 Accountancy Sales Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount 2014 Rahul 60,000 Cash 10,000 70,000 Cash Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount 2014 2014 Jan. 01 Balanc e b/d 15,000 Rohan 40,000 Capital 20,000 Wages 5,000 Rahul 55,000 Purchases 12,000 Sales 10,000 Dec. 31 Balance c/d 43,000 1,00,000 1,00,000 2015 Jan. 01 Balance b/d 43,000 Wages Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount 2014 Cash 5,000 5,000 Depreciation Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount 2014 Machinery 3,000 3,000 2022-23 Trial Balance and Rectification of Errors 187 Purchases Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount 2014 Rohan 50,000 Cash 12,000 62,000 The trial balance under the three methods is illustrated below: (i) Trial Balance as at March 31, 2014 (Using Totals Method) Account L.F. Debit Credit Title Total Total Rawat 60,000 Rohan 40,000 60,000 Machinery 20,000 3,000 Rahul 75,000 55,000 Sales 70,000 Cash 1,00,000 57,000 Wages 5,000 Depreciation 3,000 Purchases 62,000 3,05,000 3,05,000 (ii) Trial Balance as at March 31, 2014 (Using Balances Method) Account Title L.F. Debit Credit Balance Balance Rawat's Capital 60,000 Rohan's Capital 20,000 Machinery 17,000 Rahul 20,000 Sales 70,000 Cash 43,000 Wages 5,000 Depreciation 3,000 Purchases 62,000 Total 1,50,000 1,50,000 2022-23 188 Accountancy (iii) Trial Balance as at March 31, 2014 (Using Totals-cum-Balances Method) Account Title L.F. Debit Credit Debit Credit Total Total Balance Balance Rawat's Capital 60,000 60,000 Rohan 40,000 60,000 20,000 Machinery 20,000 3,000 17,000 Rahul 75,000 55,000 20,000 Sales 70,000 70,000 Cash 1,00,000 57,000 43,000 Wages 5,000 5,000 Depreciation 3,000 3,000 Purchases 62,000 62,000 Total 3,05,000 3,05,000 1,50,000 1,50,000 Test Your Understanding - I Indicate against each amount wheather it is a debit or a credit balance, and prepare a trial balance as at March 31, 2014 based on the following balances: Accounts Title Amount Capital 1,00,000 Drawings 16,000 Machinery 20,000 Sales 2,00,000 Purchases 2,10,000 Sales return 20,000 Purchases return 30,000 Wages 40,000 Goodwill 60,000 Interest received 15,000 Discount allowed 6,000 Bank overdraft 22,000 Bank loan 90,000 Debtors : Nathu 55,000 Roopa 20,000 Creditors : Reena 35,000 Ganesh 25,000 Cash 54,000 Stock on April 01, 2013 16,000 2022-23 Trial Balance and Rectification of Errors 189 6.4. Significance of Agreement of Trial Balance It is important for an accountant that the trial balance should tally. Normally a tallied trial balance means that both the debit and the credit entries have been made correctly for each transaction. However, as stated earlier, the agreement of trial balance is not an absolute proof of accuracy of accounting records. A tallied trial balance only proves, to a certain extent, that the posting to the ledger is arithmetically correct. But it does not guarantee that the entry itself is correct. There can be errors, which affect the equality of debits and credits, and there can be errors, which do not affect the equality of debits and credits. Some common errors include the following: • Error in totalling of the debit and credit balances in the trial balance. • Error in totalling of subsidiary books. • Error in posting of the total of subsidiary books. • Error in showing account balances in wrong column of the tiral balance, or in the wrong amount. • Omission in showing an account balance in the trial balance. • Error in the calculation of a ledger account balance. • Error while posting a journal entry: a journal entry may not have been posted properly to the ledger, i.e., posting made either with wrong amount or on the wrong side of the account or in the wrong account. • Error in recording a transaction in the journal: making a reverse entry, i.e., account to be debited is credited and amount to be credited is debited, or an entry with wrong amount. • Error in recording a transaction in subsidiary book with wrong name or wrong amount. 6.4.1 Classification of Errors Keeping in view the nature of errors, all the errors can be classified into the following four categories: • Errors of Commission • Errors of Omission • Errors of Principle • Compensating Errors 6.4.2 Errors of Commission These are the errors which are committed due to wrong posting of transactions, wrong totalling or wrong balancing of the accounts, wrong casting of the subsidiary books, or wrong recording of amount in the books of original entry, etc. For example: Raj Hans Traders paid ¯25,000 to Preetpal Traders (a supplier of goods). This transaction was correctly recorded in the cashbook. 2022-23 190 Accountancy But while posting to the ledger, Preetpal's account was debited with ¯2,500 only. This constitutes an error of commission. Such an error by definition is of clerical nature and most of the errors of commission affect in the trial balance. 6.4.3 Errors of Omission The errors of omission may be committed at the time of recording the transaction in the books of original entry or while posting to the ledger. These can be of two types: (i) error of complete omission (ii) error of partial omission When a transaction is completely omitted from recording in the books of original record, it is an error of complete omission. For example, credit sales to Mohan ¯10,000, not entered in the sales book. When the recording of transaction is partly omitted from the books, it is an error of partial omission. If in the above example, credit sales had been duly recorded in the sales book but the posting from sales book to Mohan's account has not been made, it would be an error of partial omission. 6.4.4 Errors of Principle Accounting entries are recorded as per the generally accepted accounting principles. If any of these principles are violated or ignored, errors resulting from such violation are known as errors of principle. An error of principle may occur due to incorrect classification of expenditure or receipt between capital and revenue. This is very important because it will have an impact on financial statements. It may lead to under/over stating of income or assets or liabilities, etc. For example, amount spent on additions to the buildings should be treated as capital expenditure and must be debited to the asset account. Instead, if this amount is debited to maintenance and repairs account, it has been treated as a revenue expense. This is an error of principle. Similarly, if a credit purchase of machinery is recorded in purchases book instead of journal proper or rent paid to the landlord is recorded in the cash book as payment to landlord, these errors of principle. These errors do not affect the trial balance. 6.4.5 Compensating Errors When two or more errors are committed in such a way that the net effect of these errors on the debits and credits of accounts is nil, such errors are called compensating errors. Such errors do not affect the tallying of the trial balance. For example, if purchases book has been overcast by ¯10,000 resulting in excess debit of ¯10,000 in purchases account and sales returns book is undercast by ¯10,000 resulting in short debit to sales returns account is a 2022-23 Trial Balance and Rectification of Errors 191 case of two errors compensating each other's effect. One plus is set off by the other minus, the net effect of these two errors is nil and so they do not affect the agreement of trial balance. 6.5 Searching of Errors If the trial balance does not tally, it is a clear indication that at least one error has occured. The error (or errors) needs to be located and corrected before preparing the financial statements. If the trial balance does not tally, the accountant should take the following steps to detect and locate the errors : • Recast the totals of debit and credit columns of the trial balance. • Compare the account head/title and amount appearing in the trial balance, with that of the ledger to detect any difference in amount or omission of an account. • Compare the trial balance of current year with that of the previous year to check additions and deletions of any accounts and also verify whether there is a large difference in amount, which is neither expected nor explained. • Re-do and check the correctness of balances of individual accounts in the ledger. • Re-check the correctness of the posting in accounts from the books of original entry. • If the difference between the debit and credit columns is divisible by 2, there is a possibility that an amount equal to one-half of the difference may have been posted to the wrong side of another ledger account. For example, if the total of the debit column of the trial balance exceeds by 1,500, it is quite possible that a credit item of 750 may have been wrongly posted in the ledger as a debit item. To locate such errors, the accountant should scan all the debit entries of an amount of 750. • The difference may also indicate a complete omission of a posting. For example, the difference of 1,500 given above may be due to omissions of a posting of that amount on the credit side. Thus, the accountant should verify all the credit items with an amount of 1,500. • If the difference is a multiple of 9 or divisible by 9, the mistake could be due to transposition of figures. For example, if a debit amount of 459 is posted as 954, the debit total in the trial balance will exceed the credit side by 495 (i.e. 954 – 459 = 495). This difference is divisible by 9. A mistake due to wrong placement of the decimal point may also be checked by this method. Thus, a difference in trial balance divisible by 9 helps in checking the errors for a transposed mistake. 2022-23 192 Accountancy 6.6 Rectification of Errors From the point of view of rectification, the errors may be classified into the following two categories: (a) errors which do not affect the trial balance. (b) errors which affect the trial balance. This distinction is relevant because the errors which do not affect the trial balance usually take place in two accounts in such a manner that it can be easily rectified through a journal entry whereas the errors which affect the trial balance usually affect one account and a journal entry is not possible for rectification unless a suspense account has been opened. Such errors are rectified by passing a nullifying entry in the respective account as explained before under 6.6.2. 6.6.1 Rectification of Errors which do not Affect the Trial Balance 6.6.1 Rectification of Errors which do not Affect the Trial Balance 6.6.1 Rectification of Errors which do not Affect the Trial Balance These errors are committed in two or more accounts. Such errors are also known as two sided errors. They can be rectified by recording a journal entry giving the correct debit and credit to the concerned accounts. Examples of such errors are – complete omission to record an entry in the books of original entry; wrong recording of transactions in the book of accounts; complete omission of posting to the wrong account on the correct side, and errors of principle. The rectification process essentially involves: • Cancelling the effect of wrong debit or credit by reversing it; and • Restoring the effect of correct debit or credit. For this purpose, we need to analyse the error in terms of its effect on the accounts involved which may be: (i) Short debit or credit in an account; and/or (ii) Excess debit or credit in an account. Therefore, rectification entry can be done by: (i) debiting the account with short debit or with excess credit, (ii) crediting the account with excess debit or with short credit. The procedure for rectification for such errors is explained with the help of following examples: (a) Credit sales to Mohan 10,000 were not recorded in the sales book. This is an error of complete omission. Its affect is that Mohan's account has not been debited and Sales account has not been credited. Accordingly, recording usual entry for credit sales will rectify the error. 2022-23 Trial Balance and Rectification of Errors 193 Mohan's A/c Dr. 10,000 To Sales A/c 10,000 (b) Credit sales to Mohan 10,000 were recorded as 1,000 in the sales book. This is an error of commission. The effect of wrong recording is shown below: Mohan's A/c Dr. 1,000 To Sales A/c 1,000 Correct effect should have been: Mohan's A/c Dr. 10,000 To Sales A/c 10,000 Now that Mohan's account has to be given an additional debit of 9,000 and sales account has to be credited with additional amount of 9,000, rectification entry will be: Mohan's A/c Dr. 9,000 To Sales A/c 9,000 (c) Credit sales to Mohan 10,000 were recorded as 12,000. This is an error of commission. The effect of wrong entry made has been: Mohan's A/c Dr. 12,000 To Sales A/c 12,000 Correct effect should have been: Mohan's A/c Dr. 10,000 To Sales A/c 10,000 You can see that there is an excess debit of 2,000 in Mohan's account and excess credit of 2,000 in sales account. The, rectification entry will be recorded as follows: Sales A/c Dr. 2,000 To Mohan's A/c 2,000 2022-23 194 Accountancy (d) Credit sales to Mohan 10,000 was correctly recorded in the sales book but was posted to Ram's account. This is an error of commission. The effect of wrong posting has been: Ram's A/c Dr. 10,000 To Sales A/c 10,000 Correct effect should have been : Mohan's A/c Dr. 10,000 To Sales A/c 10,000 Notice that there is no error in sales account. But Ram's account has been debited with 10,000 instead of Mohan's account. Hence rectification entry will be: Mohan's A/c Dr. 10,000 To Ram's A/c 10,000 (e) Rent paid 2,000 was wrongly shown as payment to landlord in the cash book: The effect of wrong posting has been: Landlord's A/c Dr. 2,000 To Cash A/c 2,000 Correct effect should have been: Rent A/c Dr. 2,000 To Cash A/c 2,000 Landlord's account has been wrongly debited instead of Rent account. Hence, rectification entry will be: Rent A/c Dr. 2,000 To Landlord's A/c 2,000 2022-23 Trial Balance and Rectification of Errors 195 Test Your Understanding - II Record the rectification entry for the following transactions: 1. Credit sales to Rajni 5,000 recorded in Purchases book: This is an error of .... State the wrong entry recorded in the book of accounts Correct effect should have been: The rectification entry will be: 2. Furniture purchased from M/s Rao Furnishigs for 8,000 was entered into the purchases book. This is the error of .... State the wrong entry recorded in the book of accounts Correct effect should have been: The rectification entry will be: 3. Cash sales to Radhika 15,000 was shown as receipt of commission in the cash book. This is the error of .... State the wrong entry recorded in the book of accounts 2022-23 196 Accountancy Correct effect should have been: The rectification entry will be: 4. Cash received from Karim 6,000 posted to Nadeem. This is the error of .... State the wrong entry recorded in the book of accounts: Correct effect should have been: The rectification entry will be: 6.6.2 Rectification of Errors Affecting Trial Balance The errors which affect only one account can be rectified by giving an exaplanatory note in the account affected or by recording a journal entry with the help of the Suspense Account. Suspense Account is explained later in this chapter. Examples of such errors are error of casting; error of carrying forward; error of balancing; error of posting to correct account but with wrong amount; error of posting to the correct account but on the wrong side; posting to the wrong side with the wrong amount; omitting to show an account in the trial balance. An error in the books of original entry, if discovered before it is posted to the ledger, may be corrected by crossing out the wrong amount by a single line and writing the correct amount above the crossed amount and initialling it. An error in an amount posted to the correct ledger account may also be corrected in a 2022-23 Trial Balance and Rectification of Errors 197 similar way, or by making an additional posting for the difference in amount and giving an explanatory note in the particulars column. But errors should never be corrected by erasing or overwriting reduces the authenticity of accounting records and give an impression that something is being concealed. A better way therefore is by noting the correction on the appropriate side for neutralising the effect of the error. Take for example a case where Shyam's account was credited short by 190. This will be rectified by an additional entry for 190 on the credit side of his account as follows. Shyam's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount Difference in 190 amount posted short on..... Take another example, purchases book was undercast by 1,000. The effect of this entry is on purchases account (debit side) where the total of purchases book is posted Purchases Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount Undercasting 1,000 purchases book for the month of....

Suspense Account Suspense Account Even if the trial balance does not tally due to the existence of one sided errors, accountant has to carry forward his accounting process prepare financial statements. The accountant tallies his trial balance by putting the difference on shorter side as 'suspense account'. The process of opening of suspense account can be understood with the help of the following example: Consider the sales book of an organisation. 2022-23 198 Accountancy Sales Book (Journal) Date Invoice Name of customers L.F. Amount No. (Accounts to be debited) ¯ Ashok traders 20,000 Bimal service centre 10,000 Chopra enterprises 5,000 Diwakar and sons 15,000 50,000 If sales to Diwakar and sons were not posted to his account, ledger will show the following position: Ashok Traders Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ¯ ¯ Sales 20,000 Balance c/d 20,000 20,000 20,000 Bimal Service Centre's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ¯ ¯ Sales 10,000 Balance c/d 10,000 10,000 10,000 Chopra Enterprises Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ¯ ¯ Sales 5,000 Balance c/d 5,000 5,000 5,000 Sales Account Cr. Dr. Date Particulars J.F. Amount Date Particulars J.F. Amount ¯ ¯ Sundries 50,000 2022-23 Trial Balance and Rectification of Errors 199 The trial balance when prepared on the basis of above balances will not tally. Its credit column total will amount to ¯ 50,000 and debit column total to ¯ 35,000. The trial balance would differ with ¯ 15,000. This difference will be temporarily put to suspense account and trial balance will be made to agree in the ledger. In the above case, difference in trial balance has arisen due to one sided error (omission of posting to Diwakar and sons's account). In a real situation, there can be many other such one-sided errors which cause a difference in trial balance and thus result in opening of the suspense account. Till the all errors affecting agreement of trial balance are not located it is not possible to rectify them and tally the trial balance in such a situation, is shown in the Suspense account, make the total of debit and credit columns and proceed further with the accounting process. When the errors are located and the specific accounts and amounts involved are identified, the amounts are transferred from suspense account to the relevant accounts thereby closing the suspense account. Thus, suspense account is not placed in any particular category of accounts and is just a temporary phenomenon. While rectifying one-sided errors using suspense account, the following steps are taken: (i) Identify the account affected due to error. (ii) Ascertain the amount of excess debit/credit or short debit/credit in the affected account. (iii) If the error has resulted in excess debit or short credit in the affected account, credit the account with the amount of excess debit or short credit. (iv) If the error has resulted in excess credit or short debit in the affected account, debit the account with the amount of excess credit or short debit. (v) Complete the journal entry by debiting or crediting the suspense account as another account affected otherwise. We will now discuss the process of rectification using suspense account: (a) Credit sales to Mohan ¯ 10,000 were not posted to his account. This is an error of partial omission comitted while posting entries of the sales book. Wrong effect has been: Mohan's A/c Dr. Nil To Sales A/c 10,000 2022-23 200 Accountancy Correct effect should have been: Mohan's A/c Dr. 10,000 To Sales A/c 10,000 The rectification entry will be : Mohan's A/c Dr. 10,000 To Suspense A/c 10,000 (b) Credit sales to Mohan ¯ 10,000 were posted to his account as ¯ 7000. This is an error of commission. Mohan's account has been debited with ¯ 7,000 instead of ¯ 10,000 resulting in short debit of ¯ 3,000. The wrong effect has been: Mohan's A/c Dr. 7,000 To Sales A/c 10,000 Correct effect should have been: Mohan's A/c Dr. 10,000 To Sales A/c 10,000 Hence, rectification entry will be: Mohan's A/c Dr. 3,000 To Suspens A/c 3,000 (c) Credit sales to Mohan ¯ 10,000 were posted to his account as ¯ 12,000. This is an error of commission. The wrong effect has been: Mohan's A/c Dr. 12,000 To Sales A/c 10,000 Correct effect should have been Mohan's A/c Dr. 10,000 To Sales A/c 10,000 The rectification entry will be: Suspense A/c Dr. 2,000 To Mohan's A/c 2,000 (d) Purchases book overcast by ¯ 1,000. Errors in casting of subsidiary books affect only those accounts where totals of the subsidiary books involved are 2022-23 Trial Balance and Rectification of Errors 201 posted. The accounts of individual parties are not affected. Consider the following example. Purchases (Journal) Book Date Invoice Name of suppliers L.F. Amount No. (Accounts to be credited) ₹ Dheru 8,000 Chandraprakash 7,000 Sachin 6,000 21,000 Wrong total 22,000 due to overcasting Dheru's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ₹ ₹ Purchases 8,000 Chandraprakash's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ₹ ₹ Purchases 7,000 Sachin's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ₹ ₹ Purchases 6,000 Purchases Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ₹ ₹ Sundries 22,000 As you can notice that there is no error in accounts of Dheeru, Chanderprakash and Sachin. Only purchases account has been debited with ₹ 1,000 extra. Hence, rectification entry will be: 2022-23 202 Accountancy Suspense A/c Dr. 1,000 To Purchases A/c 1,000 6.6.3 Rectification of Errors in the Next Accounting Year 6.6.3 Rectification of Errors in the Next Accounting Year If some errors committed during an accounting year are not located and rectified before the finalisation of financial statements, suspense account cannot be closed and its balance will be carried forward to the next accounting period. When the errors committed in one accounting year are located and rectified in the next accounting year, profit and loss adjustment account is debited or credited in place of accounts of expenses/losses and incomes/ gains in order to avoid impact on the income statement of next accounting period. You will learn about this aspect at an advanced stage of your studies in accounting. Box 1 Guiding Principles of Rectification of Errors 1. If error is committed in books of original entry then assume all postings are done accordingly. 2. If error is at the posting stage then assume that recording in the subsidiary books has been correctly done. 3. If error is in posting to a wrong account (without mentioning side and amount of posting) then assume that posting has been done on the right side and with the right amount. 4. If posting is done to a correct account but with wrong amount (without mentioning side of posting) then assume that posting has been done on the correct side. 5. If error is posting to a wrong account on the wrong side (without mentioning amount of posting) then assume that posting has been done with the amount as per the original recording of the transaction. 6. If error is of posting to a wrong account with wrong amount (without mentioning the side of posting) then assume that posting has been done on the right side. 7. If posting is done to a correct account on the wrong side (without mentioning amount of posting) then assume that posting has been done with correct amount as per original recording. 8. Any error in posting of individual transactions in subsidiaries books relates to individual account only, the sales account, purchase account, sales return account or purchases return account are not involved. 2022-23 Trial Balance and Rectification of Errors 203 9. If a transaction is recorded in cash book, then the error in posting relates to the other affected account, not to cash account/bank account 10. If a transaction is recorded through journal proper, then the phrase 'transaction was not posted' indicates error in both the accounts involved, unless stated otherwise. 11. Error in casting of subsidiary books will affect only that account where total of the particular book is posted leaving the individual personal accounts unaffected. Test Your Understanding - III Show the effect through Journal entries: 1. Credit sales to Mohan ₹ 10,000 were posted to his account as ₹ 12,000 This is an error of .... The wrong effect has been: The correct effect should have been: The rectification entry will be. 2. Cash paid to Neha ₹ 2,000 was not posted to her account. This is an error of .... The wrong effect has been: The correct effect should have been: The rectification entry will be: 2022-23 204 Accountancy 3. Sales returns from Megha ₹ 1,600 were posted to her account as ₹ 1,000. This is an error of .... The wrong effect has been: The correct effect should have been: The rectification entry will be: 4. Depreciation written off on furniture ₹ 1,500 was not posted to depreciation account. This is an error of .... The wrong effect has been: The correct effect should have been: The rectification entry: Illustration 1 Rectify the following errors: Credit purchases from Raghu ₹ 20,000 (i) were not recorded. (ii) were recorded as ₹10,000. (iii) were recorded as ₹25,000. (iv) were not posted to his account. (v) were posted to his account as ₹2,000. (vi) were posted to Reghav's account. (vii) were posted to the debit of Raghu's account. (viii) were posted to the debit of Raghav. (ix) were recorded through sales book. 2022-23 Trial Balance and Rectification of Errors 205 Solution (i) Purchases A/c Dr. 20,000 To Raghu's A/c 20,000 (Credit purchases from Raghu omitted to be recorded, now corrected) (ii) Purchases A/c Dr. 10,000 To Raghu's A/c 10,000 (Credit purchases from Raghu recorded as ₹10,000 instead of ₹20,000, now corrected) (iii) Raghu's A/c Dr. 5,000 To Purchases A/c 5,000 (Credit purchases from Raghu recorded as ₹25,000 instead of ₹20,000). (iv) Suspense A/c Dr. 20,000 To Raghu's A/c 20,000 (Credit purchases from Raghu not posted to his account now corrected). (v) Suspense A/c Dr. 18,000 To Raghu's A/c 18,000 (Credit purchases from Raghu ₹20,000 posted to his account as ₹2,000 (vi) Raghav's A/c Dr. 20,000 To Raghu's A/c 20,000 (Credit purchases from Raghu wrongly credited to Raghav, now corrected) (vii) Suspense A/c Dr. 40,000 To Raghu's A/c 40,000 (Credit purchases from Raghu ₹20,000 wrongly posted to the debit of his account, now corrected). 2022-23 206 Accountancy (viii) Suspense A/c Dr. 40,000 To Raghav's A/c 20,000 To Raghu's A/c 20,000 (Credited purchases from Raghu ₹20,000 wrongly debited to Raghav, now corrected). (ix) Sales A/c Dr. 20,000 Purchases A/c Dr. 20,000 To Raghu's A/c 40,000 (Credit purchases from Raghu wrongly recorded through sales book, now corrected). Illustration 2 Rectify the following errors : Cash sales ₹16,000 (i) were not posted to sales account. (ii) were posted as ₹6,000 in sales account. (iii) were posted to commission account. Solution (i) Suspense A/c Dr. 16,000 To Sales A/c 16,000 (Cash sales not posted to sales account now rectified) (ii) Suspense A/c Dr. 10,000 To Sales A/c 10,000 (Cash sales ₹16,000 were posted to sales account as ₹6,000, now rectified) (iii) Commission A/c Dr. 16,000 To Sales A/c 16,000 (Cash sales posted to commission account instead of sales account, now corrected) 2022-23 Trial Balance and Rectification of Errors 207 Illustration 3 Depreciation written-off as the machinery ₹2,000 (i) was not posted at all (ii) was not posted to machinery account (iii) was not posted to depreciation account Solution (i) It was recorded through journal proper. From journal proper posting to all the accounts are made individually. Hence, no posting was made to depreciation account and machinery account. Therefore, rectification entry will be : Depreciation A/c Dr. 2,000 To Machinery A/c 2,000 (Depreciation on machinery not posted, now corrected) (ii) In this case posting was not made to machinery account. It is to be assumed that depreciation account should have been correctly debited. Therefore, rectification entry shall be : Suspense A/c Dr. 2,000 To Machinery A/c 2,000 (Depreciation on machinery not posted to Machinery account, now corrected). (iii) In this case depreciation account was not been debited. However, machinery account must have been correctly credited. Therefore, rectification entry shall be : Depreciation A/c Dr. 2,000 To Suspense A/c 2,000 (Depreciation on machinery not posted to Depreciation account, now corrected). Illustration 4 Trial balance of Anurag did not agree. It showed an excess credit ₹10,000. Anurag put the difference to suspense account. He located the following errors : (i) Sales return book over cast by ₹1,000. (ii) Purchases book was undercast by ₹600. (iii) In the sales book total of page no. 4 was carried forward to page 5 as ₹1,000 instead of ₹1,200 and total of page 8 was carried forward to page 9 as ₹5,600 instead of ₹5,000. (iv) Goods returned to Ram ₹1,000 were recorded through sales book. (v) Credit purchases from M & Co. ₹8,000 were recorded through sales book. (vi) Credit purchases from S & Co. ₹5,000 were recorded through sales book. However, S & Co. were correctly credited. (vii) Salary paid ₹2,000 was debited to employee's personal account. 2022-23 208 Accountancy Solution (i) Suspense A/c Dr. 1,000 To Sales Return A/c 1,000 (Sales returns book overcast by ₹1,000, now corrected). (ii) Purchases A/c Dr. 600 To Suspense A/c 600 (Purchases book undercast by ₹600, now corrected) (iii) Sales A/c Dr. 400 To Suspense A/c 400 (Error in carry forward of sales book, now corrected). Note: Errors in carry forward the total of one page to another during a period finally affects the total of that book resulting in error of under/overcasting. In this case, carry forward from page 4 to 5 resulted in undercasting of 200 and carry forward from page 8 to page 9 resulted in overcasting of 600. Overall overcasting being 600–200 = 400. (iv) Sales A/c Dr. 1,000 To Return Outwards A/c 1,000 (Return Outwards wrongly recorded through sales book, now rectified). (v) Purchases A/c Dr. 8,000 Sales A/c Dr. 8,000 To M & Co.'s A/c 16,000 (Credit purchases wrongly recorded through sales book, now rectified). (vi) Purchases A/c Dr. 5,000 Sales A/c Dr. 5,000 To Suspense A/c 10,000 (Credit purchases wrongly recorded through sales book, however suppliers account correctly credited, now rectified). 2022-23 Trial Balance and Rectification of Errors 209 (vii) Salary A/c Dr. 2,000 To Employee's personal A/c 2,000 (Salary paid wrongly debited to employee's personal account, now corrected) Suspense Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount Difference as per 10,000 trial balance Purchases 600 Sales return 1,000 Sales 400 Purchases 5,000 Sales 5,000 11,000 11,000 Illustration 5 Trial balance of Rahul did not agree. Rahul put the difference to suspense account. Subsequently, he located the following errors : (i) Wages paid for installation of Machinery 600 was posted to wages account. (ii) Repairs to Machinery 400 debited to Machinery account. (iii) Repairs paid for the overhauling of second hand machinery purchased 1,000 was debited to Repairs account. (iv) Own business material 8,000 and wages 2,000 were used for construction of building. No adjustment was made in the books. (v) Furniture purchased for 5,000 was posted to purchase account as 500. (vi) Old machinery sold to Karim at its book value of 2,000 was recorded through sales book. (vii) Total of sales returns book 3,000 was not posted to the ledger. Rectify the above errors and prepare suspense account to ascertain the original difference in trial balance. (i) Machinery A/c Dr. 600 To Wages A/c 600 (Wages paid for installation of machinery wrongly debited to wages account, now rectified) (ii) Repairs A/c Dr. 400 To Machinery A/c 400 (Repairs paid wrongly debited to machinery account now rectified) 2022-23 210 Accountancy (iii) Machinery A/c Dr. 1,000 To Repairs A/c 1,000 (Repairs for overhauling of second hand machinery purchased, wrongly debited to repairs account, now rectified). (iv) Building A/c Dr. 10,000 To Purchases A/c 8,000 To Wages A/c 2,000 (Material and wages used for construction of Building, not debited to building account). (v) Furniture A/c Dr. 5,000 To Purchases A/c 500 To Suspense A/c 4,500 (Furniture purchased for 5,000 wrongly debited to purchases account as 500, now rectified). (vi) Sales A/c Dr. 2,000 To Machinery 2,000 (Sale of machinery wrongly recorded in sales book, now rectified). (vii) Sales Return A/c Dr. 3,000 To Suspense A/c 3,000 (Total of sales returns book not posted to ledger, now rectified). Suspense Account Date Particulars J.F. Amount Date Particulars J.F. Amount Difference as per 7,500 Furniture 4,500 trial balance Sales return 3.000 7,500 7,500 Hence, original difference in Trial Balance was 7,500 excess on the Credit side. 2022-23 Trial Balance and Rectification of Errors 211 Illustration 6 Trial balance of Anant Ram did not agree. It showed an excess credit of 16,000. He put the difference to suspense account. Subsequently the following errors were located: (i) Cash received from Mohit 4,000 was posted to Mahesh as 1,000. (ii) Cheque for 5,800 received from Arnav in full settlement of his account of 6,000, was dishonoured. No entry was passed in the books on dishonour of the cheque. (iii) 800 received from Khanna, whose account had previously been written off as bad, was credited to his account. (iv) Credit sales to Manav for 5,000 was recorded through the purchases book as 2,000. (v) Purchases book undercast by 1,000. (vi) Repairs on machinery 1,600 wrongly debited to Machinery account as 1,000. (vii) Goods returned by Nathu 3,000 were taken into stock. No entry was recorded in the books. Solution (i) Mahesh's A/c Dr. 1,000 Suspense A/c Dr. 3,000 To Mohit's A/c 4,000 (Cash received from Mohit 4,000 wrongly posted to Mahesh as 1,000, now rectified) (ii) Arnav's A/c Dr. 6,000 To Bank A/c 5,800 To Discount Allowed A/c 200 (Cheque received from Arnav for 5,800 in full settlement of his account of 6,000, dishonoured but no entry made in books, now rectified) (iii) Khanna's A/c Dr. 800 To Bad debts recovered A/c 800 (Bad debts recovered wrongly credited to Khanna's account, now rectified) 2022-23 212 Accountancy (iv) Manav's A/c Dr. 7,000 To

Purchases A/c 2,000 To Sales A/c 5,000 (Credit sales to Manav ₹5,000 wrongly recorded through purchases book as ₹2,000, now rectified) (v) Purchases A/c Dr. 1,000 To Suspense A/c 1,000 (Purchases book undercast by ₹1,000) (vi) Repairs A/c Dr. 1,600 To Machinery A/c 1,000 To Suspense A/c 600 (Repairs on machinery ₹1,600 wrongly debited to machinery account as ₹1,000, now rectified) (vii) Sales Return A/c Dr. 3,000 To Nathu's A/c 3,000 (Sales return from Nathu not recorded) Suspense Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ₹ ₹ Difference as per Purchases 1,000 trial balance 16,000 Repairs 600 Mohit 3,000 Balance c/d 17,400 19,000 19,000 Note: Even after rectification of errors suspense account is showing a debit balance of ₹17,400. This is due to non-detection of errors affecting trial balance. Balance of suspense account will be carried forward to the next year and will be eliminated as and when all the remaining errors affecting trial balance are located. 2022-23 Trial Balance and Rectification of Errors 213 Illustration 7 Trial balance of Kailash did not agree. He put the difference to suspense account. The following errors were discovered : (i) Goods withdrawn by Kailash for personal use ₹500 were not recorded in the books. (ii) Discount allowed to Ramesh ₹60 on receiving ₹2,040 from him was not recorded in the books. (iii) Discount received from Rohan ₹50 on paying ₹3,250 to him was not posted at all. (iv) ₹700 received from Khalil, a debtor, whose account had earlier been written-off as bad, were credited to his personal account. (v) Cash received from Govil, a debtor, ₹5,000 was posted to his account as ₹500. (vi) Goods returned to Mahesh ₹700 were posted to his account as ₹70. (vii) Bill receivable from Narayan ₹1,000 was dishonoured and wrongly debited to allowances account as ₹10,000. Give journal entries to rectify the above errors and prepare suspense account to ascertain the amount of difference in trial balance. Solution (i) Drawings A/c Dr. 500 To Purchases A/c 500 (Goods withdrawn by proprietor for personal use not recorded, now rectified). (ii) Discount allowed A/c Dr. 60 To Ramesh's A/c 60 (Discount allowed to Ramesh not recorded, now rectified) (iii) Rohan's A/c Dr. 50 To Discount received A/c 50 (Discount received from Rohan not posted , now corrected) (iv) Khalil's A/c Dr. 700 To Bad debts recovered A/c 700 (Bad debts recovered wrongly credited to debtor's personal account, now corrected) 2022-23 214 Accountancy (v) Suspense A/c Dr. 4,500 To Govil's A/c 4,500 (Cash received from Govil ₹5,000 wrongly posted to his account as ₹500) (vi) Mahesh's A/c Dr. 630 To Suspense A/c 630 (Goods returned to Mahesh ₹700 wrongly posted to his account as ₹70, now corrected) (vii) Narayan's A/c Dr. 1,000 Suspense A/c Dr. 9,000 To Allowances A/c 10,000 (Bill receivables from Narayan ₹1,000 wrongly debited to allowances account as ₹10,000). Suspense Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ₹ ₹ Govil 4,500 Mahesh 630 Allowances 9,000 Difference as per 12,870 trial balance 13,500 13,500 Test Your Understanding - IV Tick the Correct Answer (1) Agreement of trial balance is affected by: (a) One sided errors only. (b) Two sided errors only. (c) Both (a) and (b). (d) None of the above. (2) Which of the following is not an error of principle: (a) Purchase of furniture debited to purchases account. (b) Repairs on the overhauling of second hand machinery purchased debited to repairs account. 2022-23 Trial Balance and Rectification of Errors 215 (c) Cash received from Manoj posted to Saroj. (d) Sale of old car credited to sales account. (3) Which of the following is not an error of commission: (a) Overcasting of sales book. (b) Credit sales to Ramesh ₹5,000 credited to his account. (c) Wrong balancing of machinery account. (d) Cash sales not recorded in cash book. (4) Which of following errors will be rectified through suspense account: (a) Sales return book undercast by ₹1,000. (b) Sales return by Madhu ₹1,000 not recorded. (c) Sales return by Madhu Rs 1,000. recorded as ₹100. (d) Sales return by Madhu ₹1,000 recorded through purchases returns book (5) If the trial balance agrees, it implies that: (a) There is no error in the books. (b) There may be two sided errors in the book. (c) There may be one sided error in the books. (d) There may be both two sided and one sided errors in the books. (6) If suspense account does not balance off even after rectification of errors it implies that: (a) There are some one sided errors only in the books yet to be located. (b) There are no more errors yet to be located. (c) There are some two sided errors only yet to be located. (d) There may be both one sided errors and two sided errors yet to be located. (7) If wages paid for installation of new machinery is debited to wages Account, it is: (a) An error of commission. (b) An error of principle. (c) A compensating error. (d) An error of omission. (8) Trial balance is: (a) An account. (b) A statement. (c) A subsidiary book. (d) A principal book. (9) A Trial balance is prepared: (a) After preparation financial statement. (b) After recording transactions in subsidiary books. (c) After posting to ledger is complete. (d) After posting to ledger is complete and accounts have been balanced, Key Terms Introduced in the Chapter • Trial Balance • Compensating Error • Error of Commission • Error of Principle • Error Omission • Suspense Account 2022-23 216 Accountancy Summary with Reference to Learning Objectives 1. Meaning of trial balance: A statement showing the abstract of the balance (debit/credit) of various accounts in the ledger. 2. Objectives of trial balance: The main objectives of preparing the trial balance are : (i) to ascertain the arithmetical accuracy of the ledger accounts; (ii) to help in locating errors; and (iii) to help in the preparatioon of the final accounts. 3. Preparation of trial balance by the balance method: In this method, the trial balance has three columns. The first column is for the head of the account, the second column for writing the debit balance and the third for the credit balance of each account in the ledger. 4. Various types of errors: (i) Errors of commission: Errors caused due to wrong recording of a transaction, wrong totalling, wrong casting, wrong balancing, etc. (ii) Errors of Omission: Errors caused due to omission of recording a transaction entirely or party in the books of account. (iii) Errors of Principle: Errors arising due to wrong classificatrion of receipts and payments between revenue and capital receipts and revenue and capital expenditure. (iv) Compensating errors: Two or more errors committed in such a way that they nullify the effect of each other on the debits and credits. 5. Rectification of errors: Errors affecting only one account can be rectified by giving an explanatory note or by passing a journal entry. Errors which affect two or more accounts are rectified by passing a journal entry. 6. Meaning and utility of suspense account: An account in which the difference in the trial balance is put till such time that errors are located and rectified. It facilitates the preparation of financial statements even when the trial balance does not tally. 7. Disposal of suspense account: When all the errors are located and rectified the suspense account stands disposed off. Questions for Practice Questions for Practice Short Answers 1. State the meaning of a trial balance? 2. Give two examples of errors of principle? 3. Give two examples of errors of commission? 4. What are the methods of preparing trial balance? 5. What are the steps taken by an accountant to locate the errors in the trial balance? 6. What is a suspense account? Is it necessary that is suspense account will balance off after rectification of the errors detected by the accountant? If not, then what happens to the balance still remaining in suspense account? 7. What kinds of errors would cause difference in the trial balance. Also list examples that would not be revealed by a trial balance? 8. State the limitations of trial balance? 2022-23 Trial Balance and Rectification of Errors 217 Long Answers 1. Describe the purpose for the preparation of trial balance. 2. Explain errors of principle and give two examples with measures to rectify them. 3. Explain the errors of commission and give two examples with measures to rectify them. 4. What are the different types of errors that are usually committed in recording business transaction. 5. As an accountant of a company, you are disappointed to learn that the totals in your new trial balance are not equal. After going through a careful analysis, you have discovered only one error. Specifically, the balance of the Office Equipment account has a debit balance of ₹15,600 on the trial balance. However, you have figured out that a correctly recorded credit purchase of pendrive for ₹3,500 was posted from the journal to the ledger with a ₹3,500 debit to Office Equipment and another ₹3,500 debit to creditors accounts. Answer each of the following questions and present the amount of any misstatement : (a) Is the balance of the office equipment account overstated, understated, or correctly stated in the trial balance? (b) Is the balance of the creditors account overstated, understated, or correctly stated in the trial balance? (c) Is the debit column total of the trial balance overstated, understated, or correclty stated? (d) Is the credit column total of the trial balance overstated, understated, or correctly stated? (e) If the debit column total of the trial balance is 2,40,000 before correcting the error, what is the total of credit column. Numerical Questions 1. Rectify the following errors: (i) Credit sales to Mohan 7,000 were not recorded. (ii) Credit purchases from Rohan 9,000 were not recorded. (iii) Goods returned to Rakesh 4,000 were not recorded. (iv) Goods returned from Mahesh 1,000 were not recorded. 2. Rectify the following errors: (i) Credit sales to Mohan 7,000 were recorded as 700. (ii) Credit purchases from Rohan 9,000 were recorded as 900. (iii) Goods returned to Rakesh 4,000 were recorded as 400. (iv) Goods returned from Mahesh 1,000 were recorded as 100. 3. Rectify the following errors: (i) Credit sales to Mohan 7,000 were recorded as 7,200. (ii) Credit purchases from Rohan 9,000 were recorded as 9,900. (iii) Goods returned to Rakesh 4,000 were recorded as 4,040. (iv) Goods returned from Mahesh 1,000 were recorded as 1,600. 2022-23 218 Accountancy 4. Rectify the following errors: (a) Salary paid 5,000 was debited to employee's personal account. (b) Rent Paid 4,000 was posted to landlord's personal account. (c) Goods withdrawn by proprietor for personal use 1,000 were debited to sundry expenses account. (d) Cash received from Kohli 2,000 was posted to Kapur's account. (e) Cash paid to Babu 1,500 was posted to Sabu's account. 5. Rectify the following errors: (a) Credit Sales to Mohan 7,000 were recorded in purchases book. (b) Credit Purchases from Rohan 9,00 were recorded in sales book. (c) Goods returned to Rakesh 4,000 were recorded in the sales return book. (d) Goods returned from Mahesh 1,000 were recorded in purchases return book. (e) Goods returned from Nahesh 2,000 were recorded in purchases book. 6. Rectify the following errors: (a) Sales book overcast by 700. (b) Purchases book overcast by 500. (c) Sales return book overcast by 300. (d) Purchase return book overcast by 200. 7. Rectify the following errors: (a) Sales book undercast by 300. (b) Purchases book undercast by 400. (c) Return Inwards book undercast by 200. (d) Return outwards book undercast by 100. 8. Rectify the following errors and ascertain the amount of difference in trial balance by preparing suspense account: (a) Credit sales to Mohan 7,000 were not posted. (b) Credit purchases from Rohan 9,000 were not posted. (c) Goods returned to Rakesh 4,000 were not posted. (d) Goods returned from Mahesh 1,000 were not posted. (e) Cash paid to Ganesh 3,000 was not posted. (f) Cash sales 2,000 were not posted. (Ans: Difference in trial balance 2,000 excess credit). 9. Rectify the following errors and ascertain the amount of difference in trial balance by preparing suspense account: (a) Credit sales to Mohan 7,000 were posted as 9,000. (b) Credit purchases from Rohan 9,000 were posted as 6,000. (c) Goods returned to Rakesh 4,000 were posted as 5,000. (d) Goods returned from Mahesh 1,000 were posted as 3,000. (e) Cash sales 2,000 were posted as 200. (Ans: Difference in trial balance 5,800 excess debit.) 2022-23 Trial Balance and Rectification of Errors 219 10. Rectify the following errors: (a) Credit sales to Mohan 7,000 were posted to Karan. (b) Credit purchases from Rohan 9,000 were posted to Gobind. (c) Goods returned to Rakesh 4,000 were posted to Naresh. (d) Goods returned from Mahesh 1,000 were posted to Manish. (e) Cash sales 2,000 were posted to commission account. 11. Rectify the following errors assuming that a suspense account was opened. Ascertain the difference in trial balance. (a) Credit sales to Mohan 7,000 were posted to the credit of his account. (b) Credit purchases from Rohan 9,000 were posted to the debit of his account as 6,000. (c) Goods returned to Rakesh 4,000 were posted to the credit of his account. (d) Goods returned from Mahesh 1,000 were posted to the debit of his account as 2,000. (e) Cash sales 2,000 were posted to the debit of sales account as 5,000. (Ans: Difference in trial balance 3,000 excess debit). 12. Rectify the following errors assuming that a suspense account was opened. Ascertain the difference in trial balance. (a) Credit sales to Mohan 7,000 were posted to Karan as 5,000. (b) Credit purchases from Rohan 9,000 were posted to the debit of Gobind as

10,000. (c) Goods returned to Rakesh ₹4,000 were posted to the credit of Naresh as ₹3,000. (d) Goods returned from Mahesh ₹1,000 were posted to the debit of Manish as ₹2,000. (e) Cash sales ₹2,000 were posted to commission account as ₹200. (Ans: Difference in trial balance ₹14, 800 excess debit). 13. Rectify the following errors assuming that suspense account was opened. Ascertain the difference in trial balance. (a) Credit sales to Mohan ₹7,000 were recorded in Purchase Book. However, Mohan's account was correctly debited. (b) Credit purchases from Rohan ₹9,000 were recorded in sales book. However, Rohan's account was correctly credited. (c) Goods returned to Rakesh ₹4,000 were recorded in sales return book. However, Rakesh's account was correctly debited. (d) Goods returned from Mahesh ₹1,000 were recorded through purchases return book. However, Mahesh's account was correctly credited. (e) Goods returned to Naresh ₹2,000 were recorded through purchases book. However, Naresh's account was correctly debited. (Ans: Difference in trial balance ₹6,000 excess debit). 2022-23 220 Accountancy 14. Rectify the following errors : (a) Furniture purchased for ₹10,000 wrongly debited to purchases account. (b) Machinery purchased on credit from Raman for ₹20,000 was recorded through purchases book. (c) Repairs on machinery ₹1,400 debited to machinery account. (d) Repairs on overhauling of secondhand machinery purchased ₹2,000 was debited to Repairs account. (e) Sale of old machinery at book value of ₹3,000 was credited to sales account. 15. Rectify the following errors assuming that suspension account was opened. Ascertain the difference in trial balance. (a) Furniture purchased for ₹10,000 wrongly debited to purchase account as ₹4,000. (b) Machinery purchased on credit from Raman for ₹20,000 recorded through Purchases Book as ₹6,000. (c) Repairs on machinery ₹1,400 debited to Machinery account as ₹2,400. (d) Repairs on overhauling of second hand machinery purchased ₹2,000 was debited to Repairs account as ₹200. (e) Sale of old machinery at book value ₹3,000 was credited to sales account as ₹5,000. (Ans : Difference in trial balance ₹8,800 excess credit). 16. Rectify the following errors : (a) Depreciation provided on machinery ₹4,000 was not posted. (b) Bad debts written off ₹5,000 were not posted. (c) Discount allowed to a debtor ₹100 on receiving cash from him was not posted. (d) Discount allowed to a debtor ₹100 on receiving cash from him was not posted to discount account. (e) Bill receivable for ₹2,000 received from a debtor was not posted. 17. Rectify the following errors : (a) Depreciation provided on machinery ₹4,000 was posted as ₹400. (b) Bad debts written off ₹5,000 were posted as ₹6,000. (c) Discount allowed to a debtor ₹100 on receiving cash from him was posted as ₹60. (d) Goods withdrawn by proprietor for personal use ₹800 were posted as ₹300. (e) Bill receivable for ₹2,000 received from a debtor was posted as ₹3,000. 18. Rectify the following errors assuming that suspense account was opened. Ascertain the difference in trial balance. (a) Depreciation provided on machinery ₹4,000 was not posted to Depreciation account. 2022-23 Trial Balance and Rectification of Errors 221 (b) Bad debts written-off ₹5,000 were not posted to Debtors account. (c) Discount allowed to a debtor ₹100 on receiving cash from him was not posted to discount allowed account. (d) Goods withdrawn by proprietor for personal use ₹800 were not posted to Drawings account. (e) Bill receivable for ₹2,000 received from a debtor was not posted to Bills receivable account. (Ans: Difference in trial balance ₹1,900 excess credit). 19. Trial balance of Anuj did not agree. It showed an excess credit of ₹6,000. He put the difference to suspense account. He discovered the following erroρσ (a) Cash received from Ravish ₹8,000 posted to his account as ₹6,000. (b) Returns inwards book overcast by ₹1,000. (c) Total of sales book ₹10,000 was not posted to Sales account. (d) Credit purchases from Nanak ₹7,000 were recorded in sales Book. However, Nanak's account was correctly credited. (e) Machinery purchased for ₹10,000 was posted to purchases account as ₹5,000. Rectify the errors and prepare suspense account. (Ans: Total of suspense account ₹19,000). 20. Trial balance of Raju showed an excess debit of ₹10,000. He put the difference to suspense account and discovered the following errors : (a)

Depreciation written-off the furniture ₹6,000 was not posted to Furniture account. (b) Credit sales to Rupam ₹10,000 were recorded as ₹7,000. (c) Purchases book undercast by ₹2,000. (d) Cash sales to Rana ₹5,000 were not posted. (e) Old Machinery sold for ₹7,000 was credited to sales account. (f) Discount received ₹800 from kanan on playing cash to him was not posted. Rectify the errors and prepare suspense account. (Ans: Balance carried forward in suspense account ₹1,000 (cr.)). 21. Trial balance of Madan did not agree and he put the difference to suspense account. He discovered the following errors: (a) Sales return book overcast by ₹800. (b) Purchases return to Sahu ₹2,000 were not posted. (c) Goods purchased on credit from Narula ₹4,000 though taken into stock, but no entry was passed in the books. (d) Installation charges on new machinery purchased ₹500 were debited to sundry expenses account as ₹50. (e) Rent paid for residential accommodation of madam (the proprietor) ₹1,400 was debited to Rent account as ₹1,000. Rectify the errors and prepare suspense account to ascertain the difference in trial balance. (Ans: Difference in trial balance ₹2,050 excess credit). 2022-23 222 Accountancy 22. Trial balance of Kohli did not agree and showed an excess debit of ₹16,300. He put the difference to a suspense account and discovered the following errors: (a) Cash received from Rajat ₹5,000 was posted to the debit of Kamal as ₹6,000. (b) Salaries paid to an employee ₹2,000 were debited to his personal account as ₹1200. (c) Goods withdrawn by proprietor for personal use ₹1,000 were credited to sales account as ₹1,600. (d) Depreciation provided on machinery ₹3,000 was posted to Machinery account as ₹300. (e) Sale of old car for ₹10,000 was credited to sales account as ₹6,000. Rectify the errors and prepare suspense account. (Ans: total of suspense account : ₹17,700). 23. Give journal entries to rectify the following errors assuming that suspense account had been opened. (a) Goods distributed as free sample ₹5,000 were not recorded in the books. (b) Goods withdrawn for personal use by the proprietor ₹2,000 were not recorded in the books. (c) Bill receivable received from a debtor ₹6,000 was not posted to his account. (d) Total of Returns inwards book ₹1,200 was posted to Returns outwards account. (e) Discount allowed to Reema ₹700 on receiving cash from her was recorded in the books as ₹70. (Ans: Difference in trial balance ₹3,600 excess debit). 24. Trial balance of Khatau did not agree. He put the difference to suspense account and discovered the following errors : (a) Credit sales to Manas ₹16,000 were recorded in the purchases book as ₹10,000 and posted to the debit of Manas as ₹1,000. (b) Furniture purchased from Noor ₹6,000 was recorded through purchases book as ₹5,000 and posted to the debit of Noor ₹2,000. (c) Goods returned to Rai ₹3,000 recorded through the Sales book as ₹1,000. (d) Old machinery sold for ₹2,000 to Maneesh recorded through sales book as ₹1,800 and posted to the credit of Manish as ₹1,200. (e) Total of Returns inwards book ₹2,800 posted to Purchase account. Rectify the above errors and prepare suspense account to ascertain the difference in trial balance. (Ans: Difference in trial balance ₹15,000 excess debit). 25. Trial balance of John did not agree. He put the difference to suspense account and discovered the following errors : (a) In the sales book for the month of January total of page 2 was carried forward to page 3 as ₹1,000 instead of ₹1200 and total of page 6 was carried forward to page 7 as ₹5,600 instead of ₹5,000. 2022-23 Trial Balance and Rectification of Errors 223 (b) Wages paid for installation of machinery ₹500 was posted to wages account as ₹50. (c) Machinery purchased from R & Co. for ₹10,000 on credit was entered in Purchase Book as ₹6,000 and posted there from to R & Co. as ₹1,000. (d) Credit sales to Mohan ₹5,000 were recorded in Purchases Book. (e) Goods returned to Ram ₹1,000 were recorded in Sales Book. (f) Credit purchases from S & Co. for ₹6,000 were recorded in sales book. However, S & Co. was correctly credited. (g) Credit purchases from M & Co. ₹6,000 were recorded in Sales Book as ₹2,000 and posted there from to the credit of M & Co. as ₹1,000. (h) Credit sales to Raman ₹4,000 posted to the credit of Raghvan as ₹1,000. (i) Bill receivable for ₹1,600 from Noor was dishonoured and posted to debit of Allowances account. (j)

Cash paid to Mani ₹5,000 against our acceptance was debited to Manu. (k) Old furniture sold for ₹3,000 was posted to Sales account as ₹1,000. (l) Depreciation provided on furniture ₹800 was not posted. (m) Material ₹10,000 and wages ₹3,000 were used for construction of building. No adjustment was made in the books. Rectify the errors and prepare suspense to ascertain the difference in trial balance. (Ans : Difference in trial balance ₹13,850 excess credit). Checklist to Test Your Understanding Test your understanding - I Trial Balance Total ₹5,17,000 Test your understanding - II 1. Purchases A/c Dr. 5,000 To Rajni's A/c 5,000 Rajni's A/c Dr. 5,000 To Sales A/c 5,000 Rajni's A/c Dr. 10,000 To Sales A/c 5,000 To Purchases A/c 5,000 2. Purchases A/c Dr. 8,000 To Rao's A/c 8,000 2022-23 224 Accountancy Furniture A/c Dr. 8,000 To Purchases A/c 8,000 3. Cash A/c Dr. 15,000 To Commission A/c 15,000 Cash A/c Dr. 15,000 To Sales A/c 15,000 Commission A/c Dr. 15,000 To Sales A/c 15,000 4. Cash A/c Dr. 6, 000 To Nadeem's A/c 6,000 Cash A/c Dr. 6,000 To Karim's A/c 6,000 Test Your Understanding - III 1. Error of Commission Mohan's A/c Dr. 12, 000 To Sales A/c 12,000 Mohan's A/c Dr. 10,000 To Sales A/c 10,000 Suspense A/c Dr. 2,000 To Mohan's A/c 2,000 2. Error of Partial omission xxx A/c Dr. 2,000 To Cash A/c 2,000 Neha's A/c Dr. 2,000 To Suspense A/c 2,000 Neha's A/c Dr. 2,000 To Suspense A/c 2,000 2022-23 Trial Balance and Rectification of Errors 225 3. Error of Commission Sales Return A/c Dr. 1,600 To Megha's A/c 1,600 Sales Returns A/c Dr. 1,600 To Megha's A/c 1,600 Suspense A/c Dr. 600 To Megha's A/c 600 4. Error of Commission xxx Dr. 1,500 To Furniture A/c 1,500 Depreciation A/c Dr. 1,500 To Furniture A/c 1,500 Depreciation A/c Dr. 1,500 To Suspense A/c 1,500 Test Your Understanding - IV 1. (c) 2. (c) 3. (d) 4. (a) 5. (b) 6. (a) 7. (b) 8. (b) 9. (d) 2022-23226 Accountancy Matching principle requires that the revenue of a given period is matched against the expenses for the same period. This ensures ascertainment of the correct amount of profit or loss. If some cost is incurred whose benefit extend to more than one accounting period, it is not justified to charge the entire cost as expense in the year in which it is incurred. In fact, such a cost must be spread over the periods in which it provides benefits. Depreciation, on fixed assets, which is the main subject matter of the present chapter, deals with such a situation. Further, it may not always be possible to ascertain with certainty the amount of some particular expense. Recall the principle of conservatism (prudence) which requires that instead of ignoring such items of costs, adequate provision must be made and charged against profits of the current period. Moreover, a part of profit may be retained in the business in the form of reserves to provide for growth, expansion or meeting certain specific needs of the business in future. This chapter deals with two distinct topics and hence is being presented in two different sections. First section deals with depreciation and second section deals with provisions and reserves. SECTION – I 7.1 Depreciation Now you are aware that fixed assets are the assets which are used in business for more than one LEARNING OBJECTIVES After studying this chapter, you will be able to : • explain the meaning of depreciation and distinguish it from amortisation and depletion; • state the need for charging depreciation and identify its causes; • compute depreciation using straight line and written down value methods; • record transactions relating to depreciation and disposition of assets; • explain the meaning and purpose of creating provisions and reserves; • distinguish between reserves and provisions; • explain the nature of various types of provisions and reserves including secret reserve. Depreciation, Provisions and Reserves 7 2022-23 Depreciation, Provisions and Reserves 227 accounting year. Fixed assets (technically referred to as "depreciable assets") tend to reduce their value once they are put to use. In general, the term "Depreciation" means decline in the value of a fixed assets due to use, passage of time or obsolescence. In other words, if a business enterprise procures a machine and uses it in production process then the value of machine declines with its usage. Even if the machine is not used in production process, we can not expect it to realise the same sales price due to the passage of time or arrival of a new model (obsolescence). It implies that fixed assets are subject to decline in value and this decline is technically referred to as depreciation. As an accounting term, depreciation is that part of the cost of a fixed asset which has expired on account of its usage and/or lapse of time. Hence, depreciation is an expired cost or expense, charged against the revenue of a given accounting period. For example, a machine is purchased for `1,00,000 on April 01, 2017. The useful life of the machine is estimated to be 10 years. It implies that the machine can be used in the production process for next 10 years till March 31, 2016. You know that by its very nature, ` 1,00,000 is a capital expenditure during the year 2017-18. However, when income statement (Statement of Profit and Loss) is prepared, the entire amount of `1,00,000 can not be charged against the revenue for the year 2017-18, because of the reason that the capital expenditure amounting to `1,00,000 is expected to derive benefits (or revenue) for 10 years and not one year. Therefore, it is logical to charge only a part of the total cost say `10,000 (one tenth of ` 1,00,000) against the revenue for the year 2017-18. This part represents the expired cost or loss in the value of machine on account of its use or passage of time and is referred to as 'Depreciation'. The amount of depreciation, being a charge against profit, is debited to Income Statement (Statement of Profit and Loss). 7.1.1 Meaning of Depreciation Depreciation may be described as a permanent, continuing and gradual shrinkage in the book value of fixed assets. It is based on the cost of assets consumed in a business and not on its market value. According to Institute of Cost and Management Accounting, London (ICMA) terminology "The depreciation is the diminution in intrinsic value of the asset due to use and/or lapse of time." Accounting Standard-6 issued by The Institute of Chartered Accountants of India (ICAI) defines depreciation as "a measure of the wearing out, consumption or other loss of value of depreciable asset arising from use, effluxion of time or obsolescence through technology and market-change. Depreciation is allocated so as to charge fair proportion of depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortisation of assets whose useful life is pre-determined". 2022-23 228 Accountancy Box 1 AS-6 (Revised): Depreciation • Depreciation is "a measure of the wearing out, consumption or other loss of value of depreciable asset arising from use, effluxion of time or obsolescence through technology and market-change. Depreciation is allocated so as to charge fair proportion of depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortisation of assets whose useful life is pre-determined". • Depreciation has a significant effect in determining and presenting the financial position and results of operations of an enterprise. Depreciation is charged in each accounting period by reference to the extent of the depreciable amount. • The subject matter of depreciation, or its base, are 'depreciable' assets which. • "are expected to be used during more than one accounting period. • have a limited useful life; and • are held by an enterprise for use in production or supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business." • The amount of depreciation basically depends upon three factors, i.e. Cost, Useful life and Net realisable value. • Cost of a fixed asset is "the total cost spent in connection with its acquisition, installation and commissioning as well as for add item or improvement of the depreciable asset". • Useful life of an asset is the "period over which it is expected to be used by the enterprise". • There are two main methods of calculating depreciation amount. • straight line method • written down value method • Selection of appropriate method depends upon the following factors: • type of the asset • nature of the use of such asset • circumstances prevailing in the business. • The selected depreciation method should be applied consistently from period to period. Change in depreciation method may be allowed only under specific circumstances. Depreciation has a significant effect in determining and presenting the financial position and results of operations of an enterprise. Depreciation is charged in each accounting period by reference to the extent of the depreciable amount. It should be noted that the subject matter of depreciation, or its base, are 'depreciable' assets which: • "are expected to be used during more than one accounting period; • have a limited useful life; and • are held by an enterprise for use in production or supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business." 2022-23

Depreciation, Provisions and Reserves 229 Examples of depreciable assets are machines, plants, furnitures, buildings, computers, trucks, vans, equipments, etc. Moreover, depreciation is the allocation of 'depreciable amount', which is the "historical cost", or other amount substituted for historical cost less estimated salvage value. Another point in the allocation of depreciable amount is the 'expected useful life' of an asset. It has been described as "either (i) the period over which a depreciable asset is expected to the used by the enterprise, or (ii) the number of production of similar units expected to be obtained from the use of the asset by the enterprise." 7.1.2 Features of Depreciation Above mentioned discussion on depreciation highlights the following features of depreciation: 1. It is decline in the book value of fixed assets. 2. It includes loss of value due to effluxion of time, usage or obsolescence. For example, a business firm buys a machine for ` 1,00,000 on April 01, 2017. In the year 2017, a new version of the machine arrives in the market. As a result, the machine bought by the business firm becomes outdated. The resultant decline in the value of old machine is caused by obsolescence. 3. It is a continuing process. 4. It is an expired cost and hence must be deducted before calculating taxable profits. For example, if profit before depreciation and tax is ` 50,000, and depreciation is ` 10,000; profit before tax will be: (`) Profit before depreciation & tax 50,000 (-) Depreciation (10,000) Profit before tax 40,000 5. It is a non-cash expense. It does not involve any cash outflow. It is the process of writing-off the capital expenditure already incurred. Do it Yourself Look at your surroundings and identify at least five depreciable assets in your home, school, hospital, printing press and in a bakery. 2022-23 230 Accountancy 7.2 Depreciation and other Similar Terms There are some terms like 'depletion' and 'amortisation', which are also used in connection with depreciation. This has been due to the similar treatment given to them in accounting on the basis of similarity of their outcome, as they represent the expiry of the usefulness of different assets. 7.2.1 Depletion The term depletion is used in the context of extraction of natural resources like mines, quarries, etc. that reduces the availability of the quantity of the material or asset. For example, if a business enterprise is into mining business and purchases a coal mine for ` 10,00,000. Then the value of coal mine declines with the extraction of coal out of the mine. This decline in the value of mine is termed as depletion. The main difference between depletion and depreciation is that the former is concerned with the exhaution of economic resources, but the latter relates to the usage of an asset. In spite of this, the result is erosion in the volume of natural resources and expiry of the service potential. Therefore, depletion and depreciation are given similar accounting treatment. 7.2.2 Amortisation Amortisation refers to writing-off the cost of intangible assets like patents, copyright, trade marks, franchises, goodwill which have utility for a specified period of time. The procedure for amortisation or periodic write-off of a portion of the cost of intangible assets is the same as that for the depreciation of fixed assets. For example, if a business firm buys a patent for ` 10,00,000 and estimates that its useful life will be 10 years then the business firm must writeoff ` 10,00,000 over 10 years. The amount so written- off is technically referred to as amortisation. 7.3 Causes of Depreciation These have been very clearly spelt out as part of the definition of depreciation in the Accounting Standard 6 and are being elaborated here. 7.3.1 Wear and Tear due to Use or Passage of Time Wear and tear means deterioration, and the consequent diminution in an assets value, arising from its use in business operations for earning revenue. It reduces the asset's technical capacities to serve the purpose for, which it has been meant. Another aspect of wear and tear is the physical deterioration. An asset deteriorates simply with the passage of time, even though they are not being put to any use. This happens especially when the assets are exposed to the rigours of nature like weather, winds, rains, etc. 2022-23 Depreciation, Provisions and Reserves 231 7.3.2 Expiration of Legal Rights Certain categories of assets lose their value after the agreement governing their use in business comes to an end after the expiry of pre-determined period. Examples of such assets are patents, copyrights, leases, etc. whose utility to business is extinguished immediately upon the removal of legal backing to them. 7.3.3 Obsolescence

Obsolescence is another factor leading to depreciation of fixed assets. In ordinary language, obsolescence means the fact of being “out-of-date”. Obsolescence implies to an existing asset becoming out-of-date on account of the availability of better type of asset. It arises from such factors as: • Technological changes; • Improvements in production methods; • Change in market demand for the product or service output of the asset; • Legal or other description. 7.3.4 Abnormal Factors Decline in the usefulness of the asset may be caused by abnormal factors such as accidents due to fire, earthquake, floods, etc. Accidental loss is permanent but not continuing or gradual. For example, a car which has been repaired after an accident will not fetch the same price in the market even if it has not been used. 7.4 Need for Depreciation The need for providing depreciation in accounting records arises from conceptual, legal, and practical business consideration. These considerations provide depreciation a particular significance as a business expense. 7.4.1 Matching of Costs and Revenue The rationale of the acquisition of fixed assets in business operations is that these are used in the earning of revenue. Every asset is bound to undergo some wear and tear, and hence lose value, once it is put to use in business. Therefore, depreciation is as much the cost as any other expense incurred in the normal course of business like salary, carriage, postage and stationary, etc. It is a charge against the revenue of the corresponding period and must be deducted before arriving at net profit according to ‘Generally Accepted Accounting Principles’. 7.4.2 Consideration of Tax Depreciation is a deductible cost for tax purposes. However, tax rules for the calculation of depreciation amount need not necessarily be similar to current business practices, 2022-23 232 Accountancy 7.4.3 True and Fair Financial Position If depreciation on assets is not provided for, then the assets will be over valued and the balance sheet will not depict the correct financial position of the business. Also, this is not permitted either by established accounting practices or by specific provisions of law. 7.4.4 Compliance with Law Apart from tax regulations, there are certain specific legislations that indirectly compel some business organisations like corporate enterprises to provide depreciation on fixed assets. Test Your Understanding - I State whether the following statements are true or false: 1. Depreciation is a non-cash expense. 2. Depreciation is also charged on current assets. 3. Depreciation is decline in the market value of tangible fixed assets. 4. The main cause of depreciation is wear and tear caused by its usage. 5. Depreciation must be charged so as to ascertain true profit or loss of the business. 6. Depletion term is used in case of intangible assets. 7. Depreciation provides fund for replacement. 8. When market value of an asset is higher than book value, depreciation is not charged. 9. Depreciation is charged to reduce the value of asset to its market value. 10. If adequate maintenance expenditure is incurred, depreciation need not be charged. 7.5 Factors Affecting the Amount of Depreciation The determination of depreciation depends on three parameters, viz. cost, estimated useful life and probable salvage value. 7.5.1 Cost of Asset Cost (also known as original cost or historical cost) of an asset includes invoice price and other costs, which are necessary to put the asset in use or working condition. Besides the purchase price, it includes freight and transportation cost, transit insurance, installation cost, registration cost, commission paid on purchase of asset add items such as software, etc. In case of purchase of a second hand asset it includes initial repair cost to put the asset in workable 2022-23 Depreciation, Provisions and Reserves 233 condition. According to Accounting Standand-6 of ICAI, cost of a fixed asset is “the total cost spent in connection with its acquisition, installation and commissioning as well as for addition or improvement of the depreciable asset”. For example, a photocopy machine is purchased for ` 50,000 and ` 5,000 is spent on its transportation and installation. In this case the original cost of the machine is ` 55,000 (i.e. ` 50,000 + `5,000) which will be written-off as depreciation over the useful life of the machine. 7.5.2 Estimated Net Residual Value Net Residual value (also known as scrap value or salvage value for accounting purpose) is the estimated net realisable value (or sale value) of the asset at the end of its useful life. The net residual value is calculated after deducting the expenses necessary for the disposal of the asset. For example, a machine is purchased for ` 50,000 and is expected to have a useful life of 10 years. At the end of 10th year it is expected to have a sale value of ` 6,000 but expenses related to its disposal are estimated at ` 1,000. Then its net residual value shall be ` 5,000 (i.e. ` 6,000 – ` 1,000). 7.5.3 Depreciable Cost Depreciable cost of an asset is equal to its cost (as calculated in point 7.5.1 above) less net residual value (as calculated in point 7.5.2,) Hence, in the above example, the depreciable cost of machine is ` 45,000 (i.e., ` 50,000 – ` 5,000.) It is the depreciable cost, which is distributed and charged as depreciation expense over the estimated useful life of the asset. In the above example, ` 45,000 shall be charged as depreciation over a period of 10 years. It is important to mention here that total amount of depreciation charged over the useful life of the asset must be equal to the depreciable cost. If total amount of depreciation charged is less than the depreciable cost then the capital expenditure is under recovered. It violates the principle of proper matching of revenue and expense. 7.5.4 Estimated Useful Life Useful life of an asset is the estimated economic or commercial life of the asset. Physical life is not important for this purpose because an asset may still exist physically but may not be capable of commercially viable production. For example, a machine is purchased and it is estimated that it can be used in production process for 5 years. After 5 years the machine may still be in good physical condition but can't be used for production profitably, i.e., if it is still used the cost of production may be very high. Therefore, the useful life of the machine is considered as 5 years irrespective of its physical life. Estimation of useful life of an asset is difficult as it depends upon several factors such as 2022-23 234 Accountancy usage level of asset, maintenance of the asset, technological changes, market changes, etc. As per Accounting Standard – 6 useful life of an asset is normally the "period over which it is expected to be used by the enterprise". Normally, useful life is shorter than the physical life. The useful life of an asset is expressed in number of years but it can also be expressed in other units, e.g., number of units of output (as in case of mines) or number of working hours. Useful life depends upon the following factors : • Pre-determined by legal or contractual limits, e.g., in case of leasehold asset, the useful life is the period of lease. • The number of shifts for which asset is to be used. • Repair and maintenance policy of the business organisation. • Technological obsolescence. • Innovation/improvement in production method. • Legal or other restrictions. 7.6 Methods of Calculating Depreciation Amount The depreciation amount to be charged for during an accounting year depends upon depreciable amount and the method of allocation. For this, two methods are mandated by law and enforced by professional accounting practice in India. These methods are straight line method and written down value method. Besides these two main methods there are other methods such as – annuity method, depreciation fund method, insurance policy method, sum of years digit method, double declining method, etc. which may be used for determining the amount of depreciation. The selection of an appropriate method depends upon the following : • Type of the asset; • Nature of the use of such asset; • Circumstances prevailing in the business; As per Accounting Standard-6, the selected depreciation method should be applied consistently from period to period. Change in depreciation method may be allowed only under specific circumstances. 7.6.1 Straight Line Method This is the earliest and one of the widely used methods of providing depreciation. This method is based on the assumption of equal usage of the asset over its entire useful life. It is called straight line for a reason that if the amount of depreciation and corresponding time period is plotted on a graph, it will result in a straight line (figure 7.1). 2022-23 Depreciation, Provisions and Reserves 235 It is also called fixed installment method because the amount of depreciation remains constant from year to year over the useful life of the asset. According to this method, a fixed and an equal amount is charged as depreciation in every accounting period during the lifetime of an asset. The amount annually charged as depreciation is such that it reduces the original cost of the asset to its scrap value, at the end of its useful life. This method is also known as fixed percentage on original cost method because same percentage of the original cost (infact depreciable cost) is written off as depreciation from year to year. The depreciation amount to be provided under this method is computed by using the following formula: Depreciation = Cost of asset - Estimated net residential value Estimated useful life of the asset Rate of depreciation under straight line method is the percentage of the total cost of the asset to be charged as deprecation during the useful lifetime of the asset. Rate of depreciation is calculated as follows: Rate of Depreciation = Annual depreciation amount Acquisition cost × 100 Consider the following example, the original cost of the asset is ` 2,50,000. The useful life of the asset is 10 years and net residual value is estimated to be ` 50,000. Now, the amount of depreciation to be charged every year will be computed as given below: Annual Depreciation Amount − = Acqusition cost of asset Estimated net residential value Estimated life of asset − = = 2,50, 000 50, 000 i.e. 20, 000 10 ` ` ` Fig. 7.1 : Depreciation amount under straight line method 2022-23 236 Accountancy The rate of depreciation will be calculated as : (i) Annual depreciation amount Rate of Depreciation 100 Acquisition cost = × From point (i), the annual depreciation amounts to ` 20,000. Thus, the rate of depreciation will be = × = 20,000 100 8% 2,50,000 ` ` 7.6.1.1 Advantages of Straight Line Method Straight Line method has certain advantages which are stated below: • It is very simple, easy to understand and apply. Simplicity makes it a popular method in practice; • Asset can be depreciated upto the net scrap value or zero value. Therefore, this method makes it possible to distribute full depreciable cost over useful life of the asset; • Every year, same amount is charged as depreciation in profit and loss account. This makes comparison of profits for different years easy; • This method is suitable for those assets whose useful life can be estimated accurately and where the use of the asset is consistent from year to year such as leasehold buildings. 7.6.1.2 Limitations of Straight Line Method Although straight line method is simple and easy to apply it suffers from certain limitations which are given below. • This method is based on the faulty assumption of same amount of the utility of an asset in different accounting years; • With the passage of time, work efficiency of the asset decreases and repair and maintenance expense increases. Hence, under this method, the total amount charged against profit on account of depreciation and repair taken together, will not be uniform throughout the life of the asset, rather it will keep on increasing from year to year. 7.6.2 Written Down Value Method Under this method, depreciation is charged on the book value of the asset. Since book value keeps on reducing by the annual charge of depreciation, it is also known as 'reducing balance method'. This method involves the application of a pre-determined proportion/percentage of the book value of the asset at the beginning of every accounting period, so as to calculate the amount of depreciation. The amount of depreciation reduces year after year. 2022-23 Depreciation, Provisions and Reserves 237 For example, the original cost of the asset is ` 2,00,000 and depreciation is charged @ 10% p.a. at written down value, then the amount of depreciation will be computed as follows: (i) Depreciation (I year) = × = 10 20, 00, 000 20, 000 100 ` ` (ii) Written down value = ` 2,00,000 – 20,000 = `1,80,000 (at the end of the I year) (iii) Depreciation (II year) = × = 10 1, 80, 000 18,000 100 ` ` (iv) Written down value = ` 1,80,000 – `18,000 = 1,62,000 (at the end of the II year) (v) Depreciation (III year) = × = 10 1, 62, 000 16,200 100 ` ` (vi) Written down value = ` 1,62,000 – ` 16,200 = ` 1,45,800 (at the end of III year) As evident from the example, the amount of depreciation goes on reducing year after year. For this reason, it is also known 'reducing installment' or 'diminishing value' method. This method is based upon the assumption that the benefit accruing to business from assets keeps on diminishing as the asset becomes old (refer figure 7.2). This is due to the reason that a predetermined percentage is applied to a gradually shrinking balance on the asset account every year. Thus, large amount is recovered depreciation charge in the earlier years than in later years. Fig. 7.2 : Depreciation amount using written down value method Under written down value method, the rate of depreciation is computed by using the following formula: = − × s R 1 n 100 c 2022-23 238 Accountancy Where, r = Rate of depreciation n = Expected useful life s = Scrap value c = Cost of an asset For example, the original cost of a truck is ` 9,00,000 and its net salvage value after 16 years of useful life is ` 50,000 then the appropriate rate of depreciation will be computed as under: = − × = − × = 50,000 R 1 16 100 (1 0.834) 100 16.6% 9,00,000 7.6.2.1 Advantages of Written Down Value Method Written down value method has the following advantages: • This method is based on a more realistic assumption that the benefits from asset go on diminishing (reducing) with the passage of time. Hence, it calls for proper allocation of cost because higher depreciation is charged in earlier years when asset's utility is higher as compared to later years when it becomes less effective. • It results into almost equal burden of depreciation and repair expenses taken together every year on profit and loss account; • Income Tax Act accept this method for tax purposes; • As a large portion of cost is written-off in earlier years, loss due to obsolescence gets reduced; • This method is suitable for fixed assets which last for long and which require increased repair and maintenance expenses with passage of time. It can also be used where obsolescence rate is high. 7.6.2.2 7.6.2.2 Limitations of Written Down Value Method Although this method is based upon a more realistic assumption it suffers from the following limitations. • As depreciation is calculated at fixed percentage of written down value, depreciable cost of the asset cannot be fully written-off. The value of the asset can never be zero; • It is difficult to ascertain a suitable rate of depreciation. 7.7 Straight Line Methodand Written Down Method: A Comparative Analysis Straight line and written down value methods are generally used for calculating depreciation amount in practice. Following are the points of differences between these two methods. 2022-23 Depreciation, Provisions and Reserves 239 7.7.1 Basis of Charging Depreciation In straight line method, depreciation is charged on the basis of original cost or (historical cost). Whereas in written down value method, the basis of charging depreciation is net book value (i.e., original cost less depreciation till date) of the asset, in the beginning of the year. 7.7.2 Annual Charge of Depreciation The annual amount of depreciation charged every year remains fixed or constant under straight line method. Whereas in written down value method the annual amount of depreciation is highest in the first year and subsequently declines in later years. The reason for this difference, is the difference in the basis of charging depreciation under both methods. Under straight line method depreciation is calculated on original cost while under written down value method it is calculated on written down value. 7.7.3 Total Charge Against Profit and Loss Account on Account of Depreciation and Repair Expenses It is a well-accepted phenomenon that repair and maintenance expenses increase in later years of the useful life of the asset. Hence, total charge against profit and loss account in respect of depreciation and repair expenses increases in later years under straight line method. This happens because annual depreciation charge remains fixed while repair expenses increase. On the other hand, under written down value method, depreciation charge declines in later years, therefore total of depreciation and repair charge remains similar or equal year after year. 7.7.4 Recognition by Income Tax Law Straight line method is not recognised by Income Tax Law while written down value method is recognised by the Income Tax Law. 7.7.5 Suitability Straight line method is suitable for assets in which repair charges are low the possibility of obsolescence is low and scrap value depends upon the time period involved, such as freehold land and buildings, patents, trade marks, etc. Written down value method is suitable for assets which are affected by technological changes and require more repair expenses with passage of time such as plant and machinery, vehicles, etc. 2022-23 240 Accountancy Basis of Difference Straight Line Method Written Down Value Method 1. Basis of charging depre- Original cost Book Value (i.e. original ciation cost less depreciation charged till date) 2. Annual depreciation charge Fixed (Constant) year Declines year after year 3. Total charge against Unequal year after year. Almost equal every year. profit and loss account in It increases in later years. respect of depreciation and repairs 4. Recognition by income Not recognised Recognised tax law 5. Suitablity It is suitable for assets in It is suitable for assets, which repair charges are which are affected by less, the possibility of technological changes and obsolescence is low and require more repair scrap value depends upon expenses with passage of the time period involved. time. Fig. 7.3 : Comparison of straight line and written down value method 7.8

Methods of Recording Depreciation In the books of account, there are two types of arrangements for recording depreciation on fixed assets: • Charging depreciation to asset account or • Creating Provision for depreciation/Accumulated depreciation account. 7.8.1 Charging Depreciation to Asset account According to this arrangement, depreciation is deducted from the depreciable cost of the asset (credited to the asset account) and charged (or debited) to profit and loss account. Journal entries under this recording method are as follows: 1. For recording purchase of asset (only in the year of purchase) Asset A/c Dr. (with the cost of asset including installation, freight, etc.) To Bank/Vendor A/c 2. Following two entries are recorded at the end of every year (a) For deducting depreciation amount from the cost of the asset. Depreciation A/c Dr. (with the amount of depreciation) To Asset A/c (b) For charging depreciation to profit and loss account. Profit & Loss A/c Dr. (with the amount of depreciation) To Depreciation A/c 2022-23 Depreciation, Provisions and Reserves 241 3. Balance Sheet Treatment When this method is used, the fixed asset appears at its net book value (i.e. cost less depreciation charged till date) on the asset side of the balance sheet and not at its original cost (also known as historical cost). 7.8.2 Creating Provision for Depreciation Account/Accumulated Depreciation Account This method is designed to accumulate the depreciation provided on an asset in a separate account generally called 'Provision for Depreciation' or 'Accumulated Depreciation' account. By such accumulation of depreciation the asset account need not be disturbed in any way and it continues to be shown at its original cost over the successive years of its useful life. There are some basic characteristic of this method of recording depreciation. These are given below: • Asset account continues to appear at its original cost year after year over its entire life; • Depreciation is accumulated on a separate account instead of being adjusted in the asset account at the end of each accounting period. The following journal entries are recorded under this method: 1. For recording purchase of asset (only in the year of purchase) Asset A/c Dr. (with the cost of asset including installation, expenses etc.) To Bank/Vendor A/c (cash/credit purchase) 2. Following two journal entries are recorded at the end of each year: (a) For crediting depreciation amount to provision for depreciation account Depreciation A/c Dr. (with the amount of depreciation) To Provision for depreciation A/c (b) For charging depreciation to profit and loss account Profit & Loss A/c Dr. (with the amount of depreciation) To Depreciation A/c 3. Balance sheet treatment In the balance sheet, the fixed asset continues to appear at its original cost on the asset side. The depreciation charged till that date appears in the provision for depreciation account, which is shown either on the "liabilities side" of the balance sheet or by way of deduction from the original cost of the asset concerned on the asset side of the balance sheet. Illustration 1 M/s Singhania and Bros. purchased a plant for ` 5,00,000 on April 01, 2017, and spent ` 50,000 for its installation. The salvage value of the plant after its useful life of 10 years is estimated to be ` 10,000. Record journal entries for the year 2016-17 and draw up Plant Account and Depreciation Account for first three years given that the depreciation is charged using straight line method if : (i) The books of account close on March 31 every year; and (ii) The firm charges depreciation to the asset account. 2022-23 242 Accountancy Solution Books of Singhania and Bros. Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2016 Apr. 01 Plant A/c Dr. 5,00,000 To Bank A/c 5,00,000 (Purchased plant for ` 5,00,000) Apr. 01 Plant A/c Dr. 50,000 To Bank A/c 50,000 (Expenses incurred on installation) 2017 Mar. 31 Depreciation A/c Dr. 54,000 To Plant A/c 54,000 (Depreciation charged on asset) Mar. 31 Profit and Loss A/c Dr. 54,000 To Depreciation A/c 54,000 (Depreciation debited to profit and loss account) Plant Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 2017 Apr. 01 Bank 5,00,000 Mar. 31 Depreciation 54,000 Balance c/d 4,96,000 Bank 50,000 (Installation expenses) 5,50,000 5,50,000 2017 2018 Apr. 01 Balance b/d 4,96,000 Mar. 31 Depreciation 54,000 Balance c/d 4,42,000 4,96,000 4,96,000 2018 2019 Apr. 01 Balance b/d 4,42,000 Mar. 31 Depreciation 54,000 Balance c/d 3,88,000 4,42,000 4,42,000 2019 Apr. 01 Balance b/d 3,88,000 2022-23 Depreciation, Provisions and Reserves 243 Depreciation Account Dr. Cr. Date Particulars J.F. Amount Date

Particulars J.F. Amounts ` ` 2017 2017 Mar. 31 Plant 54,000 Mar. 31 Profit and Loss 54,000 2018 2018 Mar. 31 Plant 54,000 Mar. 31 Profit and Loss 54,000 2019 2019 Mar. 31 Plant 54,000 Mar. 31 Profit & Loss 54,000 Workings Notes (1) Calculation of original cost (`) Purchase cost 5,00,000 Add: Installation cost 50,000 Original cost 5,50,000 Salvage value 10,000 Useful life 10 years (2) Depreciation amount = − = 5,50, 000 10, 000 54, 000 p.a. 10 ` ` ` Illustration 2 M/s Mehra and Sons acquired a machine for ` 1,80,000 on October 01, 2016, and spent ` 20,000 for its installation. The firm writes-off depreciation at the rate of 10% on original cost every year. Record necessary journal entries for the year 2017 and draw up Machine Account and Depreciation Account for first three years given that: (i) The book of accounts closes on March 31 every year; and (ii) The firm charges depreciation to asset account. Solution Books of Mehra and Sons Journal Debit Credit Date Particulars L.F. Amount Amount ` ` 2016 Oct. 01 Machine A/c Dr. 1,80,000 To Bank A/c 1,80,000 (Purchased machine for `1,80,000) Oct. 01 Machine A/c Dr. 20,000 To Bank A/c 20,000 (Expenses incurred on installation) 2022-23 244 Accountancy 2017 Mar. 31 Depreciation A/c Dr. 10,000 To Machine A/c 10,000 Depreciation charged on machine) Mar. 31 Profit and Loss A/c Dr. 10,000 To Depreciation A/c 10,000 (Depreciation debited to profit and loss account) 2018 Mar. 31 Depreciation A/c Dr. 20,000 To Machine A/c 20,000 (Depreciation charged on machine) Mar. 31 Profit and Loss A/c Dr. 20,000 To Depreciation A/c 20,000 (Depreciation debited to profit and loss account) 2019 Mar. 31 Depreciation A/c Dr. 20,000 To Machine A/c 20,000 (Depreciation charged on machine) Mar. 31 Profit and Loss A/c Dr. 20,000 To Depreciation A/c 20,000 (Depreciation debited to profit and loss account) Books of M/s Mehra and Sons Machine Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 2017 Oct. 01 Bank 1,80,000 Mar. 31 Depreciation 10,000 Oct. 01 Bank 20,000 (for 6 months) (Installation Balance c/d 1,90,000 expenses) Mar. 31 2,00,000 2,00,000 2017 2018 Apr. 01 Balance b/d 1,90,000 Mar. 31 Depreciation 20,000 1,70,000 Balance c/d 1,90,000 1,90,000 2018 2019 Apr. 01 Balance b/d 1,70,000 Mar. 31 Depreciation 20,000 Balance c/d 1,50,000 1,70,000 1,70,000 2022-23 Depreciation, Provisions and Reserves 245 Depreciation Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Mar. 31 Machine 10,000 Mar. 31 Profit & Loss 10,000 10,000 10,000 2018 2018 Mar. 31 Machine 20,000 Mar. 31 Profit & Loss 20,000 20,000 20,000 2019 2019 Dec. 31 Machine 20,000 Dec. 31 Profit & Loss 20,000 20,000 20,000 Working Notes (1) Calculation of original cost of the machine ` Purchase cost 1,80,000 Add Installation cost 20,000 Original cost 2,00,000 (2) Depreciation expense = 10% of ` 2,00,000 every year = ` 20,000 p.a. (3) During the year 2016, depreciation shall be charged only for 6 months, as acquisition date is October 01, 2016, i.e., the asset is used only for 6 months during the year 2016-17. (4) 6 Depreciation (2016-17) = 20,000 x 10,000 12 ` =` Illustration 3 Based on data given in question number 2 record journal entries and prepare Machine account, Depreciation account and Provision for Depreciation account for the first 3 years if provision for depreciation account is maintained by the firm. Solution Books of Mehra and Sons Machine Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amounts ` ` 2016 2017 Oct. 1 Bank 1,80,000 Mar. 31 Balance c/d 2,00,000 Oct. 1 Bank (Installation 20,000 expenses) 2,00,000 2,00,000 2022-23 246 Accountancy 2017 2018 Apr. 01 Balance b/d 2,00,000 Mar. 31 Balance c/d 2,00,000 2,00,000 2,00,000 Provision for Depreciation Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amounts ` ` 2016 2016 Mar. 31 Balance c/d 10,000 Mar. 31 Depreciation 10,000 10,000 10,000 2017 2017 Mar. 31 Balance c/d 30,000 Apr. 01 Balance b/d 10,000 Mar. 31 Depreciation 20,000 30,000 30,000 2018 2018 Mar. 31 Balance c/d 50,000 Apr. 1 Balance b/d 30,000 2017 Mar. 31 Depreciation 20,000 50,000 50,000 Depreciation Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Mar. 31 Provision for 10,000 Mar.31 Profit & Loss 10,000 Deprection 10,000 10,000 2018 2018 Mar. 31 Provision for 20,000 Mar.31 Profit & Loss 20,000 Depreciation 20,000 20,000 2019 2019 Mar. 31 Provision for 20,000 Mar.31 Profit & Loss 20,000 Depreciation 20,000 20,000 Illustration 4 M/s. Dalmia Textile Mills purchased machinery on April 01, 2016 for ` 2,00,000 on credit from M/s Ahuja and sons and spent ` 10,000 for its installation. Depreciation is 2022-23 Depreciation, Provisions and Reserves 247 provided @10% p.a. on written down value basis. Prepare Machinery Account for the first three years. Books are closed on March 31, every year. Solution Books of Dalmia Textiles mills Machinery Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 2017 Apr. 01 Bank 2,00,000 Mar. 31 Depreciation 21,0001 Bank 10,000 Balance c/d 1,89,000 2,10,000 2,10,000 2017 2018 Apr. 01 Balance b/d 1,89,000 Mar. 31 Depreciation 18,9002 Balance c/d 1,70,100 1,89,000 1,89,000 2018 2019 Apr. 01 Balance b/d 1,70,100 Mar. 31 Depreciation 17,0103 Balance c/d 1,53,090 1,70,100 1,70,100 2020 Balance b/d 1,53,090 Working Notes 1. Calculation of the amount of depreciation (`) Original cost on 01.04.2016 2,10,000 (i.e. 2,00,000 + 10,000) Less: Depreciation for 2016-17 (21,000) WDV on 01.04.2017 1,89,000 Less: Depreciation for 2017-18 (18,900) WDV on 01.04.2018 1,70,100 Less: Depreciation for 2018-19 (17,010) WDV on 01.04.2017 1,53,090 Illustration 5 M/s Sahani Enterprises acquired a printing machine for ` 40,000 on July 01, 2014 and spent ` 5,000 on its transport and installation. Another machine for ` 35,000 was purchased on January 01, 2016. Depreciation is charged at the rate of 20% on written down value. Prepare Printing Machine account. 2022-23 248 Accountancy Solution Books of Sahani Enterprises Printing Machine Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2014 2015 Jul. 01 Bank 40,000 Mar. 31 Depreciation 6,7501 Bank 5,000 Balance c/d 38,250 45,000 45,000 2015 2016 Apr. 01 Balance b/d 38,250 Mar. 31 Depreciation 9,4002 Jan. 01 Bank 35,000 Balance c/d 63,850 73,250 73,250 2016 2017 Apr. 01 Balance b/d 63,850 Mar.31 Depreciation 12,7703 Balance c/d 51,080 63,850 63,850 2017 Apr. 01 Balance b/d 51,080 Working Notes (`) Orignal cost machine purchased on July 01, 2014 45,000 (–) Depreciation till Mar. 31, 2015 (for 9 months @ 20%) (6,750)1 38,250 + Cost of new machine purchased on Jan. 01, 2016 35,000 73,250 (–) Depreciation for the year 2015-2016 (20% of 38,250 + 20% of ` 35,000 for 3 month) (9,400)2 WDV on Mar. 31, 2016 63,850 (–) Depreciation for the year 2016 – 17 (20% of ` 63,850) (12,770)3 WDV on Mar. 31, 2017 51,080 Test Your Understanding - II Basaria Confectioner bought a cold storage plant on July 01, 2014 for `1,00,000. Compare the amount of depreciation charged for first three years using: 1. Rate of depreciation @ 10% on original cost basis; 2. Rate of depreciation @ on written down value basis; 3. Also, plot the computed amount of depreciation on a graph. 2022-23 Depreciation, Provisions and Reserves 249 7.9 Disposal of Asset Disposal of asset can take place either (a) at the end of its useful life or (b) during its useful life (due to obsolescence or any other abnormal factor). If it is sold at the end of its useful life, the amount realised on account of the sale of asset as scrap should be credited to the asset account and the balance is transferred to profit and loss account. In this regard the following journal entries are recorded. 1. For sale of asset as scrap Bank A/c Dr. To Asset A/c 2. For transfer of balance in asset account (a) In case of profit Asset A/c Dr. To Profit and Loss A/c (b) In case of loss Profit and Loss A/c Dr. To Asset A/c In case, however, the provision for depreciation account has been in use for recording the depreciation, then before passing the above entries transfer the balance of the provision for depreciation account to the asset account by recording the following journal entry: Provision for depreciation A/c Dr. To Asset A/c For example, R.S. Limited purchased a vehicle for ` 4,00,000. After 4 years its salvage value is estimated at ` 40,000. To find out the amount of depreciation to be charged every year based on straight line basis, and show as to how the vehicle account would appear for four years assuming it is sold for ` 50,000 at the end when (a) depreciation is charged to asset account; and (b) provision for depreciation account is maintained. Consider the following entries in the book of account of R.S. Limited (a) When depreciation is charged to assets account Books of R.S. Limited Vehicle Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` I Bank 4,00,000 End of Depreciation 90,000 year the year Balance c/d 3,10,000 4,00,000 4,00,000 2022-23 250 Accountancy II Balance b/d 3,10,000 End of Depreciation 90,000 year the year Balance c/d 2,20.000 3,10,000 3,10,000 III Balance b/d 2,20,000 End of Depreciation 90,000 year the year Balance c/d 1,30,000 2,20,000 2,20,000 IV Balance b/d 1,30,000 Depreciaton 99,000 year Profit and 10,000 Bank 50,000 loss (Profit on sale of vehicle) 1,40,000 1,40,000 (b) When Provision for depreciation account is maintained. Books of R.S. Limited Vehicle Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` I Bank 4,00,000 End of Balance c/d 4,00,000 year the year 4,00,000 4,00,000 II Balance b/d 4,00,000 End of Balance c/d 4,00,000 year the year 4,00,000 4,00,000 III Balance b/d 4,00,000 End of Balance c/d 4,00,000 year the year 4,00,000 4,00,000 IV Balance b/d 4,00,000 Provison for 3,60,000 year Profit and loss 10,000 depreciation (Profit on Sale Bank 50,000 of Vehicle) 4,10,000 4,10,000 Provision for Depreciation Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Ist Balance b/d 90,000 End of Depreciation 90,000 year year 90,000 90,000 2022-23 Depreciation, Provisions and Reserves 251 II Balance b/d 1,80,000 End of Balance c/d 90,000 year the year Depreciation 90,000 1,80,000 1,80,000 III Balance b/d 2,70,000 End of Balance c/d 1,80,000 year the year Depreciation 90,000 2,70,000 2,70,000 IV Machinery 3,60,000 End of Balance c/d 2,70,000 year the year Provison for 90,000 Depreciation 3,60,000 3,60,000 7.9.1 Use of Asset Disposal Account Asset disposal account is designed to provide a complete and clear view of all the transactions involved in the sale of an asset under one account head. The concerned variables are the original cost of the asset, depreciation accumulated on the asset upto date, sale price of the asset, value of the parts of the asset retained for use, if any and the resultant profit or loss on disposal. The balance of this amount is transferred to the profit and loss account. This method is generally used when a part of the asset is sold and provision for depreciation account exists. Under this method, a new account titled Asset Disposal Account is opened. The original cost of the asset being sold is debited to the asset disposal account and accumulated depreciation amount appearing in provision for depreciation account relating to that asset till the date of disposal is credited to the asset disposal account. The net amount realised from the sale of the asset is also credited to this account. The balance of asset disposal account shows profit or loss which is transferred to profit and loss account. The advantage of this method is that it gives a full picture of all the transactions related to asset disposal at one place. The journal entries required for the preparation of asset disposal account is as follows: 1. Asset Disposal A/c Dr. (with the original cost of asset, To Asset A/c being sold) 2. Provision for Depreciation A/c Dr. (with the accumulated balance in To Asset Disposal A/c provision for depreciation account) 3. Bank A/c Dr. (with the net sales proceeds) To Asset Disposal A/c Asset Disposal Account may ultimately show a debit or credit balance. The debit balance on the account indicate loss on disposal and would be dealt with as follows: 2022-23 252 Accountancy Profit and Loss A/c Dr. (with the amount of loss on sale) To Asset Disposal A/c The credit balance of the account, profit on disposal and would be closed by the following journal entry: Asset Disposal A/c Dr. (with the amount of profit on sale) To Profit and Loss A/c For example, Karan Enterprises has the following balances in its books as on March 31, 2017 Machinery (gross value): ` 6,00,000 Provision for depreciation: ` 2,50,000 A machine purchased for ` 1,00,000 on November 01, 2013, having accumulated depreciation amounting to ` 60,000 was sold on April 1, 2017 for ` 35,000. The Asset Disposal account will be prepared in the following manner: Books of Karan Enterprises Machinery Disposal Account Dr. Cr. Date Particulars J.F. Amount Date Particulars L.F. Amount ` ` 2017 2017 Apr. 01 Machinery 1,00,000 Apr. 01 Provision for 60,000 depreciation Apr. 01 Bank 35,000 2018 Mar. 31 Profit & Loss (Loss on sale) 5,0001 1,00,000 1,00,000 Machinery Account Dr. Cr. Date Particulars Amount Date Particulars Amount ` ` 2017 2017 April 01 Balance b/d 6,00,000 Apr. 01 Machine Disposal 1,00,000 2018 Mar. 31 Balance c/d 5,00,000 6,00,000 6,00,000 Working Notes (1) Computation of loss on sale of machinery ` Original cost of the asset being sold 1,00,000 Less: accumulated depreciation (60,000) 40,000 2022-23 Depreciation, Provisions and Reserves 253 (2) Sales value realised (35,000) Loss on sale (i.e. ` 40,000 – ` 35,000) 5,0001 Illustration 6 On January 01, 2015, Khosla Transport Co. purchased five trucks for ` 20,000 each. Depreciation has been provided at the rate of 10% p.a. using straight line method and accumulated in provision for depreciation acount. On January 01, 2016, one truck was sold for `

15,000. On July 01, 2017, another truck (purchased for ` 20,000 on Jan, 01, 2014) was sold for ` 18,000. A new truck costing ` 30,000 was purchased on October 01, 2016. You are required to prepare trucks account, Provision for depreciation account and Truck disposal account for the years ended on December 2015, 2016 and 2017 assuming that the firm closes its accounts in December every year. Solution Book of Khosla Transport Co. Trucks Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2015 2015 Jan. 01 Bank 1,00,000 Dec. 31 Balance c/d 1,00,000 (Purchase of truck) 1,00,000 1,00,000 2016 2016 Jan. 01 Balance b/d 1,00,000 Jan. 01 Truck disposal 20,000 Dec 31 Balance c/d 80,000 1,00,000 1,00,000 2017 2017 Jan. 01 Balance b/d 80,000 Jul. 01 Truck disposal 20,000 Oct. 01 Bank 30,000 Dec. 31 Balance c/d 90,000 (Purchase of new truck) 1,10,000 1,10,000 Truck Disposal Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 2016 Jan. 01 Machinery 20,000 Jan. 01 Provision for 2,000 Depreciation Jan. 01 Bank (Sale) 15,000 Jan. 01 Profit & Loss 3,0004 (Loss on sale) 20,000 20,000 2022-23 254 Accountancy 2017 2017 Jul. 01 Machinery 20,000 Jul. 01 Provision for Jul. 01 Profit & Loss 3,000 Depreciation (Profit on sale) 5 (` 2,000 + 2,000 +1,000) 5,000 Jul. 01 Bank (Sale) 18,000 23,000 23,000 Provision for Depreciation Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2015 2015 Dec. 31 Balance c/d 10,000 Dec. 31 Depreciation 10,0001 10,000 10,000 2016 2016 Jan. 01 Truck Disposal 2,000 Jan. 01 Balance b/d 10,000 Dec. 31 Balance c/d 16,000 Dec. 31 Depreciation 8,0002 18,000 18,000 2017 2017 Jan. 01 Truck Disposal 5,000 Jan. 01 Balance b/d 16,000 Dec. 31 Balance c/d 18,750 Dec. 31 Depreciation (` 6000+ 1000+750) 7,7503 23,750 23,750 Working Notes 1. Calculation of amount of depreciation ` Year - 2015 10% on ` 1,00,000 for one year 10,0001 Year - 2016 10% on ` 80,000 for one year 80002 Year – 2017 10% on ` 60,000 for 1 year 6,000 10% on ` 20,000 for six months 1,000 10% on ` 30,000 for three months 7,50 7,7503 2. Loss on sale of first truck Original cost on January 01, 2015 20,000 Less depreciation at 10% (2,000) Book value on January 1, 2016 18,000 Sales price realised on 01.01.2016 (15,000) Loss on sale of first machine 3,0004 2022-23 Depreciation, Provisions and Reserves 255 3. Profit on sale of second truck ` Original Cost of second truck 20,000 (Less) depreciation charged 2015 2,000 2016 2,000 2017 (upto June, 2016) 1,000 5,000 Book value of second truck 15,000 Sale price of second truck 18,000 Profit on sale 3,000 Illustration 7 On April 01, 2015, following balances appeared in the books of M/s Kanishka Traders: Furniture account ` 50,000, Provision for depreciation on furniture ` 22,000. On October 01, 2015 a part of furniture purchased for Rupees 20,000 in April 01, 2011 was sold for ` 5,000. On the same date a new furniture costing ` 25,000 was purchased. The depreciation was provided @ 10% p.a. on original cost of the asset and no depreciation was charged on the asset in the year of sale. Prepare furniture account and provision for depreciation account for the year ending March 31, 2016. Solution Books of Kanishka Traders Furniture Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2015 2015 Apr. 01 Balance b/d 50,000 Oct.01 Bank 5,000 Oct. 01 Bank 25,000 2016 Provision for 8,000 March 31 depreciation 7,0001 Profit and Loss (Loss on sale) Balance c/d 55,000 75,000 75,000 Provision for Depreciation on Furniture Account Dr. Cr. Date Particulars J.F. Amount Date Particular J.F. Amount ` ` 2015 2015 Oct. 01 Furniture 8,000 Apr. 01 Balance b/d 22,000 (Accumulated depreciation on furniture sold) 2016 2016 Mar. 31 Balance c/d 18,250 Mar. 31 Depreciation (` 3,000 + 4,250 26,250 1,250) 26,250 2022-23 256 Accountancy Working Notes 1. Calculation of amount of depreciation Calculation of loss on sale ` Original cost of furniture on 01.10.2015 20,000 Less: Depreciation for 4 year from 01.04.2011 to 31.04.2015 (no depreciation for the year of sale @10% p.a. on original cost 8,000 Value as on 01.10.2015 12,000 Sale price 5,000 2. Loss on sale 7,0001 Depreciation for the year 2015-16 10% of ` 30,000 (` 50,000 – ` 20,000) for full year 3,000 10% of ` 25,000 for 6 month 1,250 4,250 Illustration 8 Solve illustration 07, if the firm maintains furniture disposal account prepared along with furniture account and provision for depreciation on furniture account. Books of Anil Traders Furniture Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2015 2015 Apr. 01 Balance b/d 50,000 Apr. 01 Furniture

20,000 disposal Oct.01 Bank 25,000 2016 Mar. 31 Balance c/d 55,000 75,000 75,000 Provision for Depreciation on Furniture Account Dr. Cr. Date Particulars J.F. Amount Date Particular J.F. Amount ` ` 2015 2015 Oct.01 Furniture 8,000 Apr.01 Balance b/d 22,000 disposal 2016 2016 Mar. 31 Balance c/d 18,250 Mar.31 Depreciation 4,250 26,250 26,250 2022-23 Depreciation, Provisions and Reserves 257 Furniture Disposal Account Dr. Cr. Date Particulars J.F. Amount Date Particular J.F. Amount ` ` 2015 2015 Oct.01 Furniture 20,000 Oct.01 Provision for Depreciation 8,000 Bank 5,000 Profit & Loss (Loss on sale) 7,000 20,000 20, 000 Illustration 9 On Jan 01, 2012 Jain & Sons purchased a second hand plant costing ` 2,00,000 and spent ` 10,000 on its overhauling. It also spent ` 5,000 on transportation and installation of the plant. It was decided to provide for depreciation @ of 20% on written down value. The plant was destroyed by fire on July 31, 2015 and an insurance claim of ` 50,000 was admitted by the insurance company. Prepare plant account, accumulated depreciation account and plant disposal account assuming that the company closes its books on December 31, every year. Solution Books of Jain & Sons. Plant Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2012 2012 Jan. 01 Bank 2,15,000 Dec. 31 Balance c/d 2,15,000 2,15,000 2,15,000 2013 2013 Jan. 01 Balance b/d 2,15,000 Dec. 31 Balance c/d 2,15,000 2,15,000 2,15,000 2014 2014 Jan. 01 Balance b/d 2,15,000 Dec. 31 Balance c/d 2,15,000 2,15,000 2,15,000 2015 2015 Jan. 01 Balance b/d 2,15,000 Jul. 31 Plant disposal 2,15,000 2,15,000 2,15,000 2022-23 258 Accountancy Accumulated Depreciation Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2012 2012 Dec. 31 Balance c/d 43,000 Dec. 31 Depreciation 43,0001 43,000 43,000 2013 2013 Jan. 01 Balance c/d 77,400 Jan. 01 Balance b/d 43,000 Depreciation 34,4002 77,400 77,400 2014 2014 Dec. 31 Balance c/d 1,04,920 Jan. 01 Balance b/d 77,400 Dec. 31 Depreciation 27,5203 1,04,920 1,04,920 2015 2015 Jan. 01 Balance b/d 1,04,920 Jul. 31 Plant disposal 1,17,763 July 31 Depreciation 12,8434 1,17,763 1,17,763 Plant Disposal Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2015 2015 Jul. 31 Plant 2,15,000 Jul. 31 Accumulated 1,17,763 depreciation Insurance Co. 50,000 Profit & Loss 47,2375 (Loss on sale) 2,15,000 2,15,000 Working Notes: 1. Calculation of Depreciation Amount (`) Original cost on 01.01.2012 2,15,000 (2,00,000 + 10,000+ 5,000) Depreciation for the year 2012 (@20% of ` 2,15,000) (43,0001) 1,72,000 2022-23 Depreciation, Provisions and Reserves 259 Depreciation for the year 2013 (@20% of ` 1,72,000) (34,4002 ) 1,37,600 Depreciation for the year 2014 (@20% of ` 1,37,600) 27,5203 1,10,080 Depreciation till 31.07.15 (12,8434) (@20% of ` 1,10,080) 97,237 Insurance claim (50,000) Loss on disposal 47,2375 7.10 Effect of any Addition or Extension to the Existing Asset An existing asset may require some additions or extensions for being suitable for operations. Such additions/extensions may or may not become an integral part of the asset. The amount incurred on such additions/extensions is capitalised and written off as depreciation over the life of the asset. It is important to mention here that the amount so incurred is in addition to usual repair and maintenance expenses. AS-6 (Revised) mentions that • Any addition or extension, which becomes an integral part of the existing asset should be depreciated over the useful life of that asset; • The depreciation on such addition or extension may also be provided at the rate applied to the existing asset; • Where an addition or extension retains a separate identity and is capable of being used after the existing asset is disposed off, depreciation, should be provided independently on the basis of its own useful life. Illustration 10 M/s Digital Studio bought a machine for ` 8,00,000 on April 01, 2013. Depreciation was provided on straight-line basis at the rate of 20% on original cost. On April 01, 2015 a substantial modification was made in the machine to make it more efficient at a cost of ` 80,000. This amount is to be depreciated @ 20% on straight line basis. Routine maintenance expenses during the year 2013-14 were ` 2,000. Draw up the Machine account, Provision for depreciation account and charge to profit and loss account in respect of the accounting year ended on March 31, 2016. 2022-23 260 Accountancy Solution Books of Digital Studio Machine Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2015 2016 Apr 01 Balance b/d 800,000 Mar 31 Balance c/d 8,80,000 Bank 80,000 8,80,000 8,80,000

Provision for Depreciation Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2014 2015 Mar 31 Balance c/d 4,96,000 April 01 Balance b/d 3,20,0001 2016 Mar 31 Depreciation 1,76,0002 4,96,000 4,96,000 Working Notes 1. Cost of modification is capitalised but routine repair expenses are treated as revenue expenditure. 2. Calculation of balance of provision for depreciation account on 01.04.2014. Original Cost on 01.04.2013 = ` 8,00,000 Depreciation for the years 2013-14 and 2014-15 = ` 3,20,0001 (@ 20% of ` 8,00,000 ) 3. Depreciation for the year 2015-16 is calculated as under: 20% of 8,00,000 = ` 1,60,000 20% of ` 80,000 = ` 16,000 Total Depreciation for 2015-16 = ` 1,76,0002 4. Amount to be charged to profit and loss account Depreciation ` 1,76,000 Repair and maintenance ` 2,000 Illustration 11 M/s Nishit printing press bought a printing machine for ` 6, 80,000 on April 01, 2015. Depreciation was provided on straight line basis at the rate of 20% on original cost. On April 01, 2017 a modification was made in the machine to increase its technical reliability for ` 70,000. On the same date, an important component of the machine was replaced for 2022-23 Depreciation, Provisions and Reserves 261 ` 20,000 due to excessive wear and tear. Routine maintenance expenses during the year are ` 5,000 Prepare machinery account, provision for depreciation account. Show the working notes accordingly for the year ending March 31, 2018. Machinery Account Date Particular J.F. Account Date Particular J.F. Account ` ` 2017 2018 Apr. 01 Balance b/d 6,80,000 Mar. 31 Balance c/d 7,70,000 Bank 70,000 Bank 20,000 7,70,000 7,70,000 Provision for Depreciation Account Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2018 2017 Mar.31 Balance c/d 4,26,000 Apr.01 Balance b/d 2,72,000 2018 Mar.31 Depreciation 1,54,000 4,26,000 4,26,000 Working Notes ` 1. Cost of Machine for the year 2015 = 6,80,000 Depreciation Charged for the Years 2015-16 and 2016-17 = � � � � � � × 6,80,000 100 20 2 = 2,72,000 2. Depreciation for the year 2017-18 = ` 6,80,000 20% of 6,80,000 = 1,36,000 20% of 90,000 = 18,000 (i.e., ` 70,000 + ` 20,000) Depreciation for the year 2017-18 = 1,54,000 2022-23 262 Accountancy SECTION – II Provisions and Reserve 7.11 Provisions There are certain expenses/losses which are related to the current accounting period but amount of which is not known with certainty because they are not yet incurred. It is necessary to make provision for such items for ascertaining true net profit. For example, a trader who sells on credit basis knows that some of the debtors of the current period would default and would not pay or would pay only partially. It is necessary to take into account such an expected loss while calculating true and fair profit/loss according to the principle of Prudence or Conservatism. Therefore, the trader creates a Provision for Doubtful Debts to take care of expected loss at the time of realisation from debtors. In a similar way, Provision for repairs and renewals may also be created to provide for expected repair and renewal of the fixed assets. Examples of provisions are : • Provision for depreciation; • Provision for bad and doubtful debts; • Provision for taxation; • Provision for discount on debtors; and • Provision for repairs and renewals. It must be noted that the amount of provision for expense and loss is a charge against the revenue of the current period. Creation of provision ensures proper matching of revenue and expenses and hence the calculation of true profits. Provisions are created by debiting the profit and loss account. In the balance sheet, the amount of provision may be shown either: • By way of deduction from the concerned asset on the assets side. For example, provision for doubtful debts is shown as deduction from the amount of sundry debtors and provision for depreciation as a deduction from the concerned fixed assets; • On the liabilities side of the balance sheet alongwith current liabilities, for example provision for taxes and provision for repairs and renewals. 2022-23 Depreciation, Provisions and Reserves 263 7.11.1 Accounting Treatment for Provisions The accounting treatment of all types of provisions is almost similar. Therefore, the accounting treatment is explained here taking up the case of provision for doubtful debts. As already stated that when business transaction takes place on credit basis, debtors account is created and its balance is shown on the asset-side of the balance sheet. These debtors may be of three types: • Good Debtors are those from where collection of debt is certain. • Bad Debts are those debtors from where collection of money is not possible and the amount of credit given is a certain loss. • Doubtful Debts are those debtors who may pay but business firm is not sure about the collection of full amount from them. In fact, as a matter of business experience, some percentage of such debtors are not likely to pay, hence treated as doubtful debts. To consider this possible loss on account of non-payment by some debtors, it is a common practice (and necessary also) to make a suitable provision for doubtful debts at the time of ascertaining true profit or loss. The provision for doubtful debts is usually calculated as a certain percentage of the total amount due from sundry debtors after deducting/writing-off all known bad debts. Provision for doubtful debts is also called 'Provision for bad and doubtful debts'. It is created by debiting the amount of required provision to the profit and loss account and crediting it to provision for doubtful debts account. For creating a provision for doubtful debts the following journal entry is recorded: Profit and Loss A/c Dr. (with the amount of provision) To Provision for doubtful debts A/c This is explained with the help of the following example Observe an extract of the trial balance from the books of Trehan Traders on March 31, 2014 is given below: Date Account title L.F. Debit Credit Amount Amount ` ` Sundry Debtors 68,000 Additional Information • Bad debts proved bad but not recorded amounted to ` 8,000 • Provision is to be maintained at 10% of debtors. 2022-23 264 Accountancy In order to create the provision for doubtful debts, the following journal entries will be recorded: Journal Date Particulars L.F. Amount Amount ` ` 2014 Mar. 31 Bad debts A/c Dr. 8,000 To Sundry debtors A/c 8,000 (Bad debts written off) Mar. 31 Profit & Loss A/c Dr. 8,000 To Bad debts A/c 8,000 (Bad debts debited to profit and loss account) Mar. 31 Profit and Loss A/c Dr. 6,0001 To Provision for doubtful debts a/c 6,0001 (For creating provision for doubtful debts) Working Notes Provision for doubtful debts @10% of sundry debtors i.e. ` 68,000 – ` 8000 = ` 60,000 ` 10 6000 100 × = ` 6000 1 7.12 Reserves A part of the profit may be set aside and retained in the business to provide for certain future needs like growth and expansion or to meet future contingencies such as workmen compensation. Unlike provisions, reserves are the appropriations of profit to strengthen the financial position of the business. Reserve is not a charge against profit as it is not meant to cover any known liability or expected loss in future. However, retention of profits in the form of reserves reduces the amount of profits available for distribution among the owners of the business. It is shown under the head Reserves and Surpluses on the liabilities side of the balance sheet after capital.Examples of reserves are: • General reserve; • Workmen compensation fund; • Investment fluctuation fund; • Capital reserve; • Dividend equalisation reserve; • Reserve for redemption of debenture. 2022-23 Depreciation, Provisions and Reserves 265 7.12.1 Difference between Reserve and Provision The points of difference between reserve and provision are explained below: 1. Basic nature : A provision is a charge against profit whereas reserve is an appropriation of profit. Hence, net profit cannot be calculated unless all provisions have been debited to profit and loss account, while a reserve is created after the calculation of net profit. 2. Purpose : Provision is made for a known liability or expense pertaining to current accounting period, the amount of which is not certain. On the other hand reserve is created for strengthening the financial position of the business. Some reserves are also mandatory under the law. 3. Presentation in balance sheet: Provision is shown either (i) by way of deduction from the item on the asset side for which it is created, or (ii) on the liabilities side along with current liabilities. On the other hand, reserve is shown on the liabilities side after capital. 4. Effect on taxable profits : Provision is deducted before calculating taxable profits. Hence, it reduces taxable profits. A reserve is created from profit after tax and therefore it has no effect on taxable profit. 5. Element of compulsion : Creation of provision is necessary to ascertain true and fair profit or loss in compliance with 'Prudence' or 'Conservatism' concept. It has to be made even if there are no profits. Whereas creation of a reserve is generally at the discretion of the management. However, in certain cases law has stipulated for the creation of specific reserves such as Debenture Redemption Reserve. Reserve cannot be created unless there are profits. 6. Use for the payment of dividend : Provision cannot be used for distribution as dividends while general reserve can be used for dividend distribution. Basis of Difference Provision Reserve 1. Basic nature Charge against profit. Appropriation of profit. 2. Purpose It is created for a known It is made for strengthening liability or expense pertaining the financial position of to current accounting period, the business.Some reserves the amount of which is not are also mandatory under law. certain. 3. Effect on taxable It reduces taxable profits. It has no effect on taxable profits. profit. 4. Presentations in It is shown either (i) by way It is shown on the liabilities. Balance sheet of deduction from the item on side after capital amount. the asset side for which it is created, or (ii) In the liabilities side along with current liabilities. 2022-23 266 Accountancy 5. Element of Creation of provision is Generally, creation of a Reserve compulsion necessary to ascertain true is at the discretion of the manaand fair profit or loss in gement. Reserve cannot be compliance ‘Prudence’ or created unless there are profits. ‘Conservatism’ concept. However, in certain cases law It must be made even has stipulated for the creation if there are no profits. of specific reserves such as ‘Debenture’ ‘Redemption ’ reserve. 6. Use for the payment It can not be used for It can be used for divided of dividend dividend distribution. distribution. Fig. 7.4 : Showing comparison between provisions and reserves 7.12.2 Types of Reserves A reserve is created by retention of profit of the business can be for either a general or a specific purpose. 1. General reserve : When the purpose for which reserve is created is not specified, it is called General Reserve. It is also termed as free reserve because the management can freely utilise it for any purpose. General reserve strengthens the financial position of the business. 2. Specific reserve : Specific reserve is the reserve, which is created for some specific purpose and can be utilised only for that purpose. Examples of specific reserves are given below : (i) Dividend equalisation reserve: This reserve is created to stabilise or maintain dividend rate. In the year of high profit, amount is transferred to Dividend Equalisation reserve. In the year of low profit, this reserve amount is used to maintain the rate of dividend. (ii) Workmen compensation fund: It is created to provide for claims of the workers due to accident, etc. (iii) Investment fluctuation fund: It is created to make for decline in the value of investment due to market fluctuations. (iv) Debenture redemption reserve: It is created to provide funds for redemption of debentures. Reserves are also classified as revenue and capital reserves according to the nature of the profit out of which they are created. (a) Revenue reserves : Revenue reserves are created from revenue profits which arise out of the normal operating activities of the business and are otherwise freely available for distribution as dividend. Examples of revenue reserves are: • General reserve; • Workmen compensation fund; 2022-23 Depreciation, Provisions and Reserves 267 • Investment fluctuation fund; • Dividend equalisation reserve; • Debenture redemption reserve; (b) Capital reserves: Capital reserves are created out of capital profits which do not arise from the normal operating activities. Such reserves are not available for distribution as dividend. These reserves can be used for writing off capital losses or issue of bonus shares in case of a company. Examples of capital profits, which are treated as capital reserves, whether transferred as such or not, are : • Premium on issue of shares or debenture. • Profit on sale of fixed assets. • Profit on redemption of debentures. • Profit on revaluation of fixed asset & liabilities. • Profits prior to incorporation. • Profit on reissue of forfeited shares 7.12.3 Difference between Revenue and Capital Reserve Revenue reserves and capital reserves are differentiated on the following grounds: 1. Source of creation : Revenue reserve is created out of revenue profits, which arise out of the normal operating activities of the business and are otherwise available for dividend distribution. On the other hand capital reserve is created primarily out of capital profit, which do not arise from the normal operating activities of the business and are not available for distribution as dividend. But revenue profits may also be used for creation of capital reserves. 2. Purpose : Revenue reserve is created to strengthen the financial position, to meet unforeseen contingencies or for some specific purposes. Whereas capital reserve is created for compliance of legal requirements or accounting practices. 3. Usage : A specific revenue reserve can be utilised only for the earmarked purpose while a general reserve can be utilised for any purpose including distribution of dividend. Whereas a capital reserve can be utilised for specific purposes as provided in the law in force, e.g., to write off capital losses or issue of bonus shares. Basis of Difference Revenue Reserve Capital Reserve 1. Source of creation It is created out of revenue It is created primarily out of profits which arise out of capital profit which do not arise normal operating activities out of the normal operating of the business and are activities of the business and not otherwise available for available fordividend distribution. dividend distribution. But revenue profits may also be used for this purpose. 2022-23 268 Accountancy 2. Purpose It is created to strengthen It is created for compliance of the financial position, to legal requirements or accounting meet unforeseen practices. contingencies or for some specific purposes. 3. Usage A specific revenue reserve It can be utilised for specific can be utilised only for the purposes as provided in the law earmarked purpose while a in force e.g., to write off capital general reserve can be losses or issue of bonus shares. utilised for any purpose including distribution of dividend. Fig. 7.5 : Difference between capital reserve and revenue reserve 7.12.4 Importance of Reserves A business firm may consider it proper to set up some mechanism to protect itself from the consequences of unknown expenses and losses, it may be required to bear in future. It may also regard it as more appropriate in certain cases to reduce the amount that can be drawn by the proprietors as profit in order to conserve business resource to meet certain significant demands in future. An example of such a demand is the much needed expansion in the scale of business operations. This is presented as the justification for reserves in business activities and in accounting. The amount so set aside may be meant for the purpose of : • Meeting a future contingency • Strengthening the general financial position of the business; • Redeeming a long-term liability like debentures, etc. 7.13 Secret Reserve Secret reserve is a reserve which does not appear in the balance sheet. It may also help to reduce the disclosed profits and also the tax liability. The secret reserve can be merged with the profits during the lean periods to show improved profits. Management may resort to creation of secret reserve by charging higher depreciation than required. It is termed as 'Secret Reserve', as it is not known to outside stakeholders. Secret reserve can also be created by way of : • Undervaluation of inventories/stock • Charging capital expenditure to profit and loss account • Making excessive provision for doubtful debts • Showing contingent liabilities as actual liabilities Creation of secret reserves within reasonable limits is justifiable on grounds of expediency, prudence and preventing competition from other firms. 2022-23 Depreciation, Provisions and Reserves 269 Test Your Understanding - III I State with reasons whether the following statements are True or False ; (i) Making excessive provision for doubtful debits builds up the secret reserve in the business. (ii) Capital reserves are normally created out of free or distributable profits. (iii) Dividend equalisation reserve is an example of general reserve. (iv) General reserve can be used only for some specific purposes. (v) 'Provision' is a charge against profit. (vi) Reserves are created to meet future expenses or losses the amount of which is not certain. (vii) Creation of reserve reduces taxable profits of the business. II Fill in the correct words : (i) Depreciation is decline in the value of .... (ii) Installation, freight and transport expenses are a part of .... (iii) Provision is a .... against profit. (iv) Reserve created for maintaining a stable rate of dividend is termed as........... Key Terms Introduced in the Chapter • Depreciation, Depreciable cost, original cost, useful life; • Depletion, Obsolescence, Amortisation; • Salvage value/Residual value/Scrap value; • Written down value/Reducing balance value/Diminishing value; • Straight Line/Fixed Installment Method; • Asset Disposal Account; • Accumulated Depreciation/Provision for Depreciation Account, Reserve, Provision, Capital Reserve, Revenue Reserve, General Reserve, Specific Reserve, Secret Reserve, Provision for Doubtful Debts. Summary With Reference to Learning Objectives 1. Meaning of depreciation : Depreciation is decline in the value of a tangible fixed asset. In accounting, depreciation is the process of allocating depreciable cost over useful life of a fixed asset. 2. Depreciation and similar terms : Depreciation term is used in the context of tangible fixed assts. Depletion (in the context of extractive industries), and amortisation (in the context of intangible assets) are other related terms. Factors Affecting Depreciation : • Wear and Tear due to use and/or passage of time • Expiration of Legal Rights • Obsolescence 3. Importance of depreciation : • Depreciation must be charged to ascertain true and fair profit or loss. • Depreciation is a non-cash operating expense. 4. Methods of charging depreciation : Depreciation amount can be calculated using : • Straight line method, or • Written down value method 2022-23 270 Accountancy 5. Factors affecting the amount of depreciation : Depreciation amount is determined by — • Original cost • Salvage value, and • Useful life of the asset 6. Provisions and Reserves : A provision is a charge against profit. It is created for a known current liability the amount of which is uncertain. Reserve on the other hand, is an appropriation of profit. It is created to strengthen the financial position of the business. 7. Types of Reserves : Reserves may be — • General reserve and specific reserve; • Revenue reserve and capital reserve. 8. Secret Reserve : When total depreciation charged is higher than the total depreciable cost, Secret reserve' is created. Secret reserve is not explicitly shown in the balance sheet. Questions for Practice Short Answers 1. What is 'Depreciation'? 2. State briefly the need for providing depreciation. 3. What are the causes of depreciation? 4. Explain basic factors affecting the amount of depreciation. 5. Distinguish between straight line method and written down value method of calculating depreciation. 6. "In case of a long term asset, repair and maintenance expenses are expected to rise in later years than in earlier year". Which method is suitable for charging depreciation if the management does not want to increase burden on profits and loss account on account of depreciation and repair. 7. What are the effects of depreciation on profit and loss account and balance sheet? 8. Distinguish between 'provision' and 'reserve' . 9. Give four examples each of 'provision' and 'reserves'. 10. Distinguish between 'revenue reserve' and 'capital reserve'. 11. Give four examples each of 'revenue reserve' and 'capital reserves'. 12. Distinguish between 'general reserve' and 'specific reserve'. 13. Explain the concept of 'secret reserve'. Long Answers 1. Explain the concept of depreciation. What is the need for charging depreciation and what are the causes of depreciation? 2. Discuss in detail the straight line method and written down value method of depreciation. Distinguish between the two and also give situations where they are useful. 3. Describe in detail two methods of recording depreciation. Also give the necessary journal entries. 2022-23 Depreciation, Provisions and Reserves 271 4. Explain determinants of the amount of depreciation. 5. Name and explain different types of reserves in details. 6. What are 'provisions'. How are they created? Give accounting treatment in case of provision for doubtful Debts. Numerical Problems 1. On April 01, 2010, Bajrang Marbles purchased a Machine for ` 1,80,000 and spent ` 10,000 on its carriage and ` 10,000 on its installation. It is estimated that its working life is 10 years and after 10 years its scrap value will be ` 20,000. (a) Prepare Machine account and Depreciation account for the first four years by providing depreciation on straight line method. Accounts are closed on March 31st every year. (b) Prepare Machine account, Depreciation account and Provision for depreciation account (or accumulated depreciation account) for the first four years by providing depreciation using straight line method accounts are closed on March 31 every year. (Ans:[a] Balance of Machine account on April 1, 2014 `1,28,000. [b] Balance of Provision for depreciation account as on 1.04.2014 `72,000.) 2. On July 01, 2010, Ashok Ltd. Purchased a Machine for ` 1,08,000 and spent ` 12,000 on its installation. At the time of purchase it was estimated that the effective commercial life of the machine will be 12 years and after 12 years its salvage value will be ` 12,000. Prepare machine account and depreciation Account in the books of Ashok Ltd. For first three years, if depreciation is written off according to straight line method. The account are closed on December 31st, every year. (Ans: Balance of Machine account as on 1.01.2013 `97,500). 3. Reliance Ltd. Purchased a second hand machine for ` 56,000 on October 01, 2011 and spent ` 28,000 on its overhaul and installation before putting it to operation. It is expected that the machine can be sold for ` 6,000 at the end of its useful life of 15 years. Moreover an estimated cost of ` 1,000 is expected to be incurred to recover the salvage value of ` 6,000. Prepare machine account and Provision for depreciation account for the first three years charging depreciation by fixed installment Method. Accounts are closed on March 31, every year. (Ans: Balance of provision for depreciation account as on 31.03.15 `18,200). 4. Berlia Ltd. Purchased a second hand machine for ` 56,000 on July 01, 2015 and spent ` 24,000 on its repair and installation and ` 5,000 for its carriage. On September 01, 2016, it purchased another machine for ` 2,50,000 and spent ` 10,000 on its installation. (a) Depreciation is provided on machinery @10% p.a on original cost method annually on December 31. Prepare machinery account and depreciation account from the year 2015 to 2018. (b) Prepare machinery account and depreciation account from the year 2011 to 2018, if depreciation is provided on machinery @10% p.a. on written down value method annually on December 31. (Ans: [a] Balance of Machine account as on 1.01.19 `2,54,583. [b] Balance of Machine account as on 1.01.19 `2,62,448). 2022-23 272 Accountancy 5. Ganga Ltd. purchased a machinery on January 01, 2014 for ` 5,50,000 and spent ` 50,000 on its installation. On September 01, 2014 it purchased another machine for ` 3,70,000. On May 01, 2015 it purchased another machine for ` 8,40,000 (including installation expenses). Depreciation was provided on machinery @10% p.a. on original cost method annually on December 31. Prepare: (a) Machinery account and depreciation account for the years 2014, 2015, 2016 and 2017. (b) If depreciation is accumulated in provision for Depreciation account then prepare machine account and provision for depreciation account for the years 2014, 2015, 2016 and 2017. (Ans: [a] Balance of machine account as on 01.01.15 ` 12,22,666. [b] Balance of provision for dep. account as on 01.01.15 ` 5,87,334). 6. Azad Ltd. purchased furniture on October 01, 2014 for ` 4,50,000. On March 01, 2015 it purchased another furniture for ` 3,00,000. On July 01, 2016 it sold off the first furniture purchased in 2014 for ` 2,25,000. Depreciation is provided at 15% p.a. on written down value method each year. Accounts are closed each year on March 31. Prepare furniture account, and accumulated depreciation account for the years ended on March 31, 2015, March 31, 2016 and March 31, 2017. Also give the above two accounts if furniture disposal account is opened. (Ans. Loss on sale of furniture `1,15,546, Balance of provision for depreciation account as on 31.03.15 ` 85,959.) 7. M/s Lokesh Fabrics purchased a Textile Machine on April 01, 2011 for ` 1,00,000. On July 01, 2012 another machine costing ` 2,50,000 was purchased . The machine purchased on April 01, 2011 was sold for ` 25,000 on October 01, 2015. The company charges depreciation @15% p.a. on straight line method. Prepare machinery account and machinery disposal account for the year ended March 31, 2016. (Ans. Loss on sale of Machine account `7,500. Balance of machine account as on 1.04.15 `1,09,375). 8. The following balances appear in the books of Crystal Ltd, on Jan 01, 2015 ` Machinery account on 15,00,000 Provision for depreciation account 5,50,000 On April 01, 2015 a machinery which was purchased on January 01, 2012 for ` 2,00,000 was sold for ` 75,000. A new machine was purchased on July 01, 2015 for ` 6,00,000. Depreciation is provided on machinery at 20% p.a. on Straight line method and books are closed on December 31 every year. Prepare the machinery account and provision for depreciation account for the year ending December 31, 2015. (Ans. Profit on sale of Machine ` 5,000. Balance of machine account as on 31.12.15 ` 19,00,000. Balance of Provision for depreciation account as on 31.12.15 ` 4,90,000). 9. M/s. Excel Computers has a debit balance of ` 50,000 (original cost ` 1,20,000) in computers account on April 01, 2010. On July 01, 2010 it purchased another computer costing ` 2,50,000. One more computer was 2022-23 Depreciation, Provisions and Reserves 273 purchased on January 01, 2011 for ` 30,000. On April 01, 2014 the computer which has purchased on July 01, 2010 became obselete and was sold for ` 20,000. A new version of the IBM computer was purchased on August 01, 2014 for ` 80,000. Show Computers account in the books of Excel Computers for the years ended on March 31, 2011, 2012, 2013, 2014 and 2015. The computer is depreciated @10 p.a. on straight line method basis. (Ans: Loss on sale of computer ` 1,36,250. Balance of computers account as on 31.03.15 ` 83,917). 10. Carriage Transport Company purchased 5 trucks at the cost of ` 2,00,000 each on April 01, 2011. The company writes off depreciation @ 20% p.a. on original cost and closes its books on December 31, every year. On

October 01, 2013, one of the trucks is involved in an accident and is completely destroyed. Insurance company has agreed to pay ` 70,000 in full settlement of the claim. On the same date the company purchased a second hand truck for ` 1,00,000 and spent ` 20,000 on its overhauling. Prepare truck account and provision for depreciation account for the three years ended on December 31, 2013. Also give truck account if truck disposal account is prepared. (Ans: Loss of settlement of Truck Insurance `30,000. Balance of Provision for depreciation A/c as on 31.12.13 `4,46,000. Balance of Trucks account as on 31.12.13 `9,20,000). 11. Saraswati Ltd. purchased a machinery costing ` 10,00,000 on January 01, 2011. A new machinery was purchased on 01 May, 2012 for ` 15,00,000 and another on July 01, 2014 for ` 12,00,000. A part of the machinery which originally cost ` 2,00,000 in 2011 was sold for ` 75,000 on April 30, 2014. Show the machinery account, provision for depreciation account and machinery disposal account from 2011 to 2015 if depreciation is provided at 10% p.a. on original cost and account are closed on December 31, every year. (Ans: Loss on sale of Machine `58,333. Balance of Provision for dep. A/c as on 31.12.15 ` 11,30,000. Balance of Machine A/c as on 31.12.15 ` 35,00,000). 12. On July 01, 2011 Ashwani purchased a machine for ` 2,00,000 on credit. Installation expenses ` 25,000 are paid by cheque. The estimated life is 5 years and its scrap value after 5 years will be ` 20,000. Depreciation is to be charged on straight line basis. Show the journal entry for the year 2011 and prepare necessary ledger accounts for first three years. (Ans: Balance of Machine A/c as on 31.12.13 `1,22,500). 13. On October 01, 2010, a Truck was purchased for ` 8,00,000 by Laxmi Transport Ltd. Depreciation was provided at 15% p.a. on the diminishing balance basis on this truck. On December 31, 2013 this Truck was sold for ` 5,00,000. Accounts are closed on 31st March every year. Prepare a Truck Account for the four years. (Ans: Profit on Sale of Truck `58,237). 14. Kapil Ltd. purchased a machinery on July 01, 2011 for ` 3,50,000. It purchased two additional machines, on April 01, 2012 costing ` 1,50,000 and on October 01, 2012 costing ` 1,00,000. Depreciation is provided @10% p.a. on straight line basis. On January 01, 2013, first machinery become useless due to technical changes. This machinery was sold for ` 1,00,000. prepare machinery account for 4 years on the basis of calendar year. (Ans: Loss on sale of machine ` 1,97,500. Balance of Machine account as on 31.12.14 ` 1,86,250). 2022-23 274 Accountancy 15. On January 01, 2011, Satkar Transport Ltd., purchased 3 buses for ` 10,00,000 each. On July 01, 2013, one bus was involved in an accident and was completely destroyed and ` 7,00,000 were received from the Insurance Company in full settlement. Depreciation is written off @15% p.a. on diminishing balance method. Prepare bus account from 2011 to 2014. Books are closed on December 31 every year. (Ans: Profit on insurance claim ` 31,687. Balance of Bus account as on 1.01.15 ` 10,44,013). 16. On October 01, 2011 Juneja Transport Company purchased 2 Trucks for ` 10,00,000 each. On July 01, 2013, One Truck was involved in an accident and was completely destroyed and ` 6,00,000 were received from the insurance company in full settlement. On December 31, 2013 another truck was involved in an accident and destroyed partially, which was not insured. It was sold off for ` 1,50,000. On January 31, 2014 company purchased a fresh truck for ` 12,00,000. Depreciation is to be provided at 10% p.a. on the written down value every year. The books are closed every year on March 31. Give the truck account from 2011 to 2014. (Ans: Loss on Ist Truck Insurance claim ` 3,26,250. Loss on IInd Truck ` 7,05,000. Balance of Truck account as on 31.03.14 ` 11,80,000). 17. A Noida based Construction Company owns 5 cranes and the value of this asset in its books on April 01, 2017 is ` 40,00,000. On October 01, 2017 it sold one of its cranes whose value was ` 5,00,000 on April 01, 2017 at a 10% profit. On the same day it purchased 2 cranes for ` 4,50,000 each. Prepare cranes account. It closes the books on December 31 and provides for depreciation on 10% written down value. (Ans: Profit on sale of crane ` 47,500. Balance of Cranes account as on 31.12.17 ` 41,15000). 18. Shri Krishan Manufacturing Company purchased 10 machines for ` 75,000 each on July 01, 2014. On October 01, 2016, one of the machines got destroyed by fire and an insurance claim of ` 45,000 was admitted by the company. On the same date another machine is purchased by the company for ` 1,25,000. The company writes off 15% p.a. depreciation on written down value basis. The company maintains the calendar year as its financial year. Prepare the machinery account from 2014 to 2017. (Ans: Loss on settle of insurance claim ` 7,735. Balance of Machine account as on 31.12.17 ` 4,85,709). 19. On January 01, 2014, a Limited Company purchased machinery for ` 20,00,000. Depreciation is provided @15% p.a. on diminishing balance method. On March 01, 2016, one fourth of machinery was damaged by fire and ` 40,000 were received from the insurance company in full settlement. On September 01, 2016 another machinery was purchased by the company for `15,00,000. Write up the machinery account from 2010 to 2013. Books are closed on December 31, every year. (Ans: Loss on settle of insurance claim ` 3,12,219. Balance of Machine account as on 31.12.17 ` 19,94,260). 2022-23 Depreciation, Provisions and Reserves 275 20. A Plant was purchased on 1st July, 2015 at a cost of ` 3,00,000 and ` 50,000 were spent on its installation. The depreciation is written off at 15% p.a. on the straight line method. The plant was sold for ` 1,50,000 on October 01, 2017 and on the same date a new Plant was installed at the cost of ` 4,00,000 including purchasing value. The accounts are closed on December 31 every year. Show the machinery account and provision for depreciation account for 3 years. (Ans: Loss on sale of Plant ` 81,875. Balance of Machine account as on 31.12.17 ` 4,00,000. Balance of Provision for Depreciation account as on 31.12.17 ` 15,000.). 21. An extract of Trial balance from the books of Tahiliani and Sons Enterprises on March 31, 2017 is given below: Name of the Account Debit Amount Credit Amount ` ` Sundry debtors. 50,000 Bad debts 6,000 Provision for doubtful debts 4,000 Additional Information: • Bad Debts proved bad but not recorded amounted to ` 2,000. • Provision is to be maintained at 8% of Debtors. Give necessary accounting entries for writing off the bad debts and creating the provision for doubtful debts account. Also show the necessary accounts. (Ans: New provision for Bad debts ` 3,840, profit and loss account [Dr.] ` 7,840.) 22. The following information are extract from the Trial Balance of M/s Nisha traders on 31 March 2017. Sundry Debtors 80,500 Bad debts 1,000 Provision for bad debts 5,000 Additional Information Bad Debts ` 500 Provision is to be maintained at 2% of Debtors. Prepare bad debts accound, Provision for bad debts account and profit and loss account. (Ans: New provision ` 1,600 Profit and loss account [Cr.] ` 1,900). Checklist to Test Your Understanding Test Your Understanding - I 1. T, 2. F, 3. F, 4. T, 5. T, 6. F, 7. T, 8. F, 9. F, 10. F, Test Your Understanding - II Depreciation for 1 year (2014-15) = ` 7500 (Charged for 9 months) 2022-23 276 Accountancy Depreciation for 2 year (2015-16) = ` 1,00,000 – ` 7500 = ` 92,500 = ` 10 92500 100 × = ` 9250 Depreciation for 3 year (2016-17) = ` 92500 – 9250 = ` 83050 = ` 10 83050 100 × = ` 8305 Test Your Understanding - III 1. (i) True (ii) False (iii) False (iv) False (v) True (vi) False (vii) False 2. (i) Assets (ii) Acquisition cost (iii) Charge (iv) Dividend equilisation fund. 2022-23G oods can be sold or bought for cash or on credit. When goods are sold or bought for cash, payment is received immediately. On the other hand, when goods are sold/bought on credit the payment is deferred to a future date. In such a situation, normally the firm relies on the party to make payment on the due date. But in some cases, to avoid any possibility of delay or default, an instrument of credit is used through which the buyer assures the seller that the payment shall be made according to the agreed conditions. In India, instruments of credit have been in use since time immemorial and are popularly known as Hundies. The hundies are written in Indian languages and have a large variety (refer box1). Box 1 Hundies and its Types There are a variety of hundies used in our country. Let us discuss some of the most common ones. Shahjog Hundi: This is drawn by one merchant on another, asking the latter to pay the amount to a Shah. Shah is a respectable and responsible person, a man of worth and known in the bazaar. A shah-jog hundi passes from one hand to another till it reaches a shah, who, after reasonable enquiries, presents it to the drawee for acceptance of the payment. Darshani Hundi: This is hundi payable at sight. It must be presented for payment within a reasonable time after its receipt by the holder. It is similar to a demand bill. LEARNING OBJECTIVES After studying this chapter, you will be able to : • state the meaning of bill of exchange and a promissory note; • distinguish between a bill of exchange and a promissory note; • state the advantages of bill of exchange; • explain the meaning of different terms involved in the bill transaction, • record bill of exchange transactions in journal; • record transactions relating to dishonour, retirement and renewal of bill; • describe the uses of bill receivable and bill payable book; • state the meaning and use of accommodation bill. Bill of Exchange 8 2022-23 278 Accountancy Muddati Hundi: A muddati or miadi hundi is payable after a specified period of time. This is similar to a time bill. There are few other varieties of hundies like Nam-jog hundi, Dhani-jog hundi, Jawabee hundi, Hokhami hundi, Firman-jog hundi, and so on. Now a days these instruments of credit are called bills of exchange or promissory notes. The bill of exchange contains an unconditional order to pay a certain amount on an agreed date while the promissory note contains an unconditional promise to pay a certain sum of money on a certain date. In India these instruments are governed by the Indian Negotiable Instruments Act 1881. 8.1 Meaning of Bill of Exchange According to the Negotiable Instruments Act 1881, a bill of exchange is defined as an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument. The following features of a bill of exchange emerge out of this definition. • A bill of exchange must be in writing. • It is an order to make payment. • The order to make payment is unconditional. • The maker of the bill of exchange must sign it. • The payment to be made must be certain. • The date on which payment is made must also be certain. • The bill of exchange must be payable to a certain person. • The amount mentioned in the bill of exchange is payable either on demand or on the expiry of a fixed period of time. • It must be stamped as per the requirement of law. A bill of exchange is generally drawn by the creditor upon his debtor. It has to be accepted by the drawee (debtor) or someone on his behalf. It is just a draft till its acceptance is made. For example, Amit sold goods to Rohit on credit for ` 10,000 for three months. To ensure payment on due date Amit draws a bill of exchange upon Rohit for ` 10,000 payable after three months. Before it is accepted by Rohit it will be called a draft. It will become a bill of exchange only when Rohit writes the word “accepted” on it and append his signature thereto communicate his acceptance. 2022-23 Bill of Exchange 279 8.1.1 Parties to a Bill of Exchange There are three parties to a bill of exchange: (1) Drawer is the maker of the bill of exchange. A seller/creditor who is entitled to receive money from the debtor can draw a bill of exchange upon the buyer/debtor. The drawer after writing the bill of exchange has to sign it as maker of the bill of exchange. (2) Drawee is the person upon whom the bill of exchange is drawn. Drawee is the purchaser or debtor of the goods upon whom the bill of exchange is drawn. (3) Payee is the person to whom the payment is to be made. The drawer of the bill himself will be the payee if he keeps the bill with him till the date of its payment. The payee may change in the following situations: (a) In case the drawer has got the bill discounted, the person who has discounted the bill will become the payee; (b) In case the bill is endorsed in favour of a creditor of the drawer, the creditor will become the payee. Normally, the drawer and the payee is the same person. Similarly, the drawee and the acceptor is normally the person. For example, Mamta sold goods worth `10,000 to Jyoti and drew a bill of exchange upon her for the same amount payable after three months. Here, Mamta is the drawer of the bill and Jyoti is the drawee. If the bill is retained by Mamta for three months and the amount of ` 10,000 is received by her on the due date then Mamta will be the payee. If Mamtagives away this bill to her creditor Ruchi, then Ruchi will be the payee. If Mamta gets this bill discounted from the bank then the bankers will become the payee. In the above mentioned bill of exchange, Mamta is the drawer and Jyoti is the drawee. Since Jyoti has accepted the bill, she is the acceptor. Suppose in place of Jyoti the bill is accepted by Ashok then Ashok will become the acceptor. Test Your Understanding - I Write ‘True’ or ‘False’ against each statement regarding a bill of exchange: (i) A bill of exchange must be accepted by the payee. (ii) A bill of exchange is drawn by the creditor. (iii) A bill of exchange is drawn for all cash transaction. (iv) A bill payable on demand is called Time bill; (v) The person to whom payment is to be made in a bill or exchange is called payee. (vi) A negotiable instrument does not require the signature of its maker. (vii) The hundi Payable at sight is called Darshani hundi. (viii) A negotiable instrument is not freely transferable. (ix) Stamping of promissory note is not mandatory. (x) The time of payment of a negotiable instrument need not be certain. 2022-23 280 Accountancy 8.2 Promissory Note According to the Negotiable Instruments Act 1881, a promissory note is defined as an instrument in writing (not being a bank note or a currency note), containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to or to the order of a certain person, or to the bearer of the instrument. However, according to the Reserve Bank of India Act, a promissory note payable to bearer is illegal. Therefore, a promissory note cannot be made payable to the bearer. This definition suggests that when a person gives a promise in writing to pay a certain sum of money unconditionally to a certain person or according to his order the document is called is a promissory note. Following features of a promissory note emerge out of the above definition: • It must be in writing • It must contain an unconditional promise to pay. • The sum payable must be certain. • It must be signed by the maker. • The maker must sign it. • It must be payable to a certain person. • It should be properly stamped. A promissory note does not require any acceptance because the maker of the promissory note himself promises to make the payment. 8.2.1 Parties to a Promissory Note There are two parties to a promissory note. • Maker or Drawer is the person who makes or draws the promissory note to pay a certain amount as specified in the promissory note. He is also called the promisor. • Drawee or Payee is the person in whose favour the promissory note is drawn. He is called the promisee. Generally, the drawee is also the payee, unless, it is otherwise mentioned in the promissory note. In the specimen of promissory note(refer figure 8.2), Ashok Kumar is the drawer or maker who promises to pay `30,000 and Harish Chander is the drawee or payee to whom payment is to made. If Harish Chander endorses this promissory note in favour of Rohit then Rohit will become the payee. Similarly, if Harish Chander gets this promissory note discounted from the bank then the bank will become the payee. 2022-23 Bill of Exchange 281 Box 2 Distinction between a Bill of Exchange and Promissory Note Both a bill of exchange and a promissory note are instruments of credit and are similar in many ways. However, there are certain basic differences between the two. S.No. Basis Bill of Exchange Promissory Note 1. Drawer It is drawn by the creditor It is drawn by the debtor 2. Order or Promise It contains an order to make It contains a promise to make and Parties payment. There can be three payment. There are only two parties to it, viz. the drawer, parties to it, viz. the drawer the drawee and the payee. and the payee. 3. Acceptance It requires acceptance by the It does not require any drawee or someone else on his acceptance. behalf. 4. Payee Drawer and payee can be the Drawer cannot be the payee same party. of it. 5. Notice In case of its dishonour due No notice needs to be givenin notice of dishonour is to be case of its dishonour. given by the holder to the drawer Fig. 8.1 Distinction between bills of exchange and promissory note 8.3 Advantages of Bill of Exchange The bills of exchange as instruments of credit are used frequently in business because of the following advantages: • Framework for relationships: A bill of exchange represents a device, which provides a framework for enabling the credit transaction between the seller/ creditor and buyer/debtor on an agreed basis. • Certainty of terms and conditions: The creditor knows the time when he would receive the money so also debtor is fully aware of the date by which he has to pay the money. This is due to the fact that terms and conditions of the relationships between debtor and creditor such as amount required to be paid; date of payment; interest to be paid, if any, place of payment are clearly mentioned in the bill of exchange. • Convenient means of credit: A bill of exchange enables the buyer to buy the goods on credit and pay after the period of credit. However, the seller of goods even after extension of credit can get payment immediately either by discounting the bill with the bank or by endorsing it in favour of a third party. 2022-23 282 Accountancy • Conclusive proof: The bill of exchange is a legal evidence of a credit transaction implying thereby that during the course of trade buyer has obtained credit from the seller of the goods, therefore, he is liable to pay to the seller. In the event of refusal of making the payment, the law requires the creditor to obtain a certificate from the Notary to make it a conclusive evidence of the happening. • Easy transferability: A debt can be settled by transferring a bill of exchange through endorsement and delivery. 8.4 Maturity of Bill The term maturity refers the date on which a bill of exchange or a promissory note becomes due for payment. In arriving at the maturity date three days, known as days of grace, must be added to the date on which the period of credit expires instrument is payable. Thus, if a bill dated March 05 is payable 30 days after date it, falls due on April 07, i.e., 33 days after March 05 If it were payable one month after date, the due date would be April 08, i.e., one month and 3 days after March 05. However, where the date of maturity is a public holiday, the instrument will become due on the preceding business day. In this case if April 08, falls on a public holiday then the April 07 will be the maturity date. But when an emergent holiday is declared under the Negotiable Instruments Act 1881, by the Government of India which may happen to be the date of maturity of a bill of exchange, then the date of maturity will be the next working day immediately after the holiday. For example, the Government declared a holiday on April 08 which happened to be the day on which a bill of exchange drawn by Gupta upon Verma for `20,000 became due for payment, Since April 08, has been declared a holiday under the Negotiable Instruments Act, therefore, April 09, will be the date of maturity for this bill. 8.5 Discounting of Bill If the holder of the bill needs funds, he can approach the bank for encashment of the bill before the due date. The bank shall makes the payment of the bill after deducting some interest (called discount in this case). This process of encashing the bill with the bank is called discounting the bill. The bank gets the amount from the drawee on the due date. 8.6 Endorsement of Bill Any holder may transfer a bill unless its transfer is restricted, i.e., the bill has been negotiated containing words prohibiting its transfer. The bill can be initially 2022-23 Bill of Exchange 283 endorsed by the drawer by putting his signatures at the back of the bill along with the name of the party to whom it is being transferred. The act of signing and transferring the bill is called endorsement. 8.7 Accounting Treatment For the person who draws the bill of exchange and gets it back after its due acceptance, it is a bill receivable. For the person who accepts the bill, it is a bills payable. In case of a promissory note for the maker it is a bills payable and for the person in whose favour the promissory note is drawn it is a bills receivable. Bills receivables are assets and Bills payable are liabilities. Bills and Notes are used interchangeably. 8.7.1 In the Books of Drawer/Promissor A bill receivable can be treated in the following four ways by its receiver. 1. He can retain it till the date of maturity, and (a) get it collected on date of maturity directly, or (b) get it collected through the banker. 2. He can get the bill discounted from the bank. 3. He can endorse the bill in favour of his Creditor. The accounting treatment in the books of receiver under all the four alternatives is given below under the assumption that the bill is duly honoured on maturity by the acceptor. (1) When the bill of exchange is retained by the receiver with him till date of its maturity: On receiving the bill Bills Receivable A/c Dr. To Debtors A/c On maturity of the bill Cash/Bank A/c Dr. To Bills Receivable A/c However, when the bill of exchange is retained by the receiver with him and sent to bank for collection a few days before maturity, the following two entries are recorded: On sending the bill for collection Bills Sent for Collection A/c Dr. To Bills Receivable A/c 2022-23 284 Accountancy On receiving the advice from the bank that the bill has been collected Bank A/c Dr. To Bills Sent for Collection A/c (2) When the receiver gets the bill discounted from the bank: On receiving the bill Bills Receivable A/c Dr. To Debtors A/c On discounting the bill Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c On Maturity No entry is recorded because the bill becomes the property of the bank, therefore, the bank collects the amount of the bill from the acceptor and no journal entry is recorded in the books of the drawer. (3) When the bill is endorsed by the receiver in favour of his creditor: On receiving the bill Bills Receivable A/c Dr. To Debtor's A/c On endorsing the bill Creditor's A/c Dr. To Bills Receivable A/c On Maturity No entry is recorded because the bill has been transferred in favour of the creditor, therefore the creditor becomes its owner and will receive the payment on maturity. Hence, no entry is recorded in the books of drawer or endorser. 8.7.2 In the Books of Acceptor/Promissor The following journal entries are recorded in the books of the acceptor or promisesor under all the four alternatives. It makes no difference whether the bill is retained discounted, endorsed or pledged. On accepting the bill Creditor's A/c Dr. To Bills Payable A/c On Maturity of the bill Bills Payable A/c Dr. To Bank A/c 2022-23 Bill of Exchange 285 Box 3 1. When the drawer retains the bill with him till the date of its maturity and gets the same collected directly Transaction Books of Creditor/Drawer Books of Debtor/ Acceptor Sale/Purchase of goods Debtor's A/c Dr. Purchases A/c Dr. To Sales A/c To Creditor's A/c Receiving/Accepting the bill Bills Receivable A/c Dr. Creditor's A/c Dr. To Debtor's A/c To Bills Payable A/c Collection of the bill Cash/Bank A/c Dr. Bills Payable A/c Dr. To Bills Receivable A/c To Cash/Bank A/c 2. When the bill is retained by the drawer with him and sent to bank for collection a few days before maturity Transaction Books of Creditor/Drawer Books of Debtor/ Acceptor Sale/Purchase of goods Debtor's A/c Dr. Purchases A/c Dr. To Sales A/c To Creditor's A/c Receiving /Accepting the bill Bills Receivable A/c Dr. Creditor's A/c Dr. To Debtor's A/c To Bills Payable A/c Sending the bill for collection Bills sent for collection A/c Dr. No entry To Bill Receivable A/c On Receiving from the bank Bank A/c Dr. Bills Payable A/c Dr. advice that the bill has been To Bill Sent for To Bank A/c collected Collection A/c 3. When the drawer gets the bill discounted from the bank Transaction Books of Creditor/Drawer Books of Debtor/ Acceptor Sale/Purchase of goods Debtor's A/c Dr. Purchases A/c Dr. To Sales A/c To Creditor's A/c Receiving /Accepting the bill Bills Receivable A/c Dr. Creditor's A/c Dr. To Debtor's A/c To Bills payable A/c Discounting the bill Bank A/c Dr. No entry Discount A/c Dr. To Bills Receivable A/c On maturity of the bill No entry Bills payable A/c Dr. To Bank A/c 2022-23 286 Accountancy 4. When the bill is endorsed by the drawer in favour of his creditor Transaction Books of Creditor/Drawer Books of Debtor/ Acceptor Sale/Purchase of goods Debtor's A/c Dr. Purchase A/c Dr. To Sales A/c To Creditor's A/c Receiving /Accepting the bill Bills Receivable A/c Dr. Creditor's A/c Dr. To Debtor's A/c To Bills payable A/c Endorsing the bill Creditor's A/c Dr. No entry To Bills Receivable A/c On maturity of the bill No entry Bills payable A/c Dr. To Bank A/c The journal entries to be recoded in the books of the drawer and the acceptor under all the four cases have been summarised below. Illustration 1 Amit sold goods for `20,000 to Sumit on credit on Jan 01, 2017. Amit drew a bill of exchange upon Sumit for the same amount for three months. Sumit accepted the bill and returned it to Amit. Sumit met his acceptance on maturity. Record the necessary journal entries under the following circumstances: (i) Amit retained the bill till the date of its maturity and collected directly (ii) Amit discounted the bill @ 12% p.a from his bank (iii) Amit endorsed the bill to his creditor Ankit (iv) Amit retained the bill and on March 31, 2017 Amit sent the bill for collection to its bank. On April 05, 2017 bank advice was received. Solution Books of Amit Journal (i) When the bill was retained till its maturity. Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan 01 Sumit's A/c Dr. 20,000 To Sales A/c 20,000 (Sold goods to Sumit's on credit) Jan 01 Bills Receivable A/c Dr. 20,000 To Sumit's A/c 20,000 (Received Sumit's acceptance payable after three months) 2022-23 Bill of Exchange 287 Apr.05 Bank A/c Dr. 20,000 To Bills Receivable A/c 20,000 (Sumit met his acceptance on maturity) (ii) When the bill was discounted from the book. Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan 01 Sumit's A/c Dr. 20,000 To Sales A/c 20,000 (Sold goods to Sumit's) Jan 01 Bills Receivable A/c Dr. 20,000 To Sumit's A/c 20,000 (Received Sumit's acceptance three months) Jan 01 Bank A/c Dr. 19,400 Discount A/c Dr. 600 To Bills Receivable A/c 20,000 (Sumit's acceptance discounted with the bank) (iii) When Amit endorsed the bill in favour of his creditor Ankit. Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan. 01 Sumit's A/c Dr. 20,000 To Sales A/c 20,000 (Sold goods to Sumit's on credit) Jan. 01 Bills Receivable A/c Dr. 20,000 To Sumit's A/c 20,000 (Received Sumit's acceptance for three months) Jan. 01 Ankit's A/c Dr. 20,000 To Bills Receivable A/c 20,000 (Sumit acceptance endorsed in favour of Ankit) 2022-23 288 Accountancy (iv) When the bill was sent for collection by Amit to the bank. Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan.

01 Sumit’s A/c Dr. 20,000 To Sales A/c 20,000 (Sold goods to Sumit’s on credit) Jan. 01 Bills Receivable A/c Dr. 20,000 To Sumit’s A/c 20,000 (Received Sumit’s acceptance payable after three months) Mar. 31 Bills Sent for Collection A/c Dr. 20,000 To Bills Receivable A/c 20,000 (Bills sent for collection) Apr. 05 Bank A/c Dr. 20,000 To Bills sent for collection A/c 20,000 (Bills sent for collection collected by the bank) The following journal entries will be made in the books of Sumit under all the four circumstances: In the books of Sumit Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan. 01 Purchases A/c Dr. 20,000 To Amit’s A/c 20,000 (Purchases goods from Amit on credit) Jan. 01 Amit’s A/c Dr. 20,000 To Bill’s Payable A/c 20,000 (Accepted bill drawn by Amit payable after three months) Apr. 04 Bills payable A/c Dr. 20,000 To Bank A/c 20,000 (Met acceptance maturity) 2022-23 Bill of Exchange 289 Illustration 2 On March 15, 2017 Ramesh sold goods for ` 8,000 to Deepak on credit. Deepak accepted a bill of exchange drawn upon him by Ramesh payable after three months. On April, 15 Ramesh endorsed the bill in favour of his creditor Poonam in full settlement of her debt of ` 8,250. On May 15, Poonam discounted the bill with her bank @ 12% p.a. On the due date Deepak met the bill. Record the necessary journal entries in the books of Ramesh, Deepak, Poonam. Books of Ramesh Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Mar.15 Deepak A/c Dr. 8,000 To Sales A/c 8,000 (Sold goods to Deepak on credit) Mar.15 Bills Receivable A/c Dr. 8,000 To Deepak A/c 8,000 (Received Deepak’s acceptance for three months) Apr.15 Poonam’s A/c Dr. 8,250 To Bills Receivable A/c 8,000 To Discount Received A/c 250 (Bill endorsed in favour of Poonam in full settlement of her debt of ` 8,250) Book of Deepak Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Mar.05 Purchases A/c Dr. 8,000 To Ramesh A/c 8,000 (Sold goods to Deepak on credit) Mar.05 Ramesh’s A/c Dr. 8,000 To Bills Payable A/c 8,000 (Accepted Ramesh’s draft payable after three months) Jun.18 Bills Payable A/c Dr. 8,000 To Bank A/c 8,000 (Met the acceptance in favour of Ramesh on maturity) 2022-23 290 Accountancy Books of Poonam Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Mar.15 Bills Receivable A/c Dr. 8,000 Discount Allowed A/c Dr. 250 To Ramesh’s A/c 8,250 (Ramesh endorsed Deepak’s acceptance in our favour for discharge his dept of ` 8,250 in full settlement) Mar.15 Bank A/c Dr. 7,920 Discount Allowed A/c Dr. 80 To Bills Receivable A/c 8,000 (Biils receivable encashed on maturity) 8.8 Dishonour of a Bill A bill is said to have been dishonoured when the drawee fails to make the payment on the date of maturity. In this situation, liability of the acceptor is restored. Therefore, the entries made on the receipt of the bill should be reversed. For example, Anju received bill of exchange duly accepted by Manju, which was dishonoured. The entries of dishonour will be as follows in the books of Anju (receiver): When the bill was kept by Anju with her till maturity Manju’s A/c Dr. To Bill Receivables A/c When the bill had been endorsed by Anju in favour of Sandhya Manju’s A/c Dr. To Sandhaya’s A/c When the bill was discounted by Anju with his bank Manju’s A/c Dr. To Bank A/c When the bill was sent for collection by Anju Manju’s A/c Dr. To Bill Sent for Collection A/c Illustration 3 On Jan 01, 2017 Shieba sold goods to Vishal for ` 10,000 and drew upon him a bill of exchange for 2 months. Vishal accepted the bill and returned it to Shieba. On the date of maturity the bill was dishonoured by Vishal. Record the necessary entries in all the cases listed below in the books of Shieba and Vishal: 2022-23 Bill of Exchange 291 (i) When the bill kept by Shieba till its maturity; (ii) When the bill is discounted by Shieba for ` 200; (iii) When the bill is endorsed to Lal Chand by Shieba. Solution (i) When the bill was kept by Shieba till its maturity. Books of Shieba Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan.01 Vishal’s A/c Dr. 10,000 To Sales A/c 10,000 (Sold goods to Vishal) Jan. 01 Bills Receivable A/c Dr. 10,000 To Vishal’s A/c 10,000 (Received Vishal’s acceptance) Mar. 04 Vishal’s A/c Dr. 10,000 To Bills Receivable A/c 10,000 (Vishal dishonoured his acceptance) (ii) When the bill was discounted by shieba Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan.01 Vishal’s A/c Dr. 10,000 To Sales A/c 10,000 (Sold goods to Vishal) Jan. 01 Bills Receivable A/c Dr. 10,000 To Vishal’s A/c 10,000 (Received Vishal’s acceptance) Jan. 01 Bank A/c Dr. 9,800 Discount A/c Dr. 200 To Bills Receivable A/c 10,000 (Vishal’s Bill

dishonoured his acceptance) Mar.04 Vishal's A/c Dr. 10,000 To Bank A/c 10,000 (Discounted bill dishonoured by Vishal) 2022-23 292 Accountancy (iii) When the bill was endorsed by Shieba to Lal Chand Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan.01 Vishal's A/c Dr. 10,000 To Sales A/c 10,000 (Sold goods to Vishal) Jan. 01 Bills Receivable A/c Dr. 10,000 To Vishal's A/c 10,000 (Received Vishal's acceptance) Jan. 01 Lal Chand A/c Dr. 10,000 To Bills Receivable A/c 10,000 (Vishal's acceptance endorsed in favour of Lal Chand) Mar.04 Vishal's A/c Dr. 10,000 To Lal Chand A/c 10,000 (Endorsed bill dishonoured by Vishal) Whereas, in the book of Vishal, the following entries will be recorded Books of Vishal Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan.01 Purchases A/c Dr. 10,000 To Shieba's A/c 10,000 (Purchased good from shieba) Jan. 01 Shieba's A/c Dr. 10,000 To Bills Payable A/c 10,000 (Accepted Shieba's draft) Mar. 04 Bills Payable A/c Dr. 10,000 To Shieba's A/c 10,000 (Acceptance in favour of shieba dishonoured) 8.8.1 Noting Charges A bill of exchange should be duly presented for payment on the date of its maturity. The drawee is absolved of his liability if the bill is not duly presented. 2022-23 Bill of Exchange 293 Proper presentation of the bill means that it should be presented on the date of maturity to the acceptor during business working hours. To establish beyond doubt that the bill was dishonoured, despite its due presentation, it may preferably to be got noted by Notary Public. Noting authenticates the fact of dishonour. For providing this service, a fees is charged by the Notary Public which is called Noting Charges. The following facts are generally noted by the Notary: • Date, fact and reasons of dishonour; • If the bill is not expressly dishonoured, the reasons why he treats it as dishonoured and; • The amount of noting charges. The entries recorded for noting charges in the drawers book are as follows: When Drawer himself pays Drawee's A/c Dr. To Cash A/c Where endorsee pays Drawee's A/c Dr. To Endorsee A/c When the bank pays on discounted bill Drawee's A/c Dr. To Bank A/c When the bank pays in the event of sending the bill for collection to the bank Drawee's A/c Dr. To Bank A/c It may be noticed that whosoever pays the noting charges, ultimately these have to be borne by the drawee. That is why the drawee is invariably debited in the drawer's books. This is because he is responsible for the dishonour of the bill and, hence, he has to bear these expenses. For recording the noting charges in his book the drawee opens Noting Charges Acccount. He debits the Noting Charges Account and credits the Drawer's Account. For example, Azad sold goods for ` 15,000 to Bunty and immediately drew a bill upon him on Jan. 01, 2017 payable after 3 months. On maturity the bill was dishonoured and ` 50 were paid by the holder of the bill as noting charges. The journal entries will be recorded in the books of Azad and Bunty as given below under the following circumstances: (a) When the bill was kept by Azad till maturity. (b) When the bill was discounted by Azad with his bank immediately @ 12% p.a. (c) When the bill was endorsed by Azad in favour of his creditor Chitra. In the books of Azad, entries will be recorded as: 2022-23 294 Accountancy (i) When the bill was retained till its maturity Books of Azad Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan.01 Bunty's A/c Dr. 15,000 To Sales A/c 15,000 (Sold goods to Bunty) Jan. 01 Bills Receivable A/c Dr. 15,000 To Bunty's A/c 15,000 (Received Bunty's acceptance) Apr. 04 Bunty's A/c Dr. 15,050 To Bills Receivable A/c Dr. 15,000 To Cash A/c 50 (Bunty dishonoured his acceptance and paid ` 50 as noting charges) (ii) When the bill was discounted with the bank. Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan.01 Bunty's A/c Dr. 15,000 To Sales A/c 15,000 (Sold goods to Bunty) Jan. 01 Bills Receivable A/c Dr. 15,000 To Bunty's A/c 15,000 (Received Bunty's acceptance payable after three months) Jan. 01 Bank A/c Dr. 14,550 Discount A/c Dr. 450 To Bills Receivable A/c 15,000 (Bunty's acceptance discounted) Apr. 04 Bunty's A/c Dr. 15,050 To Bank A/c 15,050 (Bunty dishonoured his acceptance on maturity and bank paid noting charges) 2022-23 Bill of Exchange 295 (iii) When the bill was endorsed to Chitra Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan. 01 Bunty's A/c Dr. 15,000 To Sales A/c 15,000 (Sold goods to Bunty) Jan.01 Bill's Receivable A/c Dr. 15,000 To Bunty's A/c 15,000 (Received Bunty's acceptance) Jan. 01 Chitra's A/c Dr. 15,000 To Bills Receivable A/c 15,000 (Bunty's acceptance endorsed in favour of Chitra) Apr. 04

Bunty’s A/c Dr. 15,050 To Chitra’s A/c 15,050 (Bunty dishonoured his acceptance on maturity and chitra paid ` 50 as noting charges) The following journal entries will be made in the books of Bunty in all the three cases. Book of Bunty Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan.01 Purchases A/c Dr. 15,000 To Azad’s A/c 15,000 (Purchase goods from Azad) Jan. 01 Azad’s A/c Dr. 15,000 To Bills Payable A/c 15,000 (Accepted Azad’s draft) Apr. 04 Bills Payable A/c Dr. 15,000 Noting charges A/c Dr. 50 To Azad’s A/c 15,050 (Acceptance in favour of Azed dishonoured) 2022-23 296 Accountancy 8.9 Renewal of the Bill Sometimes, the acceptor of the bill foresees that it may be difficult to meet the obligation of the bill on maturity and may, therefore, approach the drawer with the request for extension of time for payment. If it is so, the old bill is cancelled and the fresh bill with new terms of payment is drawn and duly accepted and delivered. This is called renewal of the bill. Since the cancellation of bill is mutually agreed upon noting of the bill is not required. The dreawee may have to pay interest to the drawer for the extended period of credit. The interest is paid in cash or may be included in the amount of the new bill. Sometimes, a part of the amount due may be paid and the new bill may be drawn only for the balance. For example, a bill of ` 10,000 is cancelled on a cash payment of ` 3,000 and acceptance of a new bill for the balance of ` 7,000 plus interest as agreed between the parties. The journal entries in the books of the drawer and the drawee will be the same as that of dishonour of bill. As for the interest invalued, if it is not paid in cash, the drawer debits the drawee’s account and credits the interest account, and the drawee debits the interest and credits the drawer’s account in his books. The journal entries recorded in case of renewal for the cancellation of the old bill, for interest and for the acceptance of the new bill in the books of the drawer and drawee are given below: Transaction Books of Drawer Books of Drawee Cancellation of old bill Drawee’s A/c Dr. Bills Payable A/c Dr. To Bills Receivable A/c To Drawer’s A/c Interest Drawee’s A/c Dr. Interest A/c Dr. To Interest A/c To Drawer’s A/c New bill Bill Receivable A/c Dr. Drawer’s A/c Dr. To Drawee’s A/c To Bills Payable A/c For example on February 01, 2017 Ravi sold goods to Mohan for `18,000; ` 3,000 were paid by Mohan immediately and for the balance he accepted three months bill drawn upon him by Ravi. On the date of maturity of the bill Mohan requested Ravi to cancel the old bill and a new bill upon him for a period of 2 months. He further agreed to pay interest in cash to Ravi @ 12% p.a. Ravi agreed to Mohan’s request and cancelled the old bill and drew a new bill. The new bill was met on maturity by Mohan. In this case, the following entries will be recorded in the books of Ravi and Mohan. 2022-23 Bill of Exchange 297 Books of Ravi Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Feb. 01 Mohan’s A/c Dr. 18,000 To Sales A/c 18,000 (Sold goods to Mohan) Feb. 01 Cash A/c Dr. 3,000 Bills Receivable A/c Dr. 15,000 To Mohan’s A/c 18,000 (Received ` 3,000 in cash from Ravi and an acceptance for the balance) May 01 Mohan’s Account Dr. 15,300 To Bills Receivable A/c 15,000 To Interest A/c 300 (Cancelled old bill on renewal ` 300 as interest) May 04 Bill’s Receivable A/c Dr. 15,000 Cash A/c Dr. 300 To Mohan’s A/c 15,300 (Received new acceptance from Mohan) Jul. 07 Bank A/c Dr. 15,000 To Bills Receivable A/c 15,000 (Mohan met his new acceptance) Book of Mohan Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Feb. 01 Purchases A/c Dr. 18,000 To Ravi A/c 18,000 (Purchased goods from Ravi) Feb.01 Ravi’s A/c Dr. 18,000 To Cash’s A/c 3,000 Bills Payable A/c 15,000 (Received cash from Ravi and his acceptance) May 04 Bill Payable A/c Dr. 15,000 Interest A/c Dr. 300 To Ravi A/c 15,300 (Old bill cancelled on renewal, ` 300 charged as interest) 2022-23 298 Accountancy May 04 Ravi’s A/c Dr. 15,300 To Bills Payable A/c 15,000 To Cash A/c 300 (Accepted new bill and paid cash for interest) Jul. 07 Bill Payable A/c Dr. 15,000 Bank A/c 15,000 (Met acceptance of the new bill on maturity) 8.10 Retiring of the Bill There are instances when a bill of exchange is arranged to be retired before the due date by mutual understanding between the drawer and the drawee. This happens when the drawee of the bill has funds at his disposal and makes a request to the drawer or holder to accept the payment of the bill before its maturity. If the holder agrees to do so, the bill is said to have been retired. The retiring of a bill draws a curtain on the bill transactions before the expiry of its normal term. To encourage the retirement of the bill, the holder allows some discount called Rebate on bills for the period between date of retirement and maturity. The rebate is calculated at a certain rate of interest. The accounting treatment on the retirement of a bill is similar to the accounting treatment when a bill is honoured by the acceptor on the due date in the ordinary course. The only difference between the two relates to the granting of rebate. The following journal entries are recorded: In the books of the holder On retiring the acceptance and rebate allowed Cash A/c Dr. Rebate on bills A/c Dr. To Bills Receivables A/c In the books of the drawee Bills Payable A/c Dr. Cash A/c Dr. To Rebate on Bills A/c Amit sold goods ` 10,000 to Babli on Jan. 01, 2015 and immediately drew a bill on Babli for three month for the same amount, Babli accepted the bill and returned it to Amit. On March 04, 2017 Babli retired her acceptance under rebate of 6% per annum. 2022-23 Bill of Exchange 299 In the books of Amit Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan. 01 Babli's A/c Dr. 10,000 To Sales A/c 10,000 (Sold goods to Babli) Jan. 01 Bills Receivable A/c Dr. 10,000 To Babli's A/c 10,000 (Received Babli's acceptance for three months) Mar. 04 Bank A/c Dr. 9,950 Rebate on bills A/c Dr. 50 To Bills Receivable A/c 10,000 (Babli retired her acceptance and rebate allowed to him) The recorded entries will be posted to the following ledger acounts Babli's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Jan. 01 Sales 10,000 Jan 06 Bills Receivable 10,000 10,000 10,000 Bill Receivable Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Jan. 01 Babli 10,000 Mar 04 Cash 9,950 Rebate on bill 50 10,000 10,000 Book of Babli Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan. 01 Purchases A/c Dr. 10,000 To Amit A/c 10,000 (Purchased goods from Amit) 2022-23 300 Accountancy Amit's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Jan. 01 Bills Payable 10,000 Jan. 04 Purchases 10,000 10,000 10,000 Jan.01 Amit's A/c Dr. 10,000 To Bills Payable A/c 10,000 (Accepted Amit's draft payable after three months) Mar. 04 Bill Payable A/c Dr. 10,000 To Cash A/c 9,950 To Rebate on bills A/c 50 (Acceptance in favour of Amit retired and rebate received) Bills Payable Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2017 2017 Jan. 01 Cash 9950 Jan. 01 Amit 10,000 Rebate on bills 50 10,000 10,000 Illustration 4 On Jan. 15, 2017 Sachin sold goods `30,000 to Narain and drew upon the later a bill for the same amount payable after 3 months. The bill was accepted by Narain. The bill was discounted by Sachin from his bank for `29,250 on Jan. 31, 2017 on maturity the bill was dishonoured. He further agreed to pay `10,500 in cash including ` 500 interest and accept a new bill for two months for the remaining `20,000. The new bill was endorsed by sachin in favour of his creditor Kapil for settling a debt of ` 20,800. The new bill was duly met by Narain on maturity. Record the necessary journal entries in the books of Sachin and Narain. Solution Books of Sachin Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan. 15 Narain A/c Dr. 30,000 To Sales A/c 30,000 (Sold goods to Narain) 2022-23 Bill of Exchange 301 Jan.15 Bill's Receivable A/c Dr. 30,000 To Narain's A/c 30,000 (Received Bunty's acceptance) Jan. 31 Bank A/c Dr. 29,250 Discount A/c 750 To Bill receivable A/c 30,000 (Narains' acceptance discounted with bank) Apr. 19 Narain's A/c Dr. 30,500 To Bank A/c 30,000 To Interest A/c 500 (Narain's acceptance cancelled) Apr.19 Bank A/c Dr. 10,500 Bills Receivavble A/c Dr. 20,000 To Narain A/c 30,500 (Received cash from Narain and a new acceptance for the balace) Apr.19 Kapil A/c Dr. 20,800 To Bill Receivable A/c 20,000 To Discount Received A/c 800 (Narain's acceptance endorsed in favour of kapil and he allowed discount) Books of Narain Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 Jan. 15 Purchases A/c Dr. 30,000 To Sachin A/c 30,000 (Purchased goods from sachin) Jan.15 Sachin A/c Dr. 30,000 To Bills Payable A/c 30,000 (Accepted Sachin's draft) Jan.19 Bill Payable A/c Dr. 30,000 Interest A/c 500 To Sachin A/c 30,500 (Cancelled old bill & Sachin charged interest) Apr. 19 Sachin's A/c Dr. 30,500 To Bank A/c 10,500 To Bill Payable A/c 20,000 (Paid Sachin and accepted a new draft for the balance) Apr.22 Bills Receivavble A/c Dr. 20,000 To Bank A/c 20,000 (Met new acceptance on Maturity) 2022-23 302 Accountancy Illustration 5. Ashok sold goods `14,000 to Bishan on October 30, 2016 and drew three bills for `2,000, `4,000 &

`8,000 payable after two, three, and four months respectively. The first bill was kept by Ashok with him till maturity. He endorsed the second bill in favour of his creditor Chetan. The third bill was discounted on December 03, 2016 at 12% p.a. The first and second bills were duly met on maturity but the third bill was dishonoured and the bank paid `50 as noting charges. On March 03, 2017 Bishan paid `4,000 and noting charges in cash and accepted a new bill at two months after date for the balance plus interest `100. The new bill was met on maturity by Bishan. You are required to give the journal entries in the books of both Ashok ans Bishan and prepare Bishan's account in Ashok's books and Ashok's account in Bishan's books. Solution Books of Ashok Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2016 Oct. 30 Bishan's A/c Dr. 14,000 To Sales A/c 14,000 (Sold goods to Bishan on credit) Oct. 30 Bills Receivable A/c Dr. 14,000 To Bishan's A/c 14,000 (Received three acceptances from Bishan. First for ` 2,000 payable after two months, second for ` 4,000 payable after three months and the third for ` 8,000 payable after four months) Oct. 30 Chetan's A/c Dr. 4,000 To Bills receivable A/c 4,000 (Endorsed second bills in favour of creditor Chetan) Dec. 03 Bank A/c Dr. 7,760 Discount A/c 240 To Bill receivable A/c 8,000 (Third bill discounted at 12% p.a.) 2016 Jan.02 Bank A/c Dr. 2,000 Bills receivable A/c 2,000 (Bishan met his first acceptance on due date) Mar. 03 Bishan A/c Dr. 8,050 To Bank A/c 8,050 (Bishan dishonoured his third acceptance and bank paid `50 as noting charges) 2022-23 Bill of Exchange 303 Mar. 03 Cash A/c Dr. 4,050 To Bishan's A/c 4,050 (Cash received from Bishan) Mar. 03 Bishan's A/c Dr. 100 To Interest A/c 100 (Interest charged from Bishan for the extended period) Mar. 03 Bills Receivable A/c Dr. 4,100 To Bishan's A/c 4,100 (Received new acceptance from Bishan for two months) May 06 Bank A/c Dr. 4,100 To bills Receivable A/c 4,100 (Bishan met his new acceptance on maturity) Bishan's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 2016 Oct. 30 Sales 14,000 Oct. 30 Bills Receivable 14,000 2017 2017 Mar. 03 Bank 8,050 Mar. 03 Cash 4,050 Mar. 09 Interest 100 Mar. 03 Bills Receivable 4,100 22,150 22,150 Books of Bishan Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2016 Oct. 30 Purchases A/c Dr. 14,000 To Ashok's A/c 14,000 (Purchases goods on credit from Ashok) Oct. 30 Ashok's A/c Dr. 14,000 To Bills Payable A/c 14,000 (Accepted three drafts of Ashok, the first for ` 2,000 payable after 2 months, second for ` 4,000 Payable after 3 months and the third for ` 8,000 Payable after 4 months) 2022-23 304 Accountancy 2017 Jan. 02 Bills Payable A/c Dr. 2,000 To Bank A/c 2,000 (Met first acceptance for ` 2,000 in favour of Ashok.) Mar. 03 Bill Payable A/c Dr. 8,050 Noting charges A/c Dr. 50 To Ashok A/c 8,050 (Third acceptance in favour of Ashok dishonoured and noting charges ` 50) Mar. 03 Ashok's A/c Dr. 4,050 To Cash A/c 4,050 (Paid to Ashok ` 4,000 plus noting charges) Mar. 03 Interest A/c Dr. 100 To Ashok's A/c 100 (Interest allowed to Ashok) Mar. 03 Ashok's A/c Dr. 4,100 To Bills Payable A/c 4,100 (New draft of Ashok for two months accepted) May 03 Bills Payable A/c Dr. 4,100 To Bank A/c 4,100 (Met new acceptance for ` 4,100 in favour of Ashok on maturity) Ashok's Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` 2016 2016 Oct. 30 Bills payable 14,000 Oct. 30 Purchases 14,000 2017 2017 Mar. 03 Cash 4,050 Mar. 03 Bills Payable 8,000 Noting charges 50 Mar. 09 Bills Payable 4,100 Mar. 09 Interest 100 22,150 22,150 Illustration 6. Aashirwad draws on Aakarshak a Bill of exchange for 3 months for `10,000 which Aakarshak accepts on January 01, 2016. Aashirwad endorses the bill in favour of Aakarti. Before maturity Aakarshak approaches Aashirwad with the request that the bill be renewed for a further period of 3 months at 18 per cent per annum interest. Aashirwad pays the 2022-23 Bill of Exchange 305 sum to Aakriti on the due date and agrees to the proposal of Aakarshak. Record journal entries in the books of Aashirwad, assuming that the second bill is duly met. Solution Book of Ashirwad Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2016 Jan. 01 Bills Receivable A/c Dr. 10,000 To Aakarshak's A/c 10,000 (The Bill of exchange received from Aakarshak) Jan.01 Aakarati's A/c Dr. 10,000 To Bills Receivable A/c 10,000 (The bill of exchange received from Aakarshak, endorsed to Aakarati) Apr. 04 Aakarshak's A/c Dr. 10,000 To Aakarati's A/c 10,000 (Cancellation of the bill of exchange received from Aakarshak now with Aakarati) Apr. 04 Aakarati's A/c Dr. 10,000 To Bank A/c

10,000 (Payment of the amount due to Aakarati) Apr. 04 Aakarshak's A/c Dr. 450 To Interest A/c 450 (Interest due from Aakarshak on `10,000 for 3 months at 18% p.a.) Apr. 04 Bills Receivable A/c Dr. 10,450 To Aakarshak's A/c 10,450 (The new bill received from Aakarshak for the amountdue for him) July 07 Bank A/c Dr. 10,450 To Bills Receivable A/c 10,450 (The amount received from Aakarshak in respect of the renewed bill) Illustration 7. Ankit owes Nikita a sum of `6,000. On April 01, 2016 Ankit gives a promissory note for the amount for 3 months to Nikita who gets it discounted with her bankers for `5,760. on the due date the bill is dishonoured, the bank paid `15 as noting charges. Ankit then pays `2,000 in cash and accepts a bill of exchange drawn on him for the balance together with `100 as interest. This bill of exchange is for 2 months and on the due date the bill is again dishonoured, Nikita paid `15 as noting charges. Draft the journal entries to be recorded in Nikita's books. 2022-23 306 Accountancy Solution Books of Nikita Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2016 Apr. 01 Bills Receivable A/c Dr. 6,000 To Ankit's A/c 6,000 (Ankit's promissory note received in settlement of his account) Apr. 01 Bank A/c Dr. 5,760 Discount A/c Dr. 240 To Bills Receivable A/c 6,000 (Ankit's Promissory note discounted for `5,760) July 04 Ankit A/c Dr. 6,015 To Bank A/c 6,015 (The promissory note dishonoured by Ankit the amount of the bill and the noting charges recoverable from Ankit and payable to bank) July 04 Cash A/c Dr. 2,000 To Ankit's A/c 2,000 (The amount received from Ankit) July 04 Ankit's A/c Dr. 100 To Interest A/c 100 (Interest due from Ankit for the second bill) July 04 Bills Receivable A/c Dr. 4,115 To Ankit's A/c 4,115 (Ankit's acceptance for 2 monthsin settlement of amount due) Sept.07 Ankit's A/c Dr. 4,115 To Bills Receivable A/c 4,115 (The dishonour by Ankit of his acceptance) Sept.07 Ankit's A/c Dr. 15 To Cash A/c 15 (Payment of noting charges, recoverable from Ankit) Illustration 8. On May 01, 2016 Mohit sends his promissory note of ` 6000 for 3 months to Rohit. Rohit gets it discounted with his bankers at 18 percent per annum on May 04. On the due date the bill is dishonoured, the bank paying `10 as noting charges. Rohit agrees to accept `2,130 in cash (including `130 for noting charges and interest) and another promissory note for `4,000 at 2 months. On the due date, Mohit approaches Rohit again 2022-23 Bill of Exchange 307 and asks for renewal of the bill for a further period of 3 months. Rohit agrees to the request, provided Mohit pays `200 as interest in cash. This last bill is paid on maturity. Draft journal entries in the books of Mohit and Rohit. Solution Books of Mohit Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2016 May 01 Rohit's A/c Dr. 6,000 To Bills Payable A/c 6,000 (The amount of the promissory note sent to Rohit) Aug.04 Bills Payable A/c Dr. 6,000 Noting charges A/c Dr. 10 To Rohit's A/c 6,010 (The dishonour of the promissory note and `10 being payable as noting charges to Rohit) Aug. 04 Interest A/c Dr. 120 Rohit's A/c 120 (Interest due to Rohit from part renewal of the promissory) Aug.04 Rohit's A/c Dr. 6,130 To Bills Payable A/c 4,000 To Cash A/c 2,130 (Payment of ` 2,130 in cash and a new promissory note for ` 4,000 sent to Rohit to settle his account) Oct.07 Bill Payable A/c Dr. 4,000 To Rohit's A/c 4,000 (Cancellation of the bill due today) Oct.07 Interest A/c Dr. 200 To Rohit's A/c 200 (The amount due as interest ot Rohit on the renewed bill) Oct.07 Rohit's A/c Dr. 4,200 To Cash A/c 200 To Bills Payable A/c 4,000 (The new acceptance and cash sent to Rohit) 2017 Jan.10 Bills Payable A/c Dr. 4,000 To Cash A/c 4,000 (Payment made to meet the bill due this day) 2022-23 308 Accountancy Book of Rohit Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2016 May 01 Bills Receivable A/c Dr. 6,000 To Mohit's A/c 6,000 (Mohit's promissory note received this day) May 04 Bank's A/c Dr. 5,730 Discount A/c Dr. 270 To Bills Receivable A/c 6,000 (The discounting of the promissory note by Mohit at 18% on ` 6,000 for 3 months) Aug.04 Mohit's A/c Dr. 6,000 To Bank A/c 6,010 (The dishonour of the promissory not by Mohit ` 10 being charged by bank for noting charges) Aug.04 Mohit's A/c Dr. 120 Interest A/c 120 (The amount agreed to be paid as interest by Mohit) Aug.04 Cash A/c Dr. 2,130 Bills Receivable A/c 4,000 To Mohit's A/c 6,130 (Cash and promissory note received from Mohit for the amount due from him) Oct.07 Mohit's A/c Dr. 4,000 To Bills Receivable A/c 4,000 (Cancellation of the bill due today) Oct.07 Mohit's A/c Dr. 200 To Interest A/c 200 (The amount due from Mohit as interest) Oct.07 Cash

A/c Dr. 200 Bills Receivable A/c Dr. 4,000 To Mohit's A/c 4,200 (Cash and promissory not received from Mohit) 2017 Jan. 10 Cash/Bank A/c Dr. 4,000 To Bills Receivable A/c 4,000 (Mohit met his acceptance on maturity) 2022-23 Bill of Exchange 309 Test Your Understanding - II Fill in the blanks: (i) A bill of exchange is a ___________________________________instrument. (ii) A bill of exchange is drawn by the ________________upon his___________. (iii) A promissory note is drawn by ______________in favour of his__________. (iv) There are ____________________parties to a bill of exchange. (v) There are ____________________parties to a promissory note. (vi) Drawer and ______________can not be the same parties in case of a bill of exchange. (vii) Bill of exchange in India languages is called _____________ (viii) __________days of grace are added in terms of the bill to calculate the date of its__________. Key Terms Introduced in the Chapter (a) Drawer (b) Drawee (c) Payee (d) Bill Receivable (e) Bill Payable (f) Drawing of a Bill (g) Acceptance of a Bill (h) Payment of a bill Summary with Reference to Learning Objectives 1. Bill of exchange as an Instrument : A bill of exchange is a device by which the purchaser or debtor in a credit transaction is not required to make immediate payment but satisfies the seller or creditor by accepting in writing the liability to pay the amount due from him. 2. Meaning of bill of exchange and promissory note: A bill of exchange is an acknowledgement of debt given by one person to another, incorporating all the terms and conditions of payments. A promissory note is an undertaking in writing given by the debtor to the creditor to pay the latter a certain sum of money in accordance with the conditions stated therein. 3. Difference between a bill and a note. (a) A bill is prepared by the creditor and accepted by the debtor; a note is prepared by the debtor. (b) There are three parties to a bill; there are only two parties to a note. (c) A bill requires acceptance to acquire financial status; a note in itself has financial status. 2022-23 310 Accountancy 4. Featur and advantages of a bill : A bill is a written unconditional order; it is signed by the creditor and accepted by the debtor; the amount of the bill is payable either on demand or at a fixed period. Questions for Practice Short Answers 1. Name any two types of commonly used negotiable instruments. 2. Write two points of distinction between bills of exchange and promissory note. 3. State any four essential features of bill of exchange. 4. State the three parties involved in a bill of exchange. 5. What is meant by maturity of a bill of exchange? 6. What is meant by dishonour of a bill of exchange? 7. Name the parties to a promissory note 8. What is meant by acceptance of a bill of exchange? 9. What is Noting of a bill of exchange. 10. What is meant by renewal of a bill of exchange? 11. Give the performa of a Bills Receivable Book. 12. Give the performa of a Bills Payable Book. 13. What is retirement of a bill of exchange? 14. Give the meaning of rebate. 15. Give the performa of a Bill of Exchange. Long Answers 1. A bill of exchange must contain "an unconditional promise to pay" Do you agree with a statement? 2. Briefly explain the effects of dishonour and noting of a bill of exchange. 3. Explain briefly the procedure of calculating the date of maturity of a bill of exchange? Give example. 4. Distinguish between bill of exchange and promissory note. 5. Briefly explain the purpose and benefits of retiring a bill of exchange to the debtor and the creditor. 6. Explain briefly the purpose and advantages of maintaining of a Bills Receivable Book. 7. Briefly explain the benefits of maintaining a Bills Payable Book and state how is its posting is done in the ledger? Numerical Questions 1. On Jan 01, 2016 Rao sold goods `10,000 to Reddy. Half of the payment was made immediately and for the remaining half Rao drew a bill of exchange upon Reddy payable after 30 days. Reddy accepted the bill and returned it to Rao. On the due date Rao presented the bill to Reddy and received the payment. 2022-23 Bill of Exchange 311 Journalise the above transactions in the books Rao and prepare of Rao's account in the books of Reddy. 2. On Jan 01, 2016, Shankar purchased goods from Parvati for `8,000 and immediately drew a promissory note in favour of Parvati payable after 3 months. On the date of maturity of the promissory note, the Government of India declared holiday under the Negotiable Instrument Act 1881. Since, Parvati was unaware about the provision of the law regarding the date of maturity of the bill, she handed over the bill to her lawyer, who duly presented the bill and received the payment. The amount of the bill was handed over by the lawyer to Parvati immediately. Recore the necessary Journal entries in the books of Parvati and Shankar. 3. Vishal sold goods for `7,000 to Manju on Jan 05, 2016 and drew upon her a bill of exchange payable after 2 months. Manju accepted Vishal's draft and handed over the same to Vishal after acceptance. Vishal immediately discounted the bill with his bank@12% p.a. On the due date Manju met her acceptance. Journalise the above transactions in the books of Vishal and Manju. 4. On Feb 01, 2016, John purchased goods for `15,000 from Jimmi. He immediately made a payment of `5,000 by cheque and for the balance accepted the bill of exchange drawn upon him by Jimmi. The bill of exchange was payable after 40 days. Five days before the maturity of the bill, Jimmi sent the same to his bank for collection. The bank duly presented the bill to John on the due date who met the bill. The bank informed the same to Jimmi. Prepare John's account in the books of Jimmi and Jimmi account in the books of John. 5. On Jan 15, 2015, Kartar Sold goods for `30,000 to Bhagwan and drew upon him three bills of exchanges of `10,000 each payable after one month, two month, and three months respectively. The first bill was retained by Kartar till its maturity. The second bill was endorsed by him in favour of his creditor Ratna and the third bill was discounted by him immediately @ 6% p.a. All the bills were met by Bhagwan. Journalise the above transactions in the books of Kartar and Bhagwan. Also prepare ledger accounts in books of Kartar and Bhagwan. 6. On Jan. 01, 2016 Arun sold goods for `30,000 to Sunil. 50% of the payment was made immediately by Sunil on which Arun allowed a cash discount of 2%. For the balance Sunil drew a promissory note in favour of Arun payable after 20 days. Since, the date of maturity of bill was a public holiday, Arun presented the bill on a day, as per the provisions of Negotiable Instrument Act which was met by Sunil. State the date on which the bill was presented by Arun for payment and Jounalise the above transactions in the books of Arun and Sunil. 7. Darshan sold goods for ` 40,000 to Varun on 8.1.2016 and drew upon him a bill of exchange payable after two months. Varun accepted the bill and returned the same to Darshan. On the due date the bill was met by Varun. Record the necessary Journal entries in the books of Darshan and Varun in the following circumstances. 2022-23 312 Accountancy • When the bill was retained by Darshan till the date of its maturity. • When Darshan immediately discounted the bill @ 6% p.a. with his bank. • When the bill was endorsed immediately by Darshan in favour of his creditor Suresh. • When three days before its maturity, the bill was sent by Darshan to his bank for collection. 8. Bansal Traders allow a trade discount of 10% on the list price of the goods purchased from them. Mohan traders, who runs a retail shop made the following purchases from Bansal Traders. Date Amount (`) Dec. 21, 2016 1,000 Dec. 26, 2016 1,200 Dec. 18, 2016 2,000 Dec. 31, 2016 5,000 For all the purchases Mohan Traders drew promissory note in favour of Bansal Traders payable after 30 days. The promissory note for the sale of Dec. 21, 2016 was retained by Bansal Traders with them till the date of its maturity. The promissory note drawn on 26.12.2016 was discounted by Bansal Traders from their bank at 12% p.a. The promissory note drawn on Dec. 28, 2016 was endorsed by Bansal Traders in favour of their creditor Dream Soaps in full settlement of a purchase amounting to ` 1,900. On 25.1.2017 Bansal Traders sent the promissory note drawn on Dec. 31, 2016 to their bank for collection. All the promissory notes were met by Mohan Traders. Record the necessary journal entries for the above transactions in the books of Bansal Traders and Mohan Traders and prepare Mohan Traders account in the books of Bansal Traders and Bansal Traders account in the books of Mohan Traders. 9. Narayanan purchased goods for `25,000 from Ravinderan on Feb. 01, 2016. Ravinderan drew upon Narayanan a bill of exchange for the same amount payable after 30 days. On the due date Narayanan dishonoured his acceptance. Record the necessary journal entries in the books of Ravinderan and Narayanan in following cases: • When the bill was retained by Ravinderan with him till the date of its maturity. • When the bill was discounted by Ravinderan immediately with his bank @ 6% p.a. • When the bill was endorsed to his creditor Ganeshan. • When the bill was sent by Ravinderan to his bank for collection a few days before it maturity. 10. Ravi sold goods for `40,000 to Sudershan on Feb 13, 2016. He drew four bills of exchange upon Sudershan. The first bill was for `5,000 2022-23 Bill of Exchange 313 payable after one month. The second bill was for `10,000 payable after 40 days; the third bill was for `12,000 payable after three months and fourth bill was for the balance amount payable after 19 days. Sudershan accepted all the bills and returned the same to Ravi. Ravi discounted the first bill with his bank at 6% p.a. He endorsed the second bill to his creditor Mustaq for the full settlement of a debt of `10,200. The third bill was kept by Ravi with him till the date of maturity. Five days before the maturity of the fourth bill, Ravi sent the bill to his bank for collection. All the four bills were dishounoured by Sudarshan on maturity. Sudershan settled Ravi's claim in cash three days after the dishonour of each bill along with interest @ 12% p.a. for the terms of the bills. You are requested to record the necessary journal entries in the books to Ravi, Sudershan, Mustaq and bank for the above transaction. Also prepare Sudershan's account and Mustaq's account in the books of Ravi. 11. On Jan 01, 2016 Neha sold goods for `20,000 to Muskan and drew upon her a bill of exchange payable after two months. One month before the maturity of the bill Muskan approached Neha to accept the payment against the bill at a rebate @ 12% p.a. Neha agreed to the request of Muskan and Muskan retired the bill under the agreed rate of rebate. Journalise the above transaction in the books of Neha and Muskan. 12. On Jan 15, 2016 Raghu sold goods worth ` 35,000 to Devendra and drew upto the latter three bills of exchanges. The first bill was for `5,000 payable after one month, the second bill was for `20,000 payable after three months and third bill for balance amount for 4 months. Raghu endorsed the first bill in favour of his creditor Dewan in full settlement of a debt of `5,200. The second bill was discounted by Raghu @ 6 % p.a. and the third bill was retained by Raghu till the date of maturity. Devendra dishonoured the bill on maturity and the bank paid ` 30 as noting charges. Four days before the maturity of the third bill Raghu, sent the same for collection to his bank. The third bill was also dishonored by Devendra and the bank paid `200 as noting charges. Five days after the dishonour of the bill Devendra paid the entire amount due to Raghu along with interest `1,000 for this purpose Devendra obtained a short term loan from his bank. You are requested to record the necessary journal entries in the books of Raghu Devendra and Dewan and also prepare Devendra's account in Raghu's books and Raghu's account in Devendra's account. 13. Viaml purchased goods `25,000 from Kamal on Jan 15, 2016 and accepted a bill of exchange drawn upon him by Kamal payable after two months. On the date of the maturity the bill was duly presented for payment. Vimal dishonoured the bill. record the necessary journal entries in the books of Kamal and Vimal when. • The bill was retained by Kamal till the date of its maturity. • The bill was immediately discounted by Kamal with his bank @ 6% p.a. • The bill was endorsed by Kamal in favour of his creditor Sharad. • Five days before its maturity the bill was sent by Kamal to his bank for collection. 2022-23 314 Accountancy 14. Abdulla sold goods to Tahir on Jan 17, 2017 for `18,000. He drew a bill of exchange for the same amount on Tahir for 45 days. On the same date Tahir accepted the bill and returned it to Abdulla. On the due date Abdulla presented the bill to Tahir which was dishonoured. Abdulla paid `40 as noting charges. Five days after the dishonour of his acceptance Tahir settled his debt by making a payment of `18,700 including interest and noting charges. Record the necessary journal entries in the books of Abdulla and Tahir. Also prepare Tahir's account in the books of Abdulla and Abdulla's account in the books of Tahir. 15. Asha sold goods worth `19,000 to Nisha on March 02, 2017. `4,000 were paid by Nisha immediately and for the balance she accepted a bill of exchange drawn upon her by Asha payable after three months. Asha discounted the bill immediately with her bank. On the due date Nisha dishonoured the bill and the bank paid `30 as noting charges. Record the necessary journal entries in the books of Asha and Nisha. 16. On Feb. 02, 2017, Verma purchased from Sharma goods for `17,500. Verma paid `2,500 immediately and for the balance gave a promissory note to Sharma payable after 60 days. Sharma immediately endorsed the promissory note in favour of his creditor. Gupta for the full settlement of a debt of `15,400. On the due date of the bill Gupta presented the bill to Verma which the latter dishonoured and Gupta paid `5,000 noting charges. On the same date Gupta informed Sharma about the dishonour of the bill. Sharma settled his debt to Gupta by cheque for `15,500 which includes noting charges and interest. Verma settled Sharma's claim by cheque for the same amount. Record the necessary journal entries is the books of Sharma, Gupta and Verma for the above transaction and prepare Verma's and Gupta's accounts in the books of Sharma. Sharma's account in the books of Verma. And also Sharma's account in the books of Gupta. 17. Lilly sold goods to Methew on 1.3.2017 for `12,000 and drew upon Methew a bill of exchange for the same amount payable after two months. Lilly immediately discounted the bill with her bank at 9% p.a. The maturity date of the bill was a non business day (holiday), therefore, Lilly had to present the bill as per the provisions of the Indian Instruments Act.1881. The bill was dishonoured by Methew and Lilly paid `45 as noting charges. Methew settled the claim of Lilly five days after the disonour of the bill by a cheque, whch includes interest @ 12% for the term of the bill. Journalise the above transactions in the books of Lilly and Methew and prepare Mathew's account in the books of Lilly and Lilly's account in the books of Mathew. 18. Kapil purchased goods for `21,000 from Gaurav on 1.2.2017 and accepted a bill of exchange drawn by Gaurav for the same amount. The bill was payable after one month. On 25.2.2017 Gaurav sent the bill to his bank for collection. The bill was duly presented by the bank. Kapil dishonoured the bill and the bank paid `100 as noting charges. 2022-23 Bill of Exchange 315 Record the necessary journal entries for the above transactions in the books of Kapil and Gourav. 19. On Feb. 14, 2017 Rashmi sold good `7,500 to Alka. Alka paid `500 in cash and for the bank balance accepted a bill of exchange drawn upon her by Rashmi payable after two months. On Apr.10, 2017 Alka approached Rashmi to cancel the bill since she was short of funds. She further requested Rashmi to accept `2,000 in cash and draw a new bill for the balance including interest `500. Rashmi accepted Alka's request and drew a new bill for the amount due payable after 2 months. The bill was accepted by Alka. The new bill was duly met by Alka on maturity. Record the necessary journal entries in the books of Rashmi and Alka and prepared Alka's account in the books of Rashmi's and Rashmi's account in the books of Alka's 20. Nikhil sold goods for `23,000 to Akhil on Dec. 01, 2017. He drew upon Akhil a bill of exchange for the same amount payable after 2 months. Akhil accepted the bill and sent it back to Nikhil. Nikhil discounted the bill immediately with his bank @12 p.a. On the due date Akhil dishonoured the bill of exchange and the bank paid `100 as noting charges. Akhil requested Nikhil to draw a new bill upon him with interest @10% p.a. which he agreed. The new bill was payable after two months. A week before the maturity of the second bill Akhil requested Nikhil to cancel the second bill. He further requested to accept `10,000 in cash immediately and drew a third bill upon him including interest of `500. Nikhil agreed to Akhil's request. The third bill was payable after one month. Akhil met the third bill on its maturity. record the necessary journal entries in the books of Nikhil and Akhil and also prepare Akhil's account in the books of Nikhil and Nikhil's account in the books of Akhil. 21. On Jan 01, 2017 Vibha sold goods worth `18,000 to Sudha and drew upon the latter a bill of exchange for the same amount payable after two months. Sudha accepted Vibha's draft and returned the same to Vibha after acceptance. Vibha endorsed the bill immediately in favour of her creditor Geeta. Five days before the maturity of the bill Sudha requested Vibha to cancel the bill since she was short of funds. She further requested to draw a new bill upon her including interest of `200. Vibha accepted Sudha's request. Vibha took the bill from Geeta by making the payment to her in cash and cancelled the same. Then she drew a new bill upon Sudha as agreed. The new bill was payable after one month. The new bill was duly met by Sudha on maturity. Record the necessary journal entries in the books of Vibha. 22. Following was the position of debtor and creditor of Gautam as on 1.1.2017. Debtors Creditors ` ` Babu 5,000 - Chanderkala 8,000 - Kiran 13,500 - Anita 14,000 - 2022-23 316 Accountancy Anju - 5,000 Sheiba - 12,000 Manju - 6,000 The following transactions took place in the month of Jan 2017: Jan 2 Drew on Babu at two months after date at full settlement for `4,800. Babu accepted the bill and returned it on 5.1.2017 . Jan. 04 Babu's bill discounted for `4,750. Jan. 08 Chanderkala sent a promissory note for

`8,000 payable three months after date. Jan. 10 Promissory note received from Chanderkala discounted for `7,900. Jan. 12 Accepted Sheiba draft for the amount due payable two months after date. Jan. 22 Anita sent his promissory note payable after two months. Jan. 23 Anita's promissory note endorsed in favour of Manju. Jan. 25 Accepted Anju's draft payable after three months. Jan. 29 Kiran sent `2,000 in cash and a promissory note for the balance payable after three months. Record the above transactions in the proper subsidiary books. 23. On Jan. 01, 2017 Harsh accepted a months bill for ` 10,000 drawn on him by tanu for latter's benefit. Tanu discounted the bill on same day @ 8% p.a On the due date tanu sent a cheque to Harsh for honour the bill. Harsh duly honoured his acceptance. Record the journal entries in the Books of Tanu and Harsh. Checklist to test Your Understanding Test your understanding-I (i) False (ii) True (iii) False (iv) False (v) True (vi) False (vii) True (viii) False (ix) False (x) False Test Your Understanding-II (i) Negotiable, (ii) Drawer, Drawee (iii) Debtor, Creditor (iv) Three (v) Two. (vi) Drawee (vii) Hundi (viii) 3, Maturity 2022-23 Bill of Exchange 317 NOTE 2022-23 318 Accountancy NOTE 2022-23

Accountancy Financial Accounting Part II Textbook for Class XI 2022-23 First Edition February 2006 Phalguna 1927 Reprinted October 2006 Kartika 1928 October 2007 Kartika 1929 March 2009 Phalguna 1930 January 2010 Magha 1931 January 2011 Magha 1932 January 2012 Magha 1933 March 2013 Phalguna 1934 December 2013 Agrahayana 1935 March 2015 Phalguna 1936 December 2015 Pausa 1937 October 2016 Kartika 1938 January 2018 Magha 1939 March 2019 Phalguna 1940 September 2019 Bhadrapada 1941 PD 300T BS Publication Team Head, Publication : M. 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Ltd., B-9 & 10 Site IV, Sahibabad Industrial Area, District Ghaziabad (U.P.) 2022-23 FOREWORD The National Curriculum Framework (NCF), 2005, recommends that children's life at school must be linked to their life outside the school. This principle marks a departure from the legacy of bookish learning which continues to shape our system and causes a gap between the school, home and community. The syllabi and textbooks developed on the basis of NCF signify an attempt to implement this basic idea. They also attempt to discourage rote learning and the maintenance of sharp boundaries between different subject areas. We hope these measures will take us significantly further in the direction of a child-centred system of education outlined in the National Policy on Education (1986). The success of this effort depends on the steps that school principals and teachers will take to encourage children to reflect on their own learning and to pursue imaginative activities and questions. We must recognise that, given space, time and freedom, children generate new knowledge by engaging with the information passed on to them by adults. Treating the prescribed textbook as the sole basis of examination is one of the key reasons why other resources and sites of learning are ignored. Inculcating creativity and initiative is possible if we perceive and treat children as participants in learning, not as receivers of a fixed body of knowledge. These aims imply considerable change in school routines and mode of functioning. Flexibility in the daily time-table is as necessary as rigour in implementing the annual calendar so that the required number of teaching days are actually devoted to teaching. The methods used for teaching and evaluation will also determine how effective this textbook proves for making children's life at school a happy experience, rather than a source of stress or boredom. Syllabus designers have tried to address the problem of curricular burden by restructuring and reorienting knowledge at different stages with greater consideration for child psychology and the time available for teaching. The textbook attempts to enhance this endeavour by giving higher priority and space to opportunities for contemplation and wondering, discussion in small groups, and activities requiring hands-on experience. The National Council of Educational Research and Training (NCERT) appreciates the hard work done by the textbook development committee 2022-23 responsible for this book. We wish to thank the Chairperson of the advisory group in Social Sciences Professor Hari Vasudevan and the Chief Advisor for this book, Professor R.K. Grover, (Retd.) Director, School of Management Studies (IGNOU), New Delhi for guiding the work of this committee. Several teachers contributed to the development of this textbook; we are grateful to their principals for making this possible. We are indebted to the institutions and organisations which have generously permitted us to draw upon their resources, material and personnel. We are especially grateful to the members of the National Monitoring Committee, appointed by the Department of Secondary and Higher Education, Ministry of Human Resource Development under the Chairpersonship of Professor Mrinal Miri and Professor G.P. Deshpande, for their valuable time and contribution. As an organisation committed to the systemic reform and continuous improvement in the quality of its products, NCERT welcomes comments and suggestions which will enable us to undertake further revision and refinement. Director New Delhi National Council of Educational 20 December 2005 Research and Training iv 2022-23 TEXTBOOK DEVELOPMENT COMMITTEE CHAIRPERSON, ADVISORY COMMITTEE FOR TEXTBOOKS IN SOCIAL SCIENCES AT UPPER PRIMARY LEVEL Hari Vasudevan, Professor, Department of History, University of Calcutta, Kolkata CHIEF ADVISOR R. K. 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The efforts of DESS, Administration is acknowleged for the preparation of manuscript, and Publication Division of NCERT is acknowledged for printing this textbook. 2022-23 CONTENTS OF ACCOUNTANCY – FINANCIAL ACCOUNTING PART I 2022-23 CONTENTS 2022-23Financial Statements - I 9 LEARNING OBJECTIVES After studying this chapter, you will be able to : • state the nature of the financial statements; • identify the various stakeholders and their information requirements; • distinguish between the capital and revenue expenditure and receipts; • explain the concept of trading and profit and loss account and its preparation; • State the nature of gross profit, net profit and operating profit; • describe the concept of balance sheet and its preparation; • explain grouping and marshalling of assets and liabilities; • prepare profit and loss account and balance sheet of a sole proprietory firm; and • make an opening entry. Y ou have learnt that financial accounting is a well-defined sequential activity which begins with Journal (Journalising), Ledger (Posting), and preparation of Trial Balance (Balancing and Summarisation at the first stage). In the present chapter, we will take up the next step, namely, preparation of financial statements, and discuss the types of information requirements of various stakeholders, the distinction between capital and revenue items and its importance and the nature of financial statements and the preparation thereof. 9.1 Stakeholders and their Information Requirements Recall from chapter I (Financial Accounting Part I) that the objective of business is to communicate the meaningful information to various stakeholders in the business so that they can make informed decisions. A stakeholder is any person associated with the business. The stakes of various stakeholders can be monetary or non-monetary. The stakes can be active or passive; or can be direct or indirect. The owner and persons advancing loan to the business would have monetary stake. The government, consumer or a researcher will have non-monetary stake in the business. The stakeholders are also called users who are normally classified as internal and external depending upon whether they are inside the business or outside the business. All users have different objectives for 2022-23 320 Accountancy joining business and consequently different types of information requirements from it. In nutshell, the various users have diverse financial information requirements from the business. For example we have classified the following into the category of internal and external users specifying their objectives and consequent information requirements. Name Internal/ Objective for participating Accounting Information requirements External in business users Current Internal To make investment in the Likes to know extent of profit in the owners business and wealth grow. last accounting period, current position of the assets/liabilities of the business. Manager Internal For a career. They essenti- Accounting information in the form ally act as the agent of of financial statements is like their owners (their employers). report card and they are interested in information about both profits and financial position. Government External Its role is regulatory and Its concerns are that the rights of all tries to lay down the rules stakeholders are protected. Since the in the best public interest. government levies taxes on the business, they are interested in information about profitability in particular besides lot of other information. Prospective External He is expecting to make He is interested in information about owner investments in the business past profits and financial position as with a view to make his indicative of likely future performance. investment and wealth grow. Bank External Bank is interested in safety Bank is interested in adequacy of of the principal as well as profits only as an assurance of the the periodic return return of principal and interest back (interest). in time. Bank is equally concerned about the form in which the assets are held by the business. When more assets are held in cash or near cash form, the aspect is knnown as liquidity. Fig. 9.1 : Analysis of various users of accounting information 2022-23 Financial Statements - I 321 Box 1 Accounting Process (up to Trial balance) : 1. Identify the transactions, which that are recorded. 2. Record transactions in journal. Only those transactions are recorded which are measured in money terms. The system followed for recording is called double entry system whereby two aspects (debit and credit) of every transaction are recorded. Repeated transactions of same nature are recorded in subsidiary books, also called special journals. Instead of recording all transactions in journal, they are recorded in subsidiary books and the journal proper. For example, the business would record all credit sales in sales book and all credit purchases in purchases book. The other examples of subsidiary books are return inwards book, return outwards book. An other important special book is cash book, in which all cash and bank transactions are recorded. The entries, which are not recorded in any of these books, are recorded in a residual journal called journal proper. 3. The entries appearing in the above books are posted in the respective accounts in the ledger. 4. The accounts are balanced and listed in a statement called trial balance. If the total amounts of debit and credit balances agree, accounts are taken as free from arithmetical errors. 5. The trial balance forms the basis for making the financial statements, i.e. trading and profit and loss account and balance sheet. 9.2 Distinction between Capital and Revenue A very important distinction in accounting is between capital and revenue items. The distinction has important implications for making of the trading and profit and loss account and balance sheet. The revenue items form part of the trading and profit and loss account, the capital items help in the preparation of a balance sheet. 9.2.1 Expenditure Whenever payment and/or incurrence of an outlay are made for a purpose other than the settlement of an existing liability, it is called expenditure. The expenditures are incurred with a viewpoint they would give benefits to the business. The benefit of an expenditure may extend up to one accounting year or more than one year. If the benefit of expenditure extends up to one accounting period, it is termed as revenue expenditure. Normally, they are incurred for the day-to-day conduct of the business. An example can be payment of salaries, rent, etc. The salaries paid in the current period will not benefit the business in the next accounting period, as the workers have put in their efforts in the current accounting period. They will have to be paid the salaries in the next accounting period as well if they are made to work. If the benefit of expenditure extends more than one accounting period, it is termed 2022-23 322 Accountancy as capital expenditure. An example can be payment to acquire furniture for use in the business. Furniture acquired in the current accounting period will give benefits for many accounting periods to come. The usual examples of capital expenditure can be payment to acquire fixed assets and/or to make additions/ extensions in the fixed assets. Following points of distinction between capital expenditure and revenue expenditure are worth noting : (a) Capital expenditure increases earning capacity of business whereas revenue expenditure is incurred to maintain the earning capacity. (b) Capital expenditure is incurred to acquire fixed assets for operation of business whereas revenue expenditure is incurred on day-to-day conduct of business. (c) Revenue expenditure is generally recurring expenditure and capital expenditure is non-recurring by nature. (d) Capital expenditure benefits more than one accounting year whereas revenue expenditure normally benefits one accounting year. (e) Capital expenditure (subject to depreciation) is recorded in balance sheet whereas revenue expenditure (subject to adjustment for outstanding and prepaid amount) is transferred to trading and profit and loss account. Sometimes, it becomes difficult to classify the expenditure into revenue or capital category. In normal usage, the advertising expenditure is termed as revenue expenditure. The heavy expenditure incurred on advertising is likely to benefit the business firm for more than one accounting period. Such revenue expenditures, which are likely to give benefit for more than one accounting period, are termed as deferred revenue expenditure. It must be understood that expenditure is a wider term and includes expenses. Expenditure is any outlay made/incurred by the business firm. The part of the expenditure, which is perceived to have been used or consumed in the current year, is termed as expense of the current year. Revenue expenditure is treated as an expense for the current year and is shown in trading and profit and loss account. For example, salary paid by the business firm is treated as an expense of the current year. Capital expenditures are charged to income statement and are spread over to more than one accounting period. Hence, furniture of ` 50,000 if expected to be used for 5 years will be treated as expense @ ` 10,000 per year. The name given for the expense is depreciation. The treatment of deferred revenue expenditure is same as of capital expenditure. They are also written-off over their expected period of benefit. 2022-23 Financial Statements - I 323 9.2.2 Receipts The similar treatment is given to the receipts of the business. If the receipts imply an obligation to return the money, these are capital receipts. The example can be an additional capital brought in by the owner or a loan taken from the bank. Both receipts are leading to obligations, the first to the owner (called equity) and the other to the outsiders (called liabilities). Another example on a capital receipt can be the sale of a fixed asset like old machinery or furniture. However, if a receipt does not incur an obligation to return the money or is not in the form of a sale of fixed asset, it is termed as revenue receipt. The examples of revenue receipts sales made by the firm and interest on investment received by the firm. 9.2.3 Importance of Distinction between Capital and Revenue As stated earlier, the distinction between capital and revenue items has important implications for the preparation of trading and profit and loss account and the balance sheet as all items of revenue value are to the shown in the trading and profit and loss account and the items of capital nature in the balance sheet. If any item is wrongly classified, i.e. if any item of revenue nature is treated as capital item or vice-versa, the ascertainment of profit or loss will be incorrect. For example, the revenues earned during an accounting period are ` 10,00,000 and the expenses shown are ` 8,00,000, the profit shall work out as ` 2,00,000. On scrutiny of the details, you find that a revenue item of ` 20,000 (an expenditure on repairs of machinery) has been treated as capital expenditure (added to the cost of machinery and debited to machinery account, not to repairs account), and hence, does not form part of the expenses for the period. It means the actual expenses for the period are ` 8,20,000 and not ` 8,00,000. So, the correct profit is ` 1,80,000, not ` 2,00,000. In other words, the profit has been over stated. Similarly, if any capital expenditure is wrongly shown as revenue expenditure (for example, purchase of furniture shown as purchases), it will result in under statement of profits, and also an under statement of assets. Thus, the financial statements will not reflect the true and fair view of the affairs of the business. Hence, it is necessary to identify the correct nature of each item and treat it accordingly in the book of accounts. It is also important from taxation point of view because capital profits are taxed differently from revenue profits. 9.3 Financial Statements It has been emphasised that various users have diverse informational requirements. Instead of generating particular information useful for specific users, the business prepares a set of financial statements, which in general satisfies the informational needs of the users. 2022-23 324 Accountancy The basic objectives of preparing financial statements are : (a) To present a true and fair view of the financial performance of the business; (b) To present a true and fair view of the financial position of the business; and For this purpose, the firm usually prepares the following financial statements: 1. Trading and Profit and Loss Account 2. Balance Sheet1 Trading and Profit and Loss account, also known as Income statement, shows the financial performance in the form of profit earned or loss sustained by the business. Balance Sheet shows financial position in the form of assets, liabilities and capital. These are prepared on the basis of trial balance and additional information, if any. Example 1 Observe the following trial balance of Ankit and signify correctly the various elements of accounts and you will notice that the debit balances represent either assets or expenses/ losses and the credit balance represent either equity/liabilities or revenue/gains. [This trial balance of Ankit will be used throughout the chapter to understand the process of preparation of financial statements] Trial Balance of Ankit as on March 31, 2017 Account Title L.F. Debit Credit Amount Amount ` ` Cash 1,000 Capital 12,000 Bank 5,000 Sales 1,25,000 Wages 8,000 Creditors 15,000 Salaries 25,000 10% Long term loan (raised on April 01, 2016) 5,000 Furniture 15,000 Commission received 5,000 Rent of building 13,000 Debtors 15,500 Bad debts 4,500 Purchases 75,000 1,62,000 1,62,000 1 The balance sheet and profit and loss account are now called position statement and statement of profit and loss in the company's financial statements. Since Chapters 9 and 10 deal with the preparation of financial statements of sole proprietorship firm, the terms balance sheet and profit and loss account are retained. 2022-23 Financial Statements - I 325 Analysis of Trial Balance of Ankit as on March 31, 2017 Account Title Elements L.F. Debit Credit Amount Amount ` ` Cash Asset 1,000 Capital Equity 12,000 Bank Asset 5,000 Sales Revenue 1,25,000 Wages Expense 8,000 Creditors Liability 15,000 Salaries Expense 25,000 10% Long-term loan Liability 5,000 (raised on April 01, 2016) Furniture Asset 15,000 Commission received Revenue 5,000 Rent of building Expense 13,000 Debtors Asset 15,500 Bad debts Expense 4,500 Purchases Expense 75,000 1,62,000 1,62,000 9.4 Trading and Profit and Loss Account Trading and Profit and Loss account is prepared to determine the profit earned or loss sustained by the business enterprise during the accounting period. It is basically a summary of revenues and expenses of the business and calculates the net figure termed as profit or loss. Profit is revenue less expenses. If expenses are more than revenues, the figure is termed as loss. Trading and Profit and Loss account summarises the performance for an accounting period. It is achieved by transferring the balances of revenues and expenses to the trading and profit and loss account from the trial balance. Trading and Profit and Loss account is also an account with Debit and Credit sides. It can be observed that debit balances (representing expenses) and losses are transferred to the debit side of the Trading and a Profit and Loss account and credit balance (representing revenues/gains) are transfered to its credit side. 9.4.1 Relevant Items in Trading and Profit and Loss Account The different items appearing in the trading and profit and loss account are explained hereunder: Items on the debit side (i) Opening stock : It is the stock of goods in hand at the beginning of the accounting year. This is the stock of goods which has been carried forward 2022-23 326 Accountancy from the previous year and remains unchanged during the year and appears in the trial balance. In the trading account it appears on the debit side because it forms the part of cost of goods sold for the current accounting year. (ii) Purchases less returns : Goods, which have been bought for resale appears as purchases on the debit side of the trading account. They include both cash as well as credit purchases. Goods which are returned to suppliers are termed as purchases return. It is shown by way of deduction from purchases and the computed amount is known as Net purchases. (iii) Wages : Wages refer to renumeration paid to workers who are directly engaged in factory for loading, unloading and production of goods and are debited to trading account. (iv) Carriage inwards/Freight inwards: These expenses are the items of transport expenses, which are incurred on bringing materials/goods purchased to the place of business. These items are paid in respect of purchases made during the year and are debited to the trading account. (v) Fuel/Water/Power/Gas : These items are used in the production process and hence are part of expenses. (vi) Packaging material and Packing charges : Cost of packaging material used in the product are direct expenses as it refers to small containers which form part of goods sold. However, the packing refers to the big containers that are used for transporting the goods and is regarded as an indirect expense debited to profit and loss account. (vii) Salaries : These include salaries paid to the administration, godown and warehouse staff for the services rendered by them for running the business. If salaries are paid in kind by providing certain facilities (called perks) to the employees such as rent free accommodation, meals, uniform, medical facilities should also be regarded as salaries and debited to the profit and loss account. (viii) Rent paid : These include office and godown rent, municipal rates and taxes, factory rent, rates and taxes. The amount of rent paid is shown on the debit side of the profit and loss account. (ix) Interest paid : Interest paid on loans, bank overdraft, renewal of bills of exchange, etc. is an expense and is debited to profit and loss account. (x) Commission paid: Commission paid or payable on business transactions undertaken through the agents is an item of expense and is debited to profit and loss account. 2022-23 Financial Statements - I 327 (xi) Repairs : Repairs and small renewals/ replacements relating to plant and machinery, furniture, fixtures, fittings, etc. for keeping them in working condition are included under this head. Such expenditure is debited to profit and loss account. (xii) Miscellaneous expenses : Though expenses are classified and booked under different heads, but certain expenses being of small amount clubbed together and are called miscellaneous expenses. In normal usage these expenses are called Sundry expenses or Trade expenses. Items on the credit side (i) Sales less returns : Sales account in trial balance shows gross total sales(cash as well as credit) made during the year. It is shown on the credit side of the trading account. Goods returned by customers are called return inwards and are shown as deduction from total sales and the computed amount is known as net sales. (ii) Other incomes : Besides salaries and other gains and incomes are also recorded in the profit and loss account. Examples of such incomes are rent received, dividend received, interest received, discount received, commission received, etc. 9.4.2 Closing Entries The preparation of trading and profit and loss account requires that the balances of accounts of all concerned items are transferred to it for its compilation. • Opening stock account, Purchases account, Wages account, Carriage inwards account and direct expenses account are closed by transferring to the debit side of the trading and profit and loss account. This is done by recording the following entry : Trading A/c Dr. To Opening stock A/c To Purchases A/c To Wages A/c To Carriage inwards A/c To All other direct expenses A/c • The purchases returns or return outwards are closed by transferring its balance to the purchases account. The following entry is recorded for this purpose : Purchases return A/c Dr. To Purchases A/c 2022-23 328 Accountancy • Similarly, the sales returns or returns inwards account is closed by transferring its balance to the sales account as : Sales A/c Dr. To Sales return A/c • The sales account is closed by transferring its balance to the credit side of the trading and profit and loss account by recording the following entry: Sales A/c Dr. To Trading A/c Items of expenses, losses, etc. are closed by recording the following entries: Profit and Loss A/c Dr. To Expenses (individually) A/c To Losses (individually) A/c Items of incomes, gains, etc. are closed by recording the following entry: Incomes (individually) A/c Dr. Gains (individually) A/c Dr. To Profit and Loss A/c The posting for closing the seven accounts of expenses and revenues as they appear in the trial balance (in our example 1) are given below: (i) For closing the accounts of expenses Trading A/c Dr. 83,000 To Purchases A/c 75,000 To Wages A/c 8,000 (ii) Profit and Loss A/c Dr. 43,500 To Salaries 25,000 To Rent of building 13,000 To Bad debts 4,500 (i) For closing the accounts of revenues Sales A/c Dr. 1,25,000 To Trading A/c 1,25,000 (ii) Commission received A/c Dr. 5,000 To Profit and Loss A/c 5,000 The posting done in ledger will appear as follows : Purchases Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Balance b/d 75,000 Trading 75,000 75,000 75,000 2022-23 Financial Statements - I 329 Wages Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Balance b/d 8,000 Trading 8,000 8,000 8,000 Salaries Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Balance b/d 25,000 Profit and Loss 25,000 25,000 25,000 Rent of Building Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Balance b/d 13,000 Profit and Loss 13,000 13,000 13,000 Bad Debts Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Balance b/d 4,500 Profit and Loss 4,500 4,500 4,500 Sales Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Trading 1,25,000 Balance b/d 1,25,000 1,25,000 1,25,000 Commission Received Account Dr. Cr. Date Particulars J.F. Amount Date Particulars J.F. Amount ` ` Profit and Loss 5,000 Balance b/d 5,000 5,000 5,000 2022-23 330 Accountancy As result of the foregoing discussion, we will now learn how the trading and profit and loss account can be prepared from the trial balance, the format of which is shown in figure 9.2. However, this list is not exhaustive. In real sense, there can be many more of other items, which we will be dealing at the later stage and there you will notice how this format undergoes a change with respect to each one of them. Trading and Profit and Loss Account of ABC for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Opening stock ..... Sales ..... Purchases ..... Wages ..... Carriage inwards/ ..... Freight inwards/cartage Gross profit c/d1 Gross loss b/d2 xxx xxx Gross loss c/d1 ..... Gross profit b/d ..... Rent/rates and taxes ..... Inerest received ..... Salaries .... Repairs and renewals ..... Net loss2 Bad debts ..... Net profit2 (transferred to ..... capital account) xxx xxx 1,2either of the items computed Fig. 9.2 : A format trading and profit and loss account 9.4.3 Concept of Gross Profit and Net Profit The trading and profit and loss can be seen as combination of two accounts, viz. Trading account and Profit and Loss account. The trading account or the first part ascertains the gross profit and profit and loss account or the second part ascertains net profit. Trading Account The trading account ascertains the result from basic operational activities of the business. The basic operational activity involves the manufacturing, purchasing and selling of goods. It is prepared to ascertain whether the selling 2022-23 Financial Statements - I 331 of goods and/or rendering of services to customers have proved profitable for the business or not. Purchases is one of the main constituents of expenses in business organisation. Besides purchases, the remaining expenses are divided into two categories, viz. direct expenses and indirect expenses. Direct expenses means all expenses directly connected with the manufacture, purchase of goods and bringing them to the point of sale. Direct expenses include carriage inwards, freight inwards, wages, factory lighting, coal, water and feul, royalty on production, etc. In our example-1, besides purchases, four more items of expenses are listed. These are wages, salaries, rent of building and bad debts. Out of these items, wages is treated as direct expense while the other three are treated as indirect expenses. Similarly, sales constitute the main item of revenue for the business. The excess of sales over purchases and direct expenses is called gross profit. If the amount of purchases including direct expenses is more than the sales revenue, the resultant figure is gross loss. The computation of gross profit can be shown in the form of equation as : Gross Profit = Sales – (Purchases + Direct Expenses) The gross profit or the gross loss is transferred to profit and loss account. The indirect expenses are transferred to the debit side of the second part, viz. profit and loss account. All revenue/gains other than sales are transferred to the credit side of the profit and loss account. If the total of the credit side of the profit and loss account is more than the total of the debit side, the difference is the net profit for the period of which it is being prepared. On the other hand, if the total of the debit side is more than the total of the credit side, the difference is the net loss incurred by the business firm. In an equation form, it is shown as follows : Net Profit = Gross Profit + Other Incomes – Indirect Expenses Net profit or net loss so computed is transferred to the capital account in the balance sheet by way of the following entry : (i) For transfer of net profit Profit and Loss A/c Dr. To Capital A/c (ii) For transfer of net loss Capital A/c Dr. To Profit and Loss A/c We are now redrafting the trading and profit and loss account to show gross profit and net profit of Ankit for the year ended March 31, 2017. The redrafted trading and profit and loss account will look like as shown is shown in figure 9.3. 2022-23 332 Accountancy Trading and Profit and Loss Account of Ankit for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Purchases 75,000 Sales 1,25,000 Wages 8,000 Gross profit c/d 42,000 1,25,000 1,25,000 Salaries 25,000 Gross profit b/d 42,000 Rent of building 13,000 Commission received 5,000 Bad debts 4,500 Net Profit (transfered to 4,500 capital account) 47,000 47,000 Fig. 9.3 : Showing the computation of gross profit and net profit of Ankit Gross profit, which represents the basic operational activity of the business is computed as ` 42,000. The gross profit is transferred from trading account to profit and loss account. Besides gross profit, business has earned an income of ` 5,000 as commission received and has spent ` 42,500 (` 25,000 + `13,000 + `4,500) on expenses/losses including salaries, rent and bad debts. Therefore, the net profit is calculated as ` 4,500. Illustration 1 Prepare a trading account from the following particulars for the year ended March 31, 2017: ` Opening stock 37,500 Purchases 1, 05,000 Sales 2,70,000 Wages 30,000 Solution Trading Account for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Opening stock 37,500 Sales 2,70,000 Purchases 1,05,000 Wages 30,000 Gross profit 97,500 2,70,000 2,70,000 2022-23 Financial Statements - I 333 Illustration 2 Prepare a trading account of M/s Prime Products from the following particulars pertaining to the year 2016-17. ` Opening stock 50,000 Purchases 1,10,000 Return inwards 5,000 Sales 3,00,000 Return outwards 7,000 Factory rent 30,000 Wages 40,000 Solution Books of Prime Products Trading Account for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Opening stock 50,000 Sales 3,00,000 Purchases 1,10,000 Less : Return (5,000) 2,95,000 Less : Return (7,000) 1,03,000 inwards outwards Factory rent 30,000 Wages 40,000 Gross profit 72,000 2,95,000 2,95,000 Illustration 3. Prepare a trading account of M/s Anjali from the following information related to March 31, 2017. ` Opening stock 60,000 Purchases 3, 00,000 Sales 7, 50,000 Purchases return 18,000 Sales return 30,000 Carriage on purchases 12,000 Carriage on sales 15,000 Factory rent 18,000 Office rent 18,000 Dock and Clearing charges 48,000 Freight and Octroi 6,500 Coal, Gas and Water 10,000 2022-23 334 Accountancy Solution Books of Anjali Trading Account for the year ended March 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Opening stock 60,000 Sales 7,50,000 Purchases 3,00,000 Less : Sales return (30,000) 7,20,000 Less : Purchases return (18,000) 2,82,000 Carriage on purchases 12,000 Factory rent 18,000 Dock and Clearing charges 48,000 Freight and Octroi 6,500 Coal, Gas and Water 10,000 Gross profit 2,83,500 7,20,000 7,20,000 Illustration 4 From the following information, prepare a profit and loss account for the year ending March 31, 2017. ` Gross profit 60,000 Rent 5,000 Salary 15,000 Commission paid 7,000 Interest paid on loan 5,000 Advertising 4,000 Discount received 3,000 Printing and stationery 2,000 Legal charges 5,000 Bad debts 1,000 Depreciation 2,000 Interest received 4,000 Loss by fire 3,000 Profit and Loss Account for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Rent 5,000 Gross profit 60,000 Salary 15,000 Discount received 3,000 Commission 7,000 Interest received 4,000 Interest paid on loan 5,000 Advertising 4,000 Printing and Stationery 2,000 Legal charges 5,000

2022-23 Financial Statements - I 335 Bad debts 1,000 Depreciation 2,000 Loss by fire 3,000 Net profit (transferred to the 18,000 capital account) 67,000 67,000 Test Your Understanding - I I State True or False : (i) Gross profit is total revenue. (ii) In trading and profit and loss account, opening stock appears on the debit side because it forms the part of the cost of sales for the current accounting year. (iii) Rent, rates and taxes is an example of direct expenses. (iv) If the total of the credit side of the profit and loss account is more than the total of the debit side, the difference is the net profit. II Match the items given under 'A' with the correct items under 'B' (i) Closing stock is credited to (a) Trial balance (ii) Accuracy of book of account is tested by (b) Trading account (iii) On returning the goods to seller, the buyer sends (c) Credit note (iv) The financial position is determined by (d) Balance sheet (v) On receiving the returned goods from the (e) Debit note buyer, the seller sends 9.4.4 Cost of Goods Sold and Closing Stock–Trading Account Revisited The trading and profit and loss account prepared in figure 9.3 presents useful information as to the profitability from the basic operations of the business enterprise. It is reproduced for further perusal. Trading Account of Ankit for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Purchases 75,000 Sales 1,25,000 Wages 8,000 Gross profit 42,000 1,25,000 1,25,000 Fig. 9.4 : An illutrative trading account of Ankit 2022-23 336 Accountancy If there is no opening or closing stock, the total of purchases and direct expenses is taken as Cost of goods sold. In our example, notice that purchases amount to ` 75,000 and wages amounts to ` 8,000. Hence, the cost of goods sold will be computed using the following formula : Cost of Goods Sold = Purchases + Direct Expenses = `75,000 + ` 8,000 = ` 83,000 As there is no unsold stock, the presumption here is that all the goods purchased have been sold. But in practice, there is some unsold goods at the end of the accounting period. In our example, let us assume that out of the goods purchased amounting to ` 75,000 in the current year, Ankit is able to sell goods costing ` 60,000 only. In such a situation, the business will have an unsold stock of goods costing ` 15,000 in hand, also called closing stock. The amount of cost of goods sold will be computed as per the following equation : Cost of Goods Sold = Purchases + Direct Expenses – Closing Stock = ` 75,000 + ` 8,000 – ` 15,000 As a result, the amount of gross profit will also change with the existence of closing stock in business from ` 42,000 (as computed in figure 9.4) to ` 57,000 (refer figure 9.5). Trading Account of Ankit for the year ended March 31, 2017 Expenses/Losses Amount Revenues/Gains Amount ` ` Purchases 75,000 Sales 1,25,000 Wages 8,000 Closing stock 15,000 Gross profit c/d 57,000 1,40,000 1,40,000 Salaries 25,000 Gross profit b/d 57,000 Rent of building 13,000 Commission received 5,000 Bad debts 4,500 Net Profit (transfered to 19,500 capital account) 62,000 62,000 Fig. 9.5 : The trading account of Ankit 2022-23 Financial Statements - I 337 It may be noted that closing stock does not normally form part of trial balance, and is brought into books with the help of the following journal entry : Closing stock A/c Dr. To Trading A/c This entry opens a new account of asset, i.e. closing stock ` 15,000 which is transferred to the balance sheet. The closing stock shall be an opening stock for the next year and shall be sold during the year. In most cases, therefore, the business shall have opening stock as well as closing stock every year, and the cost of goods sold should be worked as per the following equation: Cost of Goods Sold = Opening Stock+Purchases Direct Expenses–Closing Stock Look at Illustration 5 and see how it has been computed. Illustration 5 Compute cost of goods sold for the year 2017 with the help of the following information and prepare trading account ` Sales 20, 00,000 Purchases 15, 00,000 Wages 1, 00,000 Stock (Apr. 01, 2016) 3, 00,000 Stock (March 31, 2017) 4,00,000 Freight inwards 1,00,000 Solution Computation of Cost of Goods Sold Particulars Amount ` Opening stock 3,00,000 Add Purchases 15,00,000 Direct expenses : Freight inwards 1,00,000 Wages 1,00,000 20,00,000 Less Closing stock (4,00,000) Cost of goods sold 16,00,000 2022-23 338 Accountancy Trading Account for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Opening stock 3,00,000 Sales 20,00,000 Purchases 15,00,000 Closing stock 4,00,000 Freight inwards 1,00,000 Wages 1,00,000 Gross profit 4,00,000 24,00,000 24,00,000 Illustration 6 From the following balances obtained from the few accounts of Mr. H. Balaram. Prepare the Trading and Profit and Loss Account. ` ` Stock on Apr. 01, 2016 8,000 Bad debts 1,200 Purchases for the year 22,000 Rent 1,200 Sales for the year 42,000 Discount allowed 600 Purchase expenses 2,500 Commission paid 1,100 Salaries and wages 3,500 Sales expenses 600 Advertisement 1,000 Repairs 600 Closing stock on March 31, 2017 is ` 4,500 Books of H. Balaram Trading Account for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Opening stock 8,000 Sales 42,000 Purchases 22,000 Closing stock 4,500 Purchase expenses 2,500 Gross profit c/d 14,000 46,500 46,500 Salaries and Wages 3,500 Gross profit b/d 14,000 Rent 1,200 Advertisement 1,000 Commission 1,100 Discount allowed 600 Bad debts 1,200 Sales expenses 600 Repairs 600 Net profit 4,200 (transferred to capital account) 14,000 14,000 2022-23 Financial Statements - I 339 9.5 Operating Profit (EBIT) It is the profit earned through the normal operations and activities of the business. Operating profit is the excess of operating revenue over operating expenses. While calculating operating profit, the incomes and expenses of a purely financial nature are not taken into account. Thus, operating profit is profit before interest and tax (EBIT). Similarly, abnormal items such as loss by fire, etc. are also not taken into account. It is calculated as follows: Operating profit = Net Profit+ Non Operating Expenses – Non Operating Incomes Refer to the trial balance of Ankit in example 1 (Page no. 336), you will notice that it depicts an item relating to 10% interest on long-term loan raised on April 01, 2017. The amount of interest works out to ` 500 (` 5,000 × 10/100), which has been shown on the debit side of the trading and profit and loss account (figure 9.6). Trading and Profit and Loss Account of Ankit for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Purchases 75,000 Sales 1,25,000 Wages 8,000 Closing stock 15,000 Gross profit c/d 57,000 1,40,000 1,40,000 Salaries 25,000 Gross profit b/d 57,000 Rent of building 13,000 Commission received 5,000 Bad debts 4,500 Interest 500 Net Profit (transferred 19,000 to capital account) 62,000 62,000 Fig. 9.6 : Showing the treatment of interest on profit The operating profit will be : Operating profit = Net profit + Non-operating expenses – Non-operating incomes Operating profit= ` 19,000 + 500 – nil = ` 19,500 2022-23 340 Accountancy Test Your Understanding - II Choose the correct option in the following questions : 1. The financial statements consist of: (i) Trial balance (ii) Profit and loss account (iii) Balance sheet (iv) (i) & (iii) (v) (ii) & (iii) 2. Choose the correct chronological order of ascertainment of the following profits from the profit and loss account : (i) Operating Profit, Net Profit, Gross Profit (ii) Operating Profit, Gross Profit, Net Profit (iii) Gross Profit, Operating Profit, Net Profit (iv) Gross Profit, Net Profit, Operating Profit 3. While calculating operating profit, the following are not taken into account. (i) Normal transactions (ii) Abnormal items (iii) Expenses of a purely financial nature (iv) (ii) & (iii) (v) (i) & (iii) 4. Which of the following is correct : (i) Operating Profit = Operating profit – Non-operating expenses – Non-operating incomes (ii) Operating profit = Net profit + Non-operating Expenses + Non-operating incomes (iii) Operating profit = Net profit + Non-operating Expenses – Non-operating incomes (iv) Operating profit = Net profit – Non-operating Expenses + Non-operating incomes Illustration 7 Following balance is extracted from the books of a trader ascertain gross profit, operating profit and net profit for the year ended March 31, 2017. Particulars Amount ` Sales 75,250 Purchases 32,250 Opening stock 7,600 Sales return 1,250 Purchases return 250 Rent 300 Stationery and printing 250 Salaries 3,000 Misc. expenses 200 Travelling expenses 500 Advertisement 1,800 2022-23 Financial Statements - I 341 Commission paid 150 Office expenses 1,600 Wages 2,600 Profit on sale of investment 500 Depreciation 800 Dividend on investment 2,500 Loss on sale of old furniture 300 Closing stock (March 31, 2017) valued at ` 8,000 Trading and Profit and Loss Account for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Opening stock 7,600 Sales 75,250 Purchases 32,250 Less : Sales return (1,250) 74,000 Less: Purchases return (250) 32,000 Closing stock 8,000 Wages 2,600 Gross profit c/d 39,800 82,000 82,000 Rent 300 Gross profit b/d 39,800 Stationery and printing 250 Salaries 3,000 Misc. expenses 200 Travelling expenses 500 Advertisement expenses 1,800 Commission paid

150 Office expenses 1,600 Depreciation 800 Operating profit c/d 31,200 39,800 39,800 Loss on sale of old furniture 300 Operating profit b/d 31,200 Net Profit (transferred to capital 33,900 Profit on sale of investment 500 account) Dividend on investment 2,500 34,200 34,200 9.6 Balance Sheet The balance sheet is a statement prepared for showing the financial position of the business summarising its assets and liabilities at a given date. The assets reflect debit balances and liabilities (including capital) reflect credit balances. It is prepared at the end of the accounting period after the trading and profit and 2022-23 342 Accountancy loss account have been prepared. It is called balance sheet because it is a statement of balances of ledger accounts that have not been transferred to trading and profit and loss account and are to be carried forward to the next year with the help of an opening entry made in the journal at the beginning of the next year. 9.6.1 Preparing Balance Sheet All the account of assets, liabilities and capital are shown in the balance sheet. Accounts of capital and liabilities are shown on the left hand side, known as Liabilities. Assets and other debit balances are shown on the right hand side, known as Assets. There is no prescribed form of Balance sheet, for a proprietary and partnership firms. (However, Schedule III Part I of the Companies Act 2013 prescribes the format and the order in which the assets and liabilities of a company should be shown). The horizontal format in which the balance sheet is prepared is shown in the figure 9.7. Balance Sheet of ....as at March 31, 2017 Liabilities Amount Assets Amount ` ` Capital ..... Furniture ..... Add Profit .... Cash ..... Long-term loan ..... Bank ..... Short-term loan Goodwill ..... Sundry creditors ..... Sundry debtors ..... Bills payable Land and Buildings Bank overdraft Closing stock xxxx xxxx Fig. 9.7 : Format of a balance sheet Refer to our example -1 you will observe that the trial balance of Ankit depicts 14 accounts, out of which 7 accounts have been transferred to the trading and profit and loss account (refer figure 9.3). These are the accounts of revenues and expenses. The analysis of figure 9.3 shows that the business has incurred total expenses of ` 1,25,500 and revenues generated are ` 1,30,000 making a profit of ` 4,500. The remaining seven items in the trial balance reflects the capital, assets and liabilities. We are reproducing the trial balance (example -1) to show how the accounts of assets and liabilities of Ankit would be presented in the balance sheet. 2022-23 Financial Statements - I 343 Trial Balance of Ankit as on March 31, 2017 Account Title L.F. Debit Credit Amount Amount ` ` Cash 1,000 Capital 12,000 Bank 5,000 Sales 1,25,000 Wages 8,000 Creditors 15,000 Salaries 25,000 10% Long-term loan 5,000 (raised on April 01, 2016) Furniture 15,000 Commission received 5,000 Rent of building 13,000 Debtors 15,500 Bad debts 4,500 Purchases 75,000 1,62,000 1,62,000 Fig. 9.8 : Showing the accounts of assets and liabilities in the trial balance of Ankit Balance Sheet of Ankit as at March 31, 2017 Liabilities Amount Assets Amount ` ` Capital 12,000 Furniture 15,000 Add Profit 4,500 16,500 Cash 1,000 10 % Long-term loan 5,000 Bank 5,000 Creditors 15,000 Debtors 15,500 36,500 36,500 Fig. 9.9 : Showing the balance sheet of Ankit 9.6.2 Relevant Items in the Balance Sheet Items which are generally included in a balance sheet are explained below : (1) Current Assets: Current assets are those which are either in the form of cash or a can be converted into cash within a year. The examples of such assets are cash in hand/bank, bills receivable, stock of raw materials, semi-finished goods and finished goods, sundry debtors, short term investments, prepaid expenses, etc. 2022-23 344 Accountancy (2) Current Liabilities: Current liabilities are those liabilities which are expected to be paid within a year and which are usually to be paid out of current assets. The examples of such liabilities are bank overdraft, bills payable, sundry creditors, short-term loans, outstanding expenses, etc. (3) Fixed Assets: Fixed assets are those assets, which are held on a long-term basis in the business. Such assets are not acquired for the purpose of resale, e.g. land, building, plant and machinery, furniture and fixtures, etc. Some times the term 'Fixed Block' or 'Block Capital' is also used for them. (4) Intangible Assets : These are such assets which cannot be seen or touched. Goodwill, Patents, Trademarks are some of the examples of intangible assets. (5) Investments: Investments represent the funds invested in government securities, shares of a company, etc. They are shown at cost price. If, on the date of

preparation the balance sheet, the market price of investments is lower than the cost price, a footnote to that effect may be appended to the balance sheet. (6) Long-term Liabilities : All liabilities other than the current liabilities are known as long-term liabilities. Such liabilities are usually payable after one year of the date of the balance sheet. The important items of long term liabilities are long-term loans from bank and other financial institutions. (7) Capital: It is the excess of assets over liabilities due to outsiders. It represents the amount originally contributed by the proprietor/ partners as increased by profits and interest on capital and decreased by losses drawings and intrest on drawings. (8) Drawings : Amount withdrawn by the proprietor is termed as drawings and has the effect of reducing the balance on his capital account. Therefore, the drawings account is closed by transferring its balance to his capital account. However it is shown by way of deduction from capital in the balance sheet. 9.6.3 Marshalling and Grouping of Assets and Liabilities A major concern of accounting is about preparing and presenting the financial statement. The information so provided should be decision useful for the users. Therefore, it becomes necessary that the items appearing in the balance sheet should be properly grouped and presented in a particular order. Marshalling of Assets and Liabilities In a balance sheet, the assets and liabilities are arranged either in the order of liquidity or permanence. Arrangement of assets and liabilities in a particular order is known as Marshalling. In case of permanence, the most permanent asset or liability is put on the top in the balance sheet and thereafter the assets are arranged in their reducing level of permanence. 2022-23 Financial Statements - I 345 In the balance sheet of Ankit you will find that furniture is the most permanent of all the assets. Out of debtors, bank and cash, debtors will take maximum time to convert back into cash. Bank is less liquid than cash. Cash is the most liquid of all the assets. Similarly, on the liabilities side, the capital, being the most important source of finance will tend to remain in the business for a longer period than the long-term loan. Creditors being a liquid liability will be discharged in the near future. The balance sheet of Ankit in the order of permanence is shown in figure 9.10(a). Balance Sheet of Ankit as on March 31, 2017 (in order of permanence) Liabilities Amount Assets Amount ` ` Capital 12,000 Furniture 15,000 Add Profit 4,500 16,500 Debtors 15,500 10 % Long-term loan 5,000 Bank 5,000 Creditors 15,000 Cash 1,000 36,500 36,500 Fig. 9.10 (a) : Items of balance sheet shown in the order of permanance In case of liquidity, the order is reversed. The information presented in this manner would enable the user to have a good idea about the life of the various accounts. The assets account of the relatively permanent nature would continue in the business for a longer time whereas the less permanent or more liquid accounts will change their forms in the near future and are likely to become cash or cash equivalent. The balance sheet of Ankit in the order of liquidity is shown in figure 9.10(b) Balance Sheet of Ankit as at March 31, 2017 (in order of liquidity) Liabilities Amount Assets Amount ` ` Creditors 15,000 Cash 1,000 10 % Long-term loan 5,000 Bank 5,000 Capital 12,000 Debtors 15,500 Add Profit 4,500 16,500 Furniture 15,000 36,500 36,500 Fig. 9.10 (b) : Items of balance sheet shown in the order of liquidity 2022-23 346 Accountancy Grouping of Assets and Liabilities The items appearing in the balance sheet can also be properly grouped. The term grouping means putting together items of similar nature under a common heading. For example, the balance of accounts of cash, bank, debtors, etc. can be grouped and shown under the heading of 'current assets' and the balances of all fixed assets and long-term investment under the heading of 'non-current assets'. Balance Sheet of Ankit as at March 31, 2017 (in order of permanence) Liabilities Amount Assets Amount ` ` Owners Funds Non Current Assets Capital 12,000 Furniture 15,000 Add Profit 4,500 16,500 Current Assets Non-Current Liabilities Debtors 15,500 Long-term loan 5,000 Bank 5,000 Current Liabilities Cash 1,000 Creditors 15,000 36,500 36,500 Fig. 9.10 (c): Showing assets and liabilities arranged in logical groups Do it Yourself Arrange the following items in the order of both permanence and liquidity. Also group them under logical heads : Liabilities Assets Long-term loans Building Bank overdraft Cash in hand Bills payable Cash at bank Owner's equity Bills receivable Short-term loans Sundry debtors Sundry creditors Land

Finished goods Work in progress Raw material 2022-23 Financial Statements - I 347 Illustration 8 From the following balances prepare a trading and profit and loss account and balance sheet for the year ended March 31, 2017 Account Title Amount Account Title Amount ` ` Carriage on goods 8,000 Cash in hand 2,500 purchased Bank overdraft 30,000 Carriage on goods sold 3,500 Motor car 60,000 Manufacturing expenses 42,000 Drawings 8,000 Advertisement 7,000 Audit fees 2,700 Excise duty 6,000 Plant 1,53,900 Factory lighting 4,400 Repairs to plant 2,200 Debtors 80,000 Stock at the end 76,000 Creditors 61,000 Purchases less return 1,60,000 Dock and Clearing charges 5,200 Commission on purchases 2,000 Postage and Telegram 800 Incidental trade expenses 3,200 Fire Insurance Premium 3,600 Investment 30,000 Patents 12,000 Interest on investment 4,500 Income tax 24,000 Capital 1,00,000 Office expenses 7,200 Sales less return 5,20,000 Salest tax paid 12,000 Discount allowed 2,700 Discount on purchases 3,400 2022-23 348 Accountancy Trading and Profit and Loss Account for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Purchases less return 1,60,000 Sales less return 5,20,000 Commission on purchases 2,000 Carriageongoodspurchasesd 8,000 Manufacturing expenses 42,000 Factory lighting 4,400 Dock and Clearing charges 5,200 Gross profit c/d 2,98,400 5,20,000 5,20,000 Carriage on sales 3,500 Gross profit b/d 2,98,400 Advertisement 7,000 Interest on investment 4,500 Excise duty 6,000 Discount on purchases 3,400 Postage and telegram 800 Fire Insurance premium 3,600 Office expenses 7,200 Audit fees 2,700 Repairs to plant 2,200 Incidental trading expenses 3,200 Sales tax paid 12,000 Discount allowed 2,700 Net profit 2,55,400 (transferred to capital account) 3,06,300 3,06,300 Balance Sheet as at March 31, 2017 Liabilities Amount Assets Amount ` ` Bank overdraft 30,000 Cash in hand 2,500 Creditors 61,000 Debtors 80,000 Capital 1,00,000 Closing stock 76,000 Add Net profit 2,55,400 Investment 30,000 3,55,400 Motor car 60,000 Less Drawings (8,000) Plant 1,53,900 3,47400 Patents 12,000 Less Income tax (24,000) 3,23,400 4,14,400 4,14,400 2022-23 Financial Statements - I 349 Illustration 9 From the following balances prepare trading and profit and loss account and balance sheet for the year ended March 31, 2017 Account Title Amount Account Title Amount ` ` Opening stock 15,310 Capital 2,50,000 Purchases 82,400 Drawings 48,000 Sales 256,000 Sundry debtors 57,000 Returns (Dr.) 4,000 Sundry creditors 12,000 Returns (Cr.) 2,400 Depreciation 4,200 Factory rent 18,000 Charity 500 Custom duty 11,500 Cash balance 4,460 Coal, gas & power 6,000 Bank balance 4,000 Wages and salary 36,600 Bank charges 180 Discount (Dr.) 7,500 Establishment expenses 3,600 Commission (Cr.) 1,200 Plant 42,000 Bad debts 5,850 Leasehold building 1,50,000 Bad debts recovered 2,000 Sales tax collected 2,000 Apprenticeship premium 4,800 Goodwill 20,000 Production expenses 2,600 Patents 10,000 Adminstrative expenses 5,000 Trademark 5,000 Carriage 8,700 Loan (Cr.) 25,000 Interest on loan 3,000 The value of closing stock on March 31, 2017 was ` 25,400 Solution Trading and Profit and Loss Account for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Opening stock 15,310 Sales: 2,56,000 Purchases: 82,400 Less Returns (4,000) 2,52,000 Less Returns : (2,400) 80,000 Factory rent 18,000 Closing stock 25,400 Custom duty 11,500 Coal, gas, power 6,000 Wages and salary 36,600 Production expenses 2,600 Carriage 8,700 Gross profit c/d 98,690 2,77,400 2,77,400 2022-23 350 Accountancy Discount (Dr.) 7,500 Gross profit b/d 98,690 Bad debts 5,850 Commission 1,200 Administrative expenses 5,000 Bad debts recovered 2,000 Depreciation 4,200 Apprenticeship premium 4,800 Charity 500 Bank charges 180 Establishment expenses 3,600 Interest on loan 3,000 Net profit 76,860 (transferred to capital account) 1,06,690 1,06,690 Balance Sheet as at March 31, 2017 Liabilities Amount Assets Amount ` ` Sales tax collected 2,000 Cash balance 4,460 Sundry creditors 12,000 Bank balance 4,000 Loan 25,000 Sundry debtors 57,000 Capital 2,50,000 Closing stock 25,400 Add Net profit 76,860 Leasehold building 1,50,000 3,26,860 Plant 42,000 Patents 10,000 Less Drawings (48,000) 2,78,860 Goodwill 5,000 Trade mark 20,000 3,17,860 3,17,860 9.7 Opening Entry The balances of various accounts in balance sheet are carried forward from one accounting period to another accounting period. In fact, the balance sheet of an accounting period becomes the opening trial balance of the next accounting period. Next year an opening entry is made which opens these accounts contained in the balance sheet. Refer the balance sheet shown in figure 9.10(c). The opening entry with regard to it will be recorded as follows : Furniture A/c Dr. 15,000 Debtors A/c Dr. 15,500 Bank's A/c Dr. 5,000 Cash A/c Dr. 1,000 To Capital A/c 16,500 To 10 % Long-term loan A/c 5,000 To Creditors A/c 15,000 2022-23 Financial Statements - I 351 Key Terms Introduced in the Chapter • Balance Sheet • Grouping and Marshalling • Bills Payable • Bank Overdraft • Capital • Bills Receivable • Capital Receipts • Capital Expenditure • Carriage Outwards • Carriage Inwards • Closing Entries • Cash at Bank • Current Assets • Closing Stock • Purchases Return • Currents Liabilities • Return Inwards • Rent • Revenue Expenditure • Return Outwards • Discount Allowed • Depreciation • Cash • Discount Received • Factory Expenses • Trade Expenses • Fixed Assets • Financial Statements • Gross Profit • Freight • Income Tax • Gross Loss • Interest on Drawings • Interest on Capital • Net Profit • Net Loss • Order of Performance • Revenue Expenditure and Liquidity • Salaries • Revenue Receipts • Sales Return • Sales • Opening Entries Summary with Reference to Learning Objectives 1 Meaning, usefulness and types of financial statements : After the agreement of the trial balance, a business enterprise proceeds to prepare financial statements. Financial statements are the statements, which present periodic reports on the process of business enterprises and the results achieved during a given period. Financial statements includs trading and profit and loss account, balance sheet and other statements and explanatory notes, which form part thereof. Information provided by financial statements is useful to management to plan and control the business operations. Financial statement are also useful to creditors, shareholders and employees of the enterprise. 2 Meaning need and preparation of trading and profit and loss account : The profit and loss account highlights the profit earned or loss sustained by the business entity in the course of business operation during a given period. The need for preparing the trading and profit and loss account is to ascertain the net result of business operations during a given period. The profit and loss account shows the items of revenue expenses and losses on the debit side, while items of gain and gross profit are shown on the credit side. For the preparation of the trading and profit and loss account, closing entries are recorded to transfer balances of account of items of expenses and revenues. Net profit or net loss shown by the profit and loss account is transferred to the capital account. 2022-23 352 Accountancy 3 Meaning, characteristic, need and structure of the balance sheet : The balance sheet is a statement of assets and liabilities of a business enterprise and shows the financial position at a given date Informations contained in a balance sheet is true only on that date. The balance sheet is a part of the final account. But it is not an account, it is only a statement. In a balance sheet the totals of assets and liabilities are always equal. It portrays the accounting equation. A balance sheet has to be prepared to know the financial position of the business, and the nature and values of its assets and liabilities. All the accounts which have not been closed till the preparation of the profit and loss account are shown in the balance sheet. Assets and liabilities shown in the balance sheet are marshalled in order of liquidity or in order of permanence. Questions for Practice Short Answers 1. What are the objectives of preparing financial statements ? 2. What is the purpose of preparing trading and profit and loss account? 3. Explain the concept of cost of goods sold? 4. What is a balance sheet. What are its characteristics? 5. Distinguish between capital and revenue expenditure and state whether the following statements are items of capital or revenue expenditure : (a) Expenditure incurred on repairs and whitewashing at the time of purchase of an old building in order to make it usable. (b) Expenditure incurred to provide one more exit in a cinema hall in compliance with a government order. (a) Registration fees paid at the time of purchase of a building (b) Expenditure incurred in the maintenance of a tea garden which will produce tea after four years. (c) Depreciation charged on a plant. (d) The expenditure incurred in erecting a platform on which a machine will be fixed. (e) Advertising expenditure, the benefits of which will last for four years. 6. What is an operating profit? Long Answers 1. What are financial statements? What information do they provide. 2. What are closing entries? Give four examples of closing entries. 3. Discuss the need of preparing a balance sheet. 4. What is meant by Grouping and Marshalling of assets and liabilities. Explain the ways in which a balance sheet may be marshalled. Numerical Questions 1. From the following balances taken from the books of Simmi and Vimmi Ltd. for the year ending March 31, 2017, calculate the gross profit. (`) Closing stock 2,50,000 Net sales during the year 40,00,000 Net purchases during the year 15,00,000 2022-23 Financial Statements - I 353 Opening stock 15,00,000 Direct expenses 80,000 (Ans. Gross profit `11,70,000) 2. From the following balances extracted from the books of M/s Ahuja and Nanda. Calculate the amount of : (a) Cost of goods available for sale (b) Cost of goods sold during the year (c) Gross Profit ` Opening stock 25,000 Credit purchases 7,50,000 Cash purchases 3,00,000 Credit sales 12,00,000 Cash sales 4,00,000 Wages 1,00,000 Salaries 1,40,000 Closing stock 30,000 Sales return 50,000 Purchases return 10,000 (Ans. (a) ` 11,65,000 ; (b) `11,35,000 ; (c) `4,15,000 3. Calculate the amount of gross profit and operating profit on the basis of the following balances extracted from the books of M/s Rajiv & Sons for the year ended March 31, 2017. ` Opening stock 50,000 Net sales 11,00,000 Net purchases 6,00,000 Direct expenses 60,000 Administration expenses 45,000 Selling and distribution expenses 65,000 Loss due to fire 20,000 Closing stock 70,000 (Ans. Gross profit `4,60,000, Operating profit `3,50,000) 4. Operating profit earned by M/s Arora & Sachdeva in 2016-17 was `17,00,000. Its non-operating incomes were `1,50,000 and non-operating expenses were `3,75,000. Calculate the amount of net profit earned by the firm. (Ans. Net profit `14,75,000) 5. The following are the extracts from the trial balance of M/s Bhola & Sons as on March 31, 2017 Account title Debit Credit ` ` Opening stock 2,00,000 Purchases 8,10,000 Sales 10,10,000 10,10,000 10,10,000 (only relevant items) Closing Stock as on date was valued at `3,00,000. 2022-23 354 Accountancy You are required to record the necessary journal entries and show how the above items will appear in the trading and profit and loss account and balance sheet of M/s Bhola & Sons. 6. Prepare trading and profit and loss account and balance sheet as on March 31, 2017 : Account Title Amount Account Title Amount ` ` Machinery 27,000 Capital 60,000 Sundry debtors 21,600 Bills payable 2,800 Drawings 2,700 Sundry creditors 1,400 Purchases 58,500 Sales 73,500 Wages 15,000 Sundry expenses 600 Rent & taxes 1,350 Carriage inwards 450 Bank 4,500 Openings stock 6,000 Closing stock as on March 31, 2017 `22,400 [Ans. Gross profit `15,950, Net profit `14,000, Total balance sheet `75,500] 7. The following trial balance is extracted from the books of M/s Ram on March 31, 2017. You are required to prepare trading and profit and loss account and the balance sheet as on date : Account title Amount Account title Amount ` ` Debtors 12,000 Apprenticeship premium 5,000 Purchases 50,000 Loan 10,000 Coal, gas and water 6,000 Bank overdraft 1,000 Factory wages 11,000 Sales 80,000 Salaries 9,000 Creditors 13,000 Rent 4,000 Capital 20,000 Discount 3,000 Advertisement 500 Drawings 1,000 Loan 6,000 Petty cash 500 Sales return 1,000 Machinery 5,000 Land and building 10,000 Income tax 100 Furniture 9,900 (Ans. Gross profit: ` 12,000, Net profit: ` 500, Total balance sheet: ` 43,400) 2022-23 Financial Statements - I 355 8. The following is the trial balance of Manju Chawla on March 31, 2017. You are required to prepare trading and profit and loss account and a balance sheet as on date : Account title Debit Credit Amount Amount ` ` Opening stock 10,000 Purchases and sales 40,000 80,000 Returns 200 600 Productive wages 6,000 Dock and Clearing charges 4,000 Donation and charity 600 Delivery van expenses 6,000 Lighting 500 Sales tax collected 1,000 Bad debts 600 Misc. incomes 6,000 Rent from tenants 2,000 Royalty 4,000 Capital 40,000 Drawings 2,000 Debtors and Creditors 6,0000 7,000 Cash 3,000 Investment 6,000 Patents 4,000 Land and Machinery 43,000 Closing stock ` 2,000. (Ans. Gross Profit: ` 18,400, Net profit: ` 18,700, Total balance sheet: ` 64,700) 9. The following is the trial balance of Mr. Deepak as on March 31, 2017. You are required to prepare trading account, profit and loss account and a balance sheet as on date : Account title Debit Account title Credit Amount Amount ` ` Drawings 36,000 Capital 2,50000 Insurance 3,000 Bills payable 3,600 General expenses 29,000 Creditors 50,000 Rent and taxes 14,400 Discount recived 10,400 Lighting (factory) 2,800 Purchases return 8,000 Travelling expenses 7,400 Sales 4,40,000 Cash in hand 12,600 Bills receivable 5,000 2022-23 356 Accountancy Sundry debtors 1,04,000 Furniture 16,000 Plant and Machinery 1,80,000 Opening stock 40,000 Purchases 1,60,000 Sales return 6,000 Carriage inwards 7,200 Carriage outwards 1,600 Wages 84,000 Salaries 53,000 Closing stock ` 35,000. (Ans. Gross profit: `1,83,000, Net profit : ` 85,000, Total balance sheet: ` 3,52,600) 10. Prepare trading and profit and loss account and balance sheet from the following particulars as on March 31, 2017. Account Title Debit Credit Amount Amount ` ` Purchases and Sales 3,52,000 5,60,000 Return inwards and Return outwards 9,600 12,000 Carriage inwards 7,000 Carriage outwards 3,360 Fuel and power 24,800 Opening stock 57,600 Bad debts 9,950 Debtors and Creditors 1,31,200 48,000 Capital 3,48,000 Investment 32,000 Interest on investment 3,200 Loan 16,000 Repairs 2,400 General expenses 17,000 Wages and salaries 28,800 Land and buildings 2,88,000 Cash in hand 32,000 Miscellaneous receipts 160 Sales tax collected 8,350 Closing stock ` 30,000. (Ans. Gross profit: ` 1,22,200, Net profit : `92,850, Total balance sheet: `5,13,200) 11. From the following trial balance of Mr. A. Lal, prepare trading, profit and loss account and balance sheet as on March 31, 2017. 2022-23 Financial Statements - I 357 Account Title Debit Credit Amount Amount ` ` Stock as on April 01, 2016 16,000 Purchases and Sales 67,600 1,12,000 Returns inwards and outwards 4,600 3,200 Carriage inwards 1,400 General expenses 2,400 Bad debts 600 Discount received 1,400 Bank over draft 10,000 Interest on bank overdraft 600 Commission received 1,800 Insurance and taxes 4,000 Scooter expenses 200 Salaries 8,800 Cash in hand 4,000 Scooter 8,000 Furniture 5,200 Building 65,000 Debtors and Creditors 6,000 16,000 Capital 50,000 Closing stock ` 15,000. (Ans. Gross profit : ` 40,600, Net profit: ` 27,200, Total balance sheet: ` 1,03,200) 12. Prepare trading and profit and loss account and balance sheet of M/s Royal Traders from the following balances as on March 31, 2017. Debit balances Amount Credit balances Amount ` ` Stock 20,000 Sales 2,45,000 Cash 5,000 Creditors 10,000 Bank 10,000 Bills payable 4,000 Carriage on purchases 1,500 Capital 2,00,000 Purchases 1,90,000 Drawings 9,000 Wages 55,000 Machinery 1,00,000 Debtors 27,000 Postage 300 Sundry expenses 1,700 Rent 4,500 Furniture 35,000 Closing stock `8,000 (Ans. Gross loss ` 13,500, Net loss ` 20,000, Total balance sheet ` 1,85,000) 2022-23 358 Accountancy 13. Prepare trading and profit and loss account from the following particulars of M/s Neema Traders as on March 31, 2017. Account Title Debit Account Title Credit Amount Amount ` ` Buildings 23,000 Sales 1,80,000 Plant 16,930 Loan 8,000 Carriage inwards 1,000 Bills payable 2,520 Wages 3,300 Bank overdraft 4,720 Purchases 1,64,000 Creditors 8,000 Sales return 1,820 Capital 2,36,000 Opening stock 9,000 Purchases return 1,910 Machinery 2,10,940 Insurance 1,610 Interest 1,100 Bad debts 250 Postage 300 Discount 1,000 Salaries 3,000 Debtors 3,900 Stock on March 31, 2017 `16,000. (Ans. Gross profit `17,850, Net profit ` 10,590, Total of balance sheet `2,69,830) 14. From the following balances of M/s Nilu Sarees as on March 31, 2017. Prepare trading and profit and loss account and balance sheet as on date. Account Title Debit Account Title Credit Amount Amount ` ` Opening stock 10,000 Sales 2,28,000 Purchases 78,000 Capital 70,000 Carriage inwards 2,500 Interest 7,000 Salaries 30,000 Commission 8,000 Commission 10,000 Creditors 28,000 Wages 11,000 Bills payable 2,370 Rent & taxes 2,800 Repairs 5,000 Telephone expenses 1,400 Legal charges 1,500 Sundry expenses 2,500 cash in hand 12,000 Debtors 30,000 Machinery 60,000 Investments 90,000 Drawings 18,000 2022-23 Financial Statements - I 359 Closing stock as on March 31, 2017 `22,000. (Ans. Gross profit ` 1,56,500, Net profit ` 1,10,300, Total balance sheet `2,14,000) 15. Prepare trading and profit and loss account of M/s Sports Equipments for the year ended March 31, 2017 and balance sheet as on that date : Account Title Debit Credit Amount Amount ` ` Opening stock 50,000 Purchases and sales 3,50,000 4,21,000 Sales returns 5,000 Capital 3,00,000 Commission 4,000 Creditors 1,00,000 Bank overdraft 28,000 Cash in hand 32,000 Furniture 1,28,000 Debtors 1,40,000 Plants 60,000 Carriage on purchases 12,000 Wages 8,000 Rent 15,000 Bad debts 7,000 Drawings 24,000 Stationery 6,000 Travelling expenses 2,000 Insurance 7,000 Discount 5,000 Office expenses 2,000 Closing stock as on

March 31, 2017 `2,500 (Ans. Gross loss ` 1,500, Net loss ` 41,500 , Total balance sheet `3,62,500) Checklist to Test Your Understanding 1. Test Your Understanding - I I (i) T (ii) T (iii) F (iv) T II (i) b (ii) a (iii) e (iv) c (v) d 2. Test Your Understanding - II 1. (v) 2. (iii) 3. (iv) 4. (iii) 2022-23360 Accountancy Financial Statements - II 10 I n chapter 9, you learnt about the preparation of simple final accounts in the format of trading and profit and loss account and balance sheet. The preparation of simple final accounts pre-supposes the absence of any accounting complexities which are normal to business operations. These complexities arise due to the fact that the process of determining income and financial position is based on the accrual basis of accounting. This emphasises that while ascertaining the profitability, the revenues be considered on earned basis and not on receipt basis, and the expenses be considered on incurred basis and not on paid basis. Hence, many items need some adjustment while preparing the financial statements. In this chapter we shall discuss all items which require adjustments and the way these are brought into the books of account and incorporated in the final accounts. 10.1 Need for Adjustments According to accrual concept of accounting, the profit or loss for an accounting year is not based on the revenues realised in cash and the expenses paid in cash during that year. There may exist some receipts and expenses in the current year which partially relate to the previous year or to the next year. Also, there may exist incomes and expenses relating to the current year that still need to be brought into books of account. Such items duly adjusted, the final accounts will not reflect the true and fair view of the state of affairs of the business. LEARNING OBJECTIVES After studying this chapter, you will be able to : • describe the need for adjustments while preparing the financial statements; • explainthe accounting treatment of adjustments for outstanding and prepaid expenses, accrued and advance receipts of incomes; • discuss the adjustments to be made regarding depreciation, bad debts, provision for doubtful debts, provision for discount on debtors; • explain the concepts and adjustment of manager's commission and interest on capital; • prepare profit and loss account and balance sheet with adjustments. 2022-23 Financial Statements - II 361 For example, an amount of ` 1,200 paid on July 01, 2016 towards insurance premium. Any general insurance premium paid usually covers a period of 12 months. Suppose the accounting year ends on March 31,2017, it would mean that one fourth of the insurance premium is paid on July 01, 2016 relate to the next accounting year 2017-18. Therefore, while preparing the financial statements for 2016-17, the expense on insurance premium that should be debited to the profit and loss account is ` 900 (` 1,200 – ` 300). Let us take another example. The salaries for the month of March, 2017 were paid on April 07, 2017. This means that the salaries account of 2016-17 does not include the salaries for the month of March 2017. Such unpaid salaries is termed as salaries outstanding which have to be brought into books of account and is debited to profit and loss account along with the salaries already paid for the month of April, 2016 up to Feburary, 2017. Similarly, adjustments may also become necessary in respect of certain incomes received in advance or those which have accrued but are still to be received. Apart from these, there are certain items which are not recorded on day-to-day basis such as depreciation on fixed assets, interest on capital, etc. These are adjusted at the time of preparing financial statements. The purpose of making various adjustments is to ensure that the final accounts reveal the true profit or loss and the true financial position of the business. The items which usually need adjustments are: 1. Closing stock 2. Outstanding/expenses 3. Prepaid/Unexpired expenses 4. Accrued income 5. Income received in advance 6. Depreciation 7. Bad debts 8. Provision for doubtful debts 9. Provision for discount on debtors 10. Manager's commission 11. Interest on capital It may be noted that when we prepare the financial statements, we are provided with the trial balance and some other additional information in respect of the adjustments to be made. All adjustments are reflected in the final accounts at two places to complete the double entry. Our earlier example in chapter 9 (Page no. 336) which represents the trial balance of Ankit is reproduced in figure 10.1: 2022-23 362 Accountancy Trial Balance of Ankit as on March 31, 2017 Account Title Elements L.F. Debit Credit Amount Amount

` ` Cash Assets 1,000 Bank Assets 5,000 Wages Expense 8,000 Salaries Expense 25,000 Furniture Assets 15,000 Rent of building Expense 13,000 Debtors Assets 15,500 Bad debts Expense 4,500 Purchases Expense 75,000 Capital 12,000 Equity Sales Revenue 1,25,000 Creditors Liabilities 15,000 Long-term loan (raised on 1.4.2013) Liabilities 5,000 Commission received Revenue 5,000 Total 1,62,000 1,62,000 Additional Information : The stock on March 31, 2017 was ` 15,000. Figure 10.1 : Showing the trial balance of Ankit We will now study about the items of adjustments and you will observe how these adjustments are helpful in the preparation of financial statements in order to reflect the true profit and loss and financial position of the firm. 10.2 Closing Stock As per the example in chapter 9 (Page no. 336), the closing stock represents the cost of unsold goods lying in the stores at the end of the accounting period. The adjustment with regard to the closing stock is done by (i) by crediting it to the trading and profit and loss account, and (ii) by showing it on the asset side of the balance sheet. The adjustment entry to be recorded in this regard is : Closing stock A/c Dr. To Trading A/c The closing stock of the year becomes the opening stock of the next year and is reflected in the trial balance of the next year. The trading and profit and 2022-23 Financial Statements - II 363 loss account of Ankit for the year ended March 31, 2017 and his balance sheet as on that date shall appear as follows : Trading and Profit and Loss Account of Ankit for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Purchases 75,000 Sales 1,25,000 Wages 8,000 Closing stock 15,000 Gross profit c/d 57,000 1,40,000 1,40,000 Salaries 25,000 Gross profit b/d 57,000 Rent of building 13,000 Commission received 5,000 Bad debts 4,500 Net profit (transferred to 19,500 Ankit's capital account) 62,000 62,000 Sometimes the opening and closing stock are adjusted through purchases account. In that case, the entry recorded is as follows : Closing stock A/c Dr. To Purchases A/c This entry reduces the amount in the purchases account and is also known as adjusted purchases which is shown on the debit side of the trading and profit and loss account. In this context, it may be noted, that the closing stock will not be shown on the credit side of the trading and profit and loss as it has been already been adjusted through the purchases account. Not only, in such a situation, even the opening stock will not be separately reflected in the trading and profit and loss account, as it is also adjusted in purchases by recording the following entry: Purchases A/c Dr. To Opening stock A/c Another important point to be noted in this context is that when the opening and closing stocks are adjusted through purchases, the trial balance does not show any opening stock. Instead, the closing stock shall appear in the trial balance (not as additional information or as an adjustment item) and so also the adjusted purchases. In such a situation, the adjusted purchases shall be debited to the trading and profit and loss account. 2022-23 364 Accountancy The closing stock shall be shown on the assets side of the balance sheet as shown below: Balance Sheet of Ankit as at March 31, 2017 Liabilities Amount Assets Amount ` ` Owners funds Non-Current Assets Capital 12,000 Furniture 15,000 Add Net profit 19,500 31,500 Current Assets Non-Current Liabilities Debtors 15,500 Long-term loan 5,000 Bank 5,000 Current Liabilities Cash 1,000 Creditors 15,000 Closing stock 15,000 51,500 51,500 10.3 Outstanding Expenses It is quite common for a business enterprise to have some unpaid expenses in the normal course of business operations at the end of an accounting year. Such items usually are wages, salaries, interest on loan, etc. When expenses of an accounting period remain unpaid at the end of an accounting period, they are termed as outstanding expenses. As they relate to the earning of revenue during the current accounting year, it is logical that they should be duly charged against revenue for computation of the correct amount of profit or loss. The entry to bring such expenses into account is : Concerned expense A/c Dr. To Outstanding expense A/c The above entry opens a new account called Outstanding Expenses which is shown on the liabilities side of the balance sheet. The amount of outstanding expenses is added to the total of expenses under a particular head for the purpose of preparing trading and profit and loss account. For example, refer to Ankit's trial balance (refer figure 10.1). You will notice that wages are shown at ` 8,000. Let us assume that Ankit owes `500 as wages relating to the year 2016-17 to one of his employees. In that case, the correct expense on wages amounts to ` 8,500 instead of ` 8,000. Ankit must show ` 8,500 as expense on account of wages in the trading and profit and loss account and recognise a current liability of ` 500 towards the sum owed to his staff. It will be referred to as wages outstanding and it will be adjusted to wages account by recording the following journal entry: Wages A/c Dr. 500 To Wages outstanding A/c 500 2022-23 Financial Statements - II 365 The amount of outstanding wages will be added to wages account for the preparation of the trading and profit and loss account as follows : Trading and Profit and Loss Account of Ankit for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Purchases 75,000 Sales 1,25,000 Wages 8,000 Add Outstanding wages 500 8,500 Closing stock 15,000 Gross profit c/d 56,500 1,40,000 1,40,000 Salaries 25,000 Gross profit b/d 56,500 Rent of building 13,000 Commission received 5,000 Bad debts 4,500 Net profit (transferred to 19,000 Ankit's capital account) 61,500 61,500 Observe carefully the trading and profit and loss account of Ankit. Did you notice the amount of net profit is reduced to ` 19,000 on account of outstanding wages. The item relating to outstanding wages will be shown in balance sheet as follows : Balance Sheet of Ankit as at March 31, 2017 Liabilities Amount Assets Amount ` ` Owners Funds Non-Current Assets Capital 12,000 Furniture 15,000 Add Profit 19,000 31,000 Current Assets Non-Current Liabilities Debtors 15,500 Long-term loan 5,000 Bank 5,000 Current Liabilities Cash 1,000 Creditors 15,000 Closing stock 15,000 Outstanding wages 500 51,500 51,500 10.4 Prepaid Expenses There are several items of expense which are paid in advance in the normal course of business operations. At the end of the accounting year, it is found that the benefits of such expenses have not yet been fully received; a portion 2022-23 366 Accountancy of its benefit would be received in the next accounting year. This portion of expense, is carried forward to the next year and is termed as prepaid expenses. The necessary adjustment in respect of prepaid expenses is made by recording the following entry: Prepaid expense A/c Dr. To concerned expense A/c The effect of the above adjustment entry is that the amount of prepaid part is deducted from the total of the particular expense, and the new account of prepaid expense is shown on the assets side of the balance sheet. For example, in Ankit's trial balance, let us assume that the amount of salary paid by him to the employees includes an amount of ` 5,000 which was paid in advance to one of his employees upon his joining the office. This implies that Ankit has overpaid his staff by ` 5,000 on account of his salary. Hence, correct expense on account of salary during the current period will be ` 20,000 instead of ` 25,000. Ankit must show ` 20,000 expense on account of salary in the profit and loss account and recognise a current asset of ` 5,000 as an advance salary to the employee. It will be termed as prepaid salary account and will be recorded by the following journal entry : Prepaid salary A/c Dr. 5,000 To salary A/c 5,000 The account of prepaid salary will be shown in the trading and profit and loss account as follows: Trading and Profit and Loss Account of Ankit for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Purchases 75,000 Sales 1,25,000 Wages 8,000 Closing stock 15,000 Add Outstanding wages 500 8,500 Gross profit c/d 56,500 1,40,000 1,40,000 Salaries 25,000 Gross profit b/d 56,500 Less Prepaid salary (5,000) 20,000 Rent of building 13,000 Commission received 5,000 Bad debts 4,500 Net profit (transferred to Ankit 24,000 capital account) 61,500 61,500 2022-23 Financial Statements - II 367 Observe how the prepaid salary has resulted in an increase of net profit by ` 5,000 making it as ` 24,000 Further, the item relating to prepaid salary will be shown in the balance sheet on the assets side as follows : Balance Sheet of Ankit as at March 31, 2017 Liabilities Amount Assets Amount ` ` Owners Funds Non-Current Assets Capital 12,000 Furniture 15,000 Add Profit 24,000 36,000 Current Assets Non-Current Liabilities Debtors 15,500 Long-term loan 5,000 Prepaid salary 5,000 Current Liabilities Bank 5,000 Cash 1,000 Creditors 15,000 Closing stock 15,000 Outstanding wages 500 56,500 56,500 10.5 Accrued Income It may also happen that certain items of income such as interest on loan, commission, rent, etc. are earned during the current accounting year but have not been actually received by the end of the same year. Such incomes are known as accrued income. The adjusting entry for accrued income is : Accrued income A/c Dr. To Concerned income A/c The amount of accrued income will be added to the related income in the profit and loss account and the new account of accrued income will appear on the asset side of the balance sheet. Let us, for example, assume that Ankit was giving a little help to a fellow businessman by introducing few parties to him on commission for this service. In the trial balance of Ankit you will notice an item of commission received amounting to ` 5,000. Assume that the commission amounting to `1,500 was still receivable from the fellow businessman. This implies that income from commission earned during 2016-17 is ` 6, 500 (`5, 000 + ` 1,500) Ankit needs to record an adjustment entry to give effect to the accrued commission as follows : Accrued Commission A/c Dr. 1,500 To Commission A/c 1,500 2022-23 368 Accountancy The account of accrued income will be recorded in trading and profit and loss account as follows : Trading and Profit and Loss Account of Ankit for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Purchases 75,000 Sales 1,25,000 Wages 8,000 Closing stock 15,000 Add Outstanding 500 8,500 Gross profit c/d 56,500 1,40,000 1,40,000 Salaries 25,000 Gross profit b/d 56,500 Less Prepaid salary (5,000) 20,000 Rent of building 13,000 Commission received 5,000 Add Accrued 1,500 6,500 Bad debts 4,500 commission Net profit (transferred to 25,500 Ankit's capital account) 63,000 63,000 Observe that the accrued income has resulted in an increase in the net profit by ` 1,500 making it as ` 25,500. Further, it will be shown in the balance sheet of Ankit on the assets side under the head current asset. Balance Sheet of Ankit as at March 31, 2017 Liabilities Amount Assets Amount ` ` Owners Funds Non-Current Assets Capital 12,000 Furniture 15,000 Add Profit 25,500 37,500 Current Assets Non-Current Liabilities Debtors 15,500 Long-term loan 5,000 Prepaid salary 5,000 Current Liabilities Accrued commission 1,500 Creditors 15,000 Bank 5,000 Outstanding wages 500 Cash 1,000 Closing stock 15,000 58,000 58,000 2022-23 Financial Statements - II 369 10.6 Income Received in Advance Sometimes, a certain income is received but the whole amount of it does not belong to the current period. The portion of the income which belongs to the next accounting period is termed as income received in advance or an Unearned Income. Income received in advance is adjusted by recording the following entry: Concerned income A/c Dr. To Income received in advance A/c The effect of this entry will be that the balance in the income account will be equal to the amount of income earned for the current accounting period, and the new account of income received in advance will be shown as a liability in the balance sheet. For example, let us assume Ankit has agreed in March 31, 2017 to sublet a part of the building to a fellow shopkeeper @ ` 1,000 per month. The person gives him rent in advance for the next three months of April, May and June. The amount received had been credited to the profit and loss account. However, this income does not pertain to current year and hence will not be credited to profit and loss account. It is income received in advance and will be recognised as a liability amounting to ` 3,000. Ankit needs to record an adjustment entry to give effect to income received in advance by way of following journal entry: Rent received A/c Dr. 3,000 To Rent received in advance A/c 3,000 This will lead a new account of rent received in advance of ` 3,000 which will appear as follows : Balance Sheet of Ankit as at March 31, 2017 Liabilities Amount Assets Amount ` ` Owners Funds Non Current Assets Capital 12,000 Furniture 15,000 Add Net profit 25,500 37,500 Current Assets Non Current Liabilities Debtors 15,500 Long-term loan 5,000 Prepaid salary 5,000 Current Liabilities Accrued commission 1,500 Creditors 15,000 Bank 5,000 Outstanding wages 500 Cash 4,000 Rent received in advance 3,000 Closing stock 15,000 61,000 61,000 2022-23 370 Accountancy 10.7 Depreciation Recall from chapter 7 (Part-I), that depreciation is the decline in the value of assets on account of wear and tear and passage of time. It is treated as a business expense and is debited to profit and loss account. This, in effect, amounts to writing-off a portion of the cost of an asset which has been used in the business for the purpose of earning profits. The entry for providing depreciation is : Depreciation A/c Dr. To Concerned asset A/c In the balance sheet, the asset will be shown at cost minus the amount of depreciation. For example, the trial balance in our example shows that Ankit has a furniture account with a balance of ` 15,000. Let us assume that furniture is subject to a depreciation of 10% per annum. This implies that Ankit must recognise that at the end of the year the value attached to furniture is to be reduced by ` 1,500 (` 15,000 × 10%). Ankit needs to record an adjustment entry to give effect to depreciation on furniture as follows : Depreciation A/c Dr. 1,500 To Furniture A/c 1,500 Depreciation will be shown in the profit and loss account and balance sheet as follows : Trading and Profit and Loss Account of Ankit for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Purchases 75,000 Sales 1,25,000 Wages 8,000 Closing stock 15,000 Add Outstanding wages (500) 8,500 Gross Profit c/d 56,500 1,40,000 1,40,000 Salaries 25,000 Gross profit b/d 56,500 Less Prepaid salary (5,000) 20,000 Rent of building 13,000 Commission received 5,000 6,500 Add Accrued 1,500 Depreciation-Furniture 1,500 Commission Bad debts 4,500 Net profit (transferred to 24,000 Ankit's capital account) 63,000 63,000 Notice that the amount of net profit declines with the adjustment of depreciation. Let us now see how depreciation as an expense will be shown in balance sheet. 2022-23 Financial Statements - II 371 Balance Sheet of Ankit as at March 31, 2017 Liabilities Amount Assets Amount ` ` Owners Funds Non-Current Assets Capital 12,000 Furniture 15,000 Add Profit 24,000 36,000 Less Depreciation (1,500) 13,500 Non-Current Liabilities Current Assets Long-term loan 5,000 Debtors 15,500 Current Liabilities Prepaid salary 5,000 Creditors 15,000 Accrued commission 1,500 Outstanding wages 500 Bank 5,000 Rent received in advance 3,000 Cash 4,000 Closing stock 15,000 59,500 59,500 10.8 Bad Debts Bad debts refer to the amount that the firm has not been able to realise from its debtors. It is regarded as a loss and is termed as bad debt. The entry for recording bad debt is: Bad debts A/c Dr. To Debtors A/c You will notice in Ankit's trial balance, that it contains bad debts amounting to ` 4,500. Whereas, the sundry debtors of Ankit are reported as ` 15,500. The existence of bad debts in the trial balance signifies that Ankit has incurred a loss arising out of bad debts during the year and which has been already recorded in the books of account. However, assuming one of his debtors who owed him ` 2,500 had become insolvent, and nothing is receivable from him. But the amount of bad debts related to the current year is still to be account for. This fact appears as additional information and is termed as further bad debts. The adjustment entry to be recorded for the amount will be as follows. For this purpose, Ankit needs to record an adjustment entry as under : Bad debts A/c Dr. 2,500 To Debtors A/c 2,500 This entry will reduce the value of debtors to ` 13,000( ` 15,500 – ` 2,500) and increases the amount of bad debts to ` 7,000 (` 4,500 + ` 2,500). 2022-23 372 Accountancy The treatment of further bad debts in profit and loss account and balance sheet is shown below : Trading and Profit and Loss Account of Ankit for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Purchases 75,000 Sales 1,25,000 Wages 8,000 Closing stock 15,000 Add Outstanding wages 500 8,500 Gross profit c/d 56,500 1,40,000 1,40,000 Salaries 25,000 Gross profit b/d 56,500 Less Prepaid salary (5,000) 20,000 Rent of building 13,000 Commission received 5,000 Add Accrued 1,500 6,500 1,500 commission Depreciation – Furniture Bad Debts 4,500 Add Further bad debts 2,500 7,000 Net profit (transferred to 21,500 Ankit's capital account) 63,000 63,000 Balance Sheet of Ankit as at March 31, 2017 Liabilities Amount Assets Amount ` ` Owners Funds Non-Current Assets Capital 12,000 Furniture 15,000 Add Profit 21,500 33,500 Less Depreciation (1,500) 13,500 Non-Current Liabilities Current Assets Long-term loan 5,000 Debtors 15,500 Less Further bad debts (2,500)13,000 Current Liabilities and Provisions Prepaid salary 5,000 Creditors 15,000 Accrued commission 1,500 Bank 5,000 Outstanding Wages 500 Cash 4,000 Closing stock 15,000 Rent received in advance 3,000 57,000 57,000 10.9 Provision for Bad and Doubtful Debts In the above balance sheet, debtors now appears at ` 13,000, which is their estimated realisable value during next year. It is quite possible that the whole 2022-23 Financial Statements - II 373 of this amount may not be realised in future. However, it is not possible to accurately know the amount of such bad debts. Hence, we make a reasonable estimate of such loss and provide the same. Such provision is called provision for bad debts and is created by debiting profit and loss account. The following journal entry is recorded in this context : Profit and Loss A/c Dr. To Provision for doubtful debts A/c Provision for doubtful debts is also shown as a deduction from the debtors on the asset side of the balance sheet. Let us assume, Ankit feels that 5% of his debtors on March 31, 2017 are likely to default on their payments next year. This implies he expects bad debts of ` 650 (` 13,000 × 5%). Ankit needs to record the adjustment entry as : Profit and loss A/c Dr. 650 To Provision for doubtful debts A/c 650 This implies that ` 650 will reduce the current year's profit on account of doubtful debts. In the balance sheet, it will be shown as a deduction from sundry debtors. Trading and Profit and Loss Account of Ankit for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Purchases 75,000 Sales 1,25,000 Wages 8,000 Closing stock 15,000 Add Outstanding 500 8,500 Gross profit c/d 56,500 1,40,000 1,40,000 Salaries 25,000 Gross profit b/d 56,500 Less Prepaid salary (5,000) 20,000 Rent of building 13,000 Commission received 5,000 Depreciation – Furniture 1,500 Add Accrued 1,500 6,500 Bad debts 4,500 commission Add Further bad debts 2,500 7,000 Provision for doubtful debts 650 Net profit (transferred to Ankit's 20,850 capital account) 63,000 63,000 2022-23 374 Accountancy Balance Sheet of Ankit as at March 31, 2017 Liabilities Amount Assets Amount ` ` Owners Funds Non-Current Assets Capital 12,000 Furniture 15,000 Add Net profit 20,850 32,850 Less Depreciation (1,500) 13,500 Non-Current Liabilities Current Assets Long-term loan 5,000 Debtors 15,500 Less Furtherbad debts 2,500 13,000 Less Provision for 650 12,350 doubtful debts Current Liabilities & Provisions Prepaid salary 5,000 Creditors 15,000 Accrued commission 1,500 Outstanding wages 500 Bank 5,000 Rent received in advance 3,000 Cash 4,000 Closing stock 15,000 56,350 56,350 It may be noted that the provision created for doubtful debts at the end of a particular year will be carried forward to the next year and it will be used for meeting the loss due to bad debts incurred during the next year. The provision for doubtful debts brought forward from the previous year is called the opening provision or old provision.When such a provision already exists, the loss due to bad debts during the current year are adjusted against the same and while making provision for doubtful debts required at the end of the current year is called new provision. The balance of old provision as given in trial balance should also be taken into account. Let us take an example to understand how bad debts and provision for doubtful debts are recorded. An extract from a trial balance on March 31, 2017 is given below : ` Sundry debtors 32,000 Bad debts 2,000 Provision for doubtful debts 3,500 Additional Information : Write-off further bad debts ` 1,000 and create a provision for doubtful debts @ 5% on debtors. 2022-23 Financial Statements - II 375 In this case, the following journal entries will be recorded : Debit Credit Date Particulars L.F. Amount Amount ` ` March (a) Bad debts A/c Dr. 1,000 31, 2017 To Sundry debtors 1,000 (Futher bad debts) (b) Provision for doubtful debts A/c Dr. 3,000 To Bad debts A/c 3,000 (Bad debts adjusted against the provision) Profit and Loss A/c Dr. 1,050 To Provision for doubtful debts A/c 1,050 (Amount charges from profit and loss account) Profit and Loss Account for the year ended March 31, 2017 ` ` Provision for doubtful debts: Bad debts 2,000 Further bad debts 1,000 New provision 1,550 4,550 Less Old provision 3,500 1,050 *Only relevant items. Balance Sheet as at March 31, 2017 ` Sundry debtors 32,000 Less Further (1,000) bad debts 31,000 Less Provision (1,550) for doubtful debts 29,450 *Only relevant items. Note : The amount of new provision for doubtful debts has been calculated as follows: ` 31,000 1 × 5/100 = ` 1,550. 10.10 Provision for Discount on Debtors A business enterprise allows discount to its debtors to encourage prompt payments. Discount likely to be allowed to customers in an accounting year 2022-23 376 Accountancy can be estimated and provided for by creating a provision for discount on debtors. Provision for discount is made on good debtors which are arrived at by deducting further bad debts and the provision for doubtful debts. The following journal entry is recorded to create provision for discount on debtors: Profit and loss A/c Dr. To Provision for discount on debtors A/c As stated above, the provision for discount on debtors will be created only on good debtors. It will be calculated on the amount of debtors arrived at after deducting the doubtful debts, i.e. ` 12,350 (` 13,000 – ` 650).

Ankit needs to record the adjustment entry as : Profit and loss A/c Dr. 227 To Provision for discount on debtors A/c 227 This will reduce the current year profit by ` 227 on account of probable discount on prompt payment. In the balance sheet, it will be shown as a deduction from the debtors account to portray correctly the expected realiable value of debtors as ` 12,123. Trading and Profit and Loss Account of Ankit for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Purchases 75,000 Sales 1,25,000 Wages 8,000 Closing stock 15,000 Add Outstanding wages (500) 8,500 Gross profit c/d 56,500 1,40,000 1,40,000 Salaries 25,000 Gross profit b/d 56,500 Less Prepaid salary (5,000) 20,000 Rent of building 13,000 Commission received 5,000 Add Accrued 1,500 6,500 Depreciation–Furniture 1,500 commission Bad debts 4,500 Add Further bad debts 2,500 7,000 Provision for doubtful debts 650 Provision for discount on debtors 227 Net profit (transferred to 20,623 Ankit's capital account) 63,000 63,000 2022-23 Financial Statements - II 377 Balance Sheet of Ankit as on March 31, 2017 Liabilities Amount Assets Amount ` ` Owners Funds Non-Current Assets Capital 12,000 Furniture 15,000 Add Net profit 20,623 32,623 Less Depreciation (1,500) 13,500 Non-Current Liabilities Current Assets Long-term loan 5,000 Debtors 15,500 Less Further 2,500 bad debts 13,000 Less Provision for doubtful 650 debts 12,350 Less Provision for discount on debtors (227) 12,123 Current Liabilities & Provisions Prepaid salary 5,000 Creditors 15,000 Accrued commission 1,500 Bank 5,000 Outstanding wages 500 Cash 4,000 Closing stock 15,000 Rent received in advance 3,000 56,123 56,123 In the subsequent year, the discount will be transferred to the provision for discount on debtors account. The account will be treated in the same manner as the provision for doubtful debts. 10.11 Manager's Commission The manager of the business is sometimes given the commission on the net profit of the company. The percentage of the commission is applied on the profit either before charging such commission or after charging such commission. In the absence of any such information, it is assumed that commission is allowed as a percentage of the net profit before charging such commission. Suppose the net profit of a business is ` 110 before charging commission. If the manager is entitled to 10% of the profit before charging such commission, the commission will be calculated as : = ` 110 × 10 100 = ` 11 2022-23 378 Accountancy In case the commission is 10% of the profit after charging such commission, it will be calculated as : = Profit before commission × Rate of commission/ (100 + commission) ` ` 10 110 = 1 0 11 0 = × The managers commission will be adjusted in the books of account by recording the following entry : Profit and loss A/c Dr. To Manager's commission A/c Let us recall our example and assume that Ankit's manager is entitled to a commission @ 10%. Observe the following profit and loss account if it is based on : (i) amount of net profit before charging such commission (ii) amount of profit after charging such commission. (i) Trading and Profit and Loss Account of Ankit for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Purchases 75,000 Sales 1,25,000 Wages 8,000 Closing stock 15,000 Add Outstanding wages 500 8,500 Gross profit c/d 56,500 1,40,000 1,40,000 Salaries 25,000 Gross profit 56,500 Less Prepaid salary (5,000) 20,000 Rent of building 13,000 Commission received 5,000 Add Accrued 1,500 6,500 1,500 commission Depreciation – Furniture Bad debts 4,500 Add Further bad debts 2,500 7,000 Provision for doubtful debts 650 Provision for discount on debtors 227 Manager's commission 2,062 Net profit (transferred to 18,561 Ankit's capital account) 63,000 63,000 2022-23 Financial Statements - II 379 Balance Sheet of Ankit as at March 31, 2017 Liabilities Amount Assets Amount ` ` Owners Funds Non-Current Assets Capital 12,000 Furniture 15,000 Add Net profit 18,561 30,561 Less Depreciation (1,500) 13,500 Non-Current Liabilities Current Assets Long-term loan 5,000 Debtors 15,500 Less Further bad debts(2,500) 13,000 Less Provision for Current Liabilities and Provisions doubtful (650) Creditors 15,000 debts 12,350 Less Provision for discount on debtors (227) 12,123 Outstanding wages 500 Prepaid salary 5,000 Rent received in advance 3,000 Accrued commission 1,500 Bank 5,000 Cash 4,000 Manager's commission 2,062 Closing stock 15,000 outstanding 56,123 56,123 (ii) Trading and Profit and Loss Account of Ankit for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains

Amount ` ` Purchases 75,000 Sales 1,25,000 Wages 8,000 Closing stock 15,000 Add Outstanding wages 500 8,500 Gross profit c/d 56,500 1,40,000 1,40,000 Salaries 25,000 Gross profit b/d 56,500 Less Prepaid salary (5,000) 20,000 Rent of building 13,000 Commission received 5,000 Add Accrued 1,500 6,500 1,500 commission Depreciation–Furniture Bad debts 4,500 Add Further bad debts 2,500 7,000 Provision for doubtful debts 650 Provision for discount on debtors 227 Manager's commission 1,875 Net profit (transferred to Ankit's capital account) 18,748 63,000 63,000 2022-23 380 Accountancy Balance Sheet of Ankit as at March 31, 2017 Liabilities Amount Assets Amount ` ` Owners Funds Non-Current Assets Capital 12,000 Furniture 15,000 Add Net profit 18,748 30,748 Less Depreciation (1,500) 13,500 Non-Current Liabilities Long-term loan 5,000 Current Assets Debtors 15,500 Less Further bad debts (2,500) 13,000 Less Provision for doubtful (650) debts 12,350 Less Provision for Current Liabilities and Provisions discount on debtors(227) 12,123 Creditors 15,000 Prepaid salary 5,000 Outstanding wages 500 Accrued commission 1,500 Bank 5,000 Rent received in advance 3,000 Cash 4,000 Manager commission outstanding 1,875 Closing stock 15,000 56,123 56,123 10.12 Interest on Capital Sometimes, the proprietor may like to know the profit made by the business after providing for interest on capital. In such a situation, interest is calculated at a given rate of interest on capital as at the beginning of the accounting year. If however, any additional capital is brought during the year, the interest may also be computed on such amount from the date on which it was brought into the business. Such interest is treated as expense for the business and the following journal entry is recorded in the books of account: Interest on capital A/c Dr. To Capital A/c In the final accounts, it is shown as an expense on the debit side of the profit and loss account and added to capital in the balance sheet. Let us assume, Ankit decides to provide 5% interest on his capital. This shall amount to ` 600 for which the following journal entry will be recorded: Interest on capital A/c Dr. 600 To Capital A/c 600 This implies that net profit shall be reduced by ` 600. As a result, the reduced amount of profit shall be added to the capital in the balance sheet. But, when 2022-23 Financial Statements - II 381 interest on capital shall be added to the capital, this effect shall be neutralised. As shown below : ` Capital 12,000 Add Profit 17,961 29,961 Add Interest on capital 600 30,561 Test Your Understanding Tick the correct answer : 1. Rahul's trial balance provide you the following information : Debtors ` 80,000 Bad debts ` 2,000 Provision for doubtful debts ` 4,000 It is desired to maintain a provision for bad debts of ` 1,000 State the amount to be debited/credited in profit and loss account : (a) ` 5,000 (Debit) (b) ` 3,000 (Debit) (c) ` 1,000 (Credit) (d) none of these. 2. If the rent of one month is still to be paid the adjustment entry will be : (a) Debit outstanding rent account and Credit rent account (b) Debit profit and loss account and Credit rent account (c) Debit rent account and Credit profit and loss account (d) Debit rent account and Credit outstanding rent account. 3. If the rent received in advance ` 2,000. The adjustment entry will be : (a) Debit profit and loss account and Credit rent account (b) Debit rent account Credit rent received in advance account (c) Debit rent received in advance account and Credit rent account (d) None of these. 4. If the opening capital is ` 50,000 as on April 01, 2016 and additional capital introduced ` 10,000 on January 01, 2017. Interest charge on capital 10% p.a. The amount of interest on capital shown in profit and loss account as on March 31, 2017 will be : (a) ` 5,250 (b) ` 6,000 (c) ` 4,000 (d) Rs, 3,000. 5. If the insurance premium paid ` 1,000 and pre-paid insurance ` 300. The amount of insurance premium shown in profit and loss account will be : (a) ` 1,300 (b) ` 1,000 (c) ` 300 (d) ` 700. 2022-23 382 Accountancy Adjustment Adjustment Entry Treatment in Trading Treatment in and Profit and Loss Balance Sheet Account 1. Closing stock Closing stock A/c Dr. Shown on the credit Shown on the To Trading A/c assets side and profit assets side and loss account 2. Outstanding Expense A/c Dr. Added to the Shown on the expenses To outstanding respective expense liabilities side expense A/c on the debit side 3. Prepaid/ Prepaid expense A/c Dr. Deducted from the Shown on the Unexpired To Expenses A/c respective expense on assets side expenses the debit side 4. Income earned Accured income A/c Dr. Added to the Shown on the but not received To Income A/c respective income assets side on the credit side 5. Income received Income A/c Dr. Deducted from the Shown on the in advance To Income received respective income liabilities in advence A/c on the credit side sides 6. Depreciation Depreciaton A/c Dr. Shown on the debit Deducted from To Assets A/c side the value of asset 7. Provision for Profit and Loss A/c Dr. Shown on the debit Shown as bad and To Provision for side deduction doubtful debts doubtful debts from debtors 8. Provision for Profit and Loss A/c Dr. Shown on the debit Shown as discount on To Provision for side deductoin debtors discount debtors form debtors 9. Manager's Manager's Dr. Shown on the debit Shown on the commission commission A/c side liabilities side To outstanding commission A/c 10. Interest on Interest on capital A/c Dr. Shown on the debit Shown as capital To capital A/c side addition to capital 11. Further bad Bad debts A/c Dr. Shown on the debit Deducted from debts To Sundry Debtors A/c side debtors Fig. 10.2 : Showing treatment of various types of adjustments 2022-23 Financial Statements - II 383 Debit Balances Amount Credit Balances Amount ` ` Drawings 6,300 Capital 1,50,000 Cash at bank 13,870 Discount received 2,980 Bills receivable 1,860 Loans 15,000 Loan and Building 42,580 Purchases return 1,450 Furniture 5,130 Sales 2,81,500 Discount allowed 3,960 Reserve for bad debts 4,650 Bank charges 100 Creditors 18,670 Salaries 6,420 Purchases 1,99,080 Stock (opening) 60,220 Sales return 1,870 Carriage 5,170 Rent and Taxes 7,680 General expenses 3,630 Plant and Machinery 31,640 Book debts 82,740 Bad debts 1,250 Insurance 750 4,74,250 4,74,250 Adjustments 1. Closing stock ` 70,000 2. Create a reserve for bad and doubtful debts @ 10% on book debts 3. Insurance prepaid ` 50 4. Rent outstanding ` 150 5. Interest on loan is due @ 6% p.a. Solution Trading and Profit and Loss Account for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Opening stock 60,220 Sales 2,81,500 Purchase 1,99,080 Less : Sales return (1,870) 2,79,630 Less Purchases return (1,450) 1,97,630 Closing stock 70,000 Carriage 5,170 Gross profit c/d 86,610 3,49,630 3,49,630 Illustration 1 From the following balances, prepare the trading and profit and loss account and balance sheet as on March 31, 2017. 2022-23 384 Accountancy Discount allowed 3,960 Gross profit b/d 86,610 Bank charges 100 Discount received 2,980 Salaries 6,420 Rent and Taxes 7,680 Add Rent outstanding 150 7,830 General expenses 3,630 Insurance 750 Less Insurance prepaid (50) 700 Bad debts 1,250 Add New provision 8,274 for bad debts 9,524 Less Old provision (4,650) for bad debts 4,874 Interest on loan outstanding 900 Net profit (transferred to 61,176 capital account) 89,590 89,590 Balance Sheet as at March 31, 2017 Liabilities Amount Assets Amount ` ` Creditors 18,670 Cash at bank 13,870 Loan 15,000 Add Interest on loan 900 15,900 Book debts 82,740 outstanding Rent outstanding 150 Less Reserve (8,274) 74,466 for bad debts Capital 1,50,000 Bills receivable 1,860 Add Net profit 61,176 Land and Building 42,580 2,11,176 Furniture 5,130 Less Drawings (6,300) 2,04,876 Plant and Machinery 31,640 Insurance (prepaid) 50 Closing stock 70,000 2,39,596 2,39,596 2022-23 Financial Statements - II 385 Illustration 2 The following were the balances extracted from the books of Yogita as on March 31, 2017: Debit Balances Amount Credit Balances Amount ` ` Cash in hand 540 Sales 98,780 Cash at bank 2,630 Return outwards 500 Purchases 40,675 Capital 62,000 Return inwards 680 Sundry creditors 6,300 Wages 8,480 Rent 9,000 Fuel and Power 4,730 Carriage on sales 3200 Carriage on purchases 2040 Opening stock 5,760 Building 32,000 Freehold land 10,000 Machinery 20,000 Salaries 15,000 Patents 7,500 General expenses 3,000 Insurance 600 Drawings 5,245 Sundry debtors 14,500 Taking into account the following adjustments prepare trading and profit and loss account and balance sheet as on March 31, 2017 : (a) Stock in hand on March 31, 2017, was ` 6,800. (b) Machinery is to be depreciated at the rate of 10% and patents @ 20%. (c) Salaries for the month of March, 2017 amounting to ` 1,500 were outstanding. (d) Insurance includes a premium of ` 170 on a policy expiring on September 30, 2017. (e) Further bad debts are ` 725. Create a provision @ 5% on debtors. (f) Rent receivable ` 1,000. 2022-23 386 Accountancy Solution Books of Yogita Trading and Profit and Loss Account for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Opening stock 5,760 Purchases 40,675 Sales 98,780 Less Return outwards (500) 40,175 Less Return inwards (680) 98,100 Wages 8,480 Closing stock 6,800 Fuel and Power 4,730 Carriage on purchases 2,040 Gross profit c/d 43,715 1,04,900 1,04,900 Salaries 15,000 Gross profit b/d 43,715 Add Outstanding salaries 1,500 16,500 Rent 9,000 Carriage 3,200 Add Accrued rent 1,000 10,000 General expenses 3,000 Insurance 600 Less Prepaid insurance (85) 515 Further bad debts 725 Add Provision for doubtful debts 689 1,414 Depreciation : machinery 2,000 Patent 1,500 3,500 Net profit 25,586 (transferred to capital account) 53,715 53,715 Balance Sheet as at March 31, 2017 Dr. Cr. Liabilities Amount Assets Amount ` ` Sundry creditors 6,300 Cash in hand 540 Cash in bank 2,630 Salaries outstanding 1,500 Sundry debtors 14,500 Capital 62,000 Less Further (725) bad debts 13,775 Less Provision (689) 13,086 for bad debts Add Net profit 25,586 Insurance prepaid 85 87,586 Stock 6,800 Rent accrued 1,000 Less Drawings (5,245) 82,341 Freehold land 10,000 Building 32,000 Machinery 20,000 Less Depreciation (2,000) 18,000 Patents 7,500 Less Depreciation (1,500) 6,000 90,141 90,141 2022-23 Financial Statements - II 387 Illustration 3 The following balances were extracted from the books of Shri R. Lal on March 31, 2017: Account Title Amount Account Title Amount ` ` Capital 1,00,000 Rent (Cr.) 2,100 Drawings 17,600 Railway freight on sales 16,940 Purchases 80,000 Carriage inwards 2,310 Sales 1,40,370 Office expenses 1,340 Purchases return 2,820 Printing and Stationery 660 Stock on April 01, 2016 11,460 Postage and Telegram 820 Bad debts 1,400 Sundry debtors 62,070 doubtful debts reserve 3,240 Sundry creditors 18,920 April 01, 2016 Cash in bank 12,400 Rates and Insurance 1,300 Cash in hand 2,210 Discount (Cr.) 190 Office furniture 3,500 Bills receivable 1,240 Salaries and Commission 9,870 Sales returns 4,240 Addition to buildings 7,000 Wages 6,280 Buildings 25,000 Prepare the trading and profit and loss account and a balance sheet as on March 31, 2017 after keeping in view the following adjustments : (i) Depreciate old building by ` 625 and addition to building at 2% and office furniture at 5%. (ii) Write-off further bad debts ` 570. (iii) Increase the bad debts reserve to 6% of debtors. (iv) On March 31, 2017 ` 570 are outstanding for salary. (v) Rent receivable ` 200 on March 31, 2017. (vi) Interest on capital at 5% to be charged. (vii) Unexpired insurance ` 240. (viii) Stock was valued at ` 14,290 on March 31, 2017. 2022-23 388 Accountancy Solution Books of Shri R. Lal Trading and Profit and Loss Account for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenues/Gains Amount ` ` Opening stock 11,460 Sales 1,40,370 Purchases 80,000 Less Sales Return (4,240) 1,36,130 Less Purchase return (2,820) 77,180 Carriage inwards 2,310 Wages 6,280 Closing stock 14,290 Gross profit c/d 53,190 1,50,420 1,50,420 Railway freight on sales 16,940 Gross profit c/d 53,190 Rent 2,100 Office expenses 1,340 Add Accrued rent 200 2,300 Postage and Telegram 820 Discount 190 Printing and Stationery 660 Salary and Commission 9,870 Add Outstanding salary 570 10,440 Rates and Insurance 1,300 Less unexpired insurance (240) 1,060 Bad debts 1,400 Add Further bad debts 570 Add New doubtful debts 3,690 provision 5660 Less Old provision (3,240) 2,420 for bad debts Interest on capital 5,000 Depreciation on building 625 Depreciation on addition 140 to building Depreciation on furniture 175 Net profit (transferred to 16,060 capital account) 55,680 55,680 2022-23 Financial Statements - II 389 Balance Sheet as at March 31, 2017 Liabilities Amount Assets Amount ` ` Sundry creditors 18,920 Cash at bank 12,400 Outstanding salaries 570 Cash in hand 2,210 Capital 1,00,000 Bills receivable 1,240 Add Net profit 16,060 Add Interest on capital 5,000 1,21,060 Debtors 62,070 Less Further bad debts (570) Less Drawings (17,600) 1,03,460 61,500 Less New provision (3,690) 57,810 for doubtful debts Accrued rent 200 Unexpired insurance 240 Building 25,000 Less Depreciation (625) 24,375 Addition to building 7,000 Less Depreciation (140) 6,860 Office furniture 3,500 Less Depreciation (175) 3,325 Closing stock 14,290 1,22,950 1,22,950 Illustration 4 Prepare the trading profit and loss account of M/s Mohit Traders as on 31 March 2017 and draw necessary Journal entries and balance sheet as on that date : Debit Balances Amount Credit Balances Amount ` ` Opening stock 24,000 Sales 4,00,000 Purchases 1,60,000 Return outwards 2,000 Cash in hand 16,000 Capital 1,50,000 Cash at bank 32,000 Creditors 64,000 Return inwards 4,000 Bills payable 20,000 Wages 22,000 Commission received 4,000 Fuel and Power 18,000 Carriage inwards 6,000 Insurance 8,000 Buildings 1,00,000 Plant 80,000 Patents 30,000 Salaries 28,000 Furniture 12,000 Drawings 18,000 Rent 2,000 Debtors 80,000 6,40,000 6,40,000 2022-23 390 Accountancy Adjustments ` (a) Salaries outstanding 12,000 (b) Wages outstanding 6,000 (c) Commission is accrued 2,400 (d) Depreciation on building 5% and plant 3% (e) Insurance paid in advance 700 (f) Closing stock 12,000 Solution Books of Mohit Traders Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2017 March 31 Salary A/c Dr. 12,000 Wages A/c Dr. 6,000 To Salary outstanding A/c 12,000 To Wages outstanding A/c 6,000 (Amount of salary and wages outstanding as on March 31, 2017) March 31 Prepaid Insurance A/c Dr. 1,400 To Insurance A/c 1,400 (Insurance paid in advance] March 31 Commission accrued A/c Dr. 2,400 To Commission A/c 2,400 (Commission accrued but not received) March 31 Depreciation A/c Dr. 7,400 To Building A/c 5,000 To Plant A/c 2,400 (Depreciation charged on plant and building) March 31 Profit and Loss A/c Dr. 1,23,700 To Capital A/c 1,23,700 (Profit transferred to capital account) 2022-23 Financial Statements - II 391 Books of Mohit Traders Trading and Profit and Loss Account for the year ended March 31, 2017 Dr. Cr. Expenses /Losses Amount Revenue/Gains Amount ` ` Opening stock 24,000 Sales 4,00,000 Purchases 1,60,000 Less Returns (4,000) 3,96,000 Less returns (2,000) 1,58,000 Closing stock 12,000 Wages 22,000 Add Outstanding wages 6,000 28,000 Fuel and Power 18,000 Carriage inwards 6,000 Gross profit c/d 1,74,000 4,08,000 4,08,000 Salary 28,000 Gross Profit b/d 1,74,000 Add Outstanding salary 12,000 40,000 Commission received(4,000) Insurances 8,000 Add Accrued 2,400 6,400 Less Prepaid (700) 7,300 commission Rent 2,000 Depreciation on building 5,000 Plants 2,400 Net Profit (transferred to capital 1,23,700 account) 1,80,400 1,80,400 Balance Sheet as at March 31, 2017 Liabilities Amount Assets Amount ` ` Creditors 64,000 Cash in hand 16,000 Bills payable 20,000 Cash at bank 32,000 Capital 1,50.000 Building 95,000 Add Net profit 1,23,700 Plant 77,600 2,73,700 Patents 30,000 Less Drawings (18,000) 2,55,700 Debtors 80,000 Outstanding salaries 12,000 Insurance prepaid 700 Outstanding wages 6,000 Commission accrued 2,400 Furniture 12,000 Closing stock 12,000 3,57,700 3,57,700 2022-23 392 Accountancy Illustration 5 The following information has been extracted from the trial balance of M/s Randhir Transport Corporation. Debit balances Amount Credit balances Amount ` ` Opening stock 40,000 Capital 2,70,000 Rent 2,000 Creditors 50,000 Plant and Machinery 1,20,000 Bills payable 50,000 Land and Buildings 2,55,000 Loan 1,10,000 Power 3,500 Discount 1,500 Purchases 75,000 Sales 1,50,000 Sales return 2,500 Provision for bad debts 1,000 Telegram and Postage 400 General reserves 50,000 Wages 4,500 Salary 2,500 Insurance 3,200 Discount 1,000 Repair and Renewals 2,000 Legal charges 700 Trade taxes 1,200 Debtors 75,000 Investment 65,000 Bad debts 2,000 Trade expenses 4,500 Commission 1,250 Travelling expenses 1,230 Drawings 20,020 6,82,500 6,82,500 Adjustments 1. Closing stock for the year was ` 35,500. 2. Depreciation charged on plant and machinery 5% and land and building 6%. 3. Interest on drawing @ 6% and Interest on loan @ 5%. 4. Interest on investments @ 4%. 5. Further bad debts 2,500 and make provision for doubtful debts on debtors 5%. 6. Discount on debtors @ 2%. 7. Salary outstanding ` 200. 8. Wages outstanding ` 100. 9. Insurance prepaid ` 500. You are required to make trading and profit and loss account and a balance sheet on March 31, 2017. 2022-23 Financial Statements - II 393 Solution Books of Randhir Transport Corporation Trading and Profit and Loss Account for the year ended March 31, 2017 Expenses/Losses Amount Revenue/Gains Amount ` ` Opening stock 40,000 Sales 1,50,000 Purchases 75,000 Less Sales return (2,500) 1,47,500 Wages 4,500 Closing stock 35,500 Add Outstanding wages 100 4,600 Power 3,500 Gross profit c/d 59,900 1,83,000 1,83,000 Rent 2,000 Gross profit b/d 59,900 Telegram and Postage 400 Outstanding interest 2,600 on investment Salary 2,500 Discount 1,500 Add Outstanding salary 200 2,700 Interest on drawings 1,200 Insurance 3,200 Less Prepaid (500) 2,700 Discount 1,000 Repair and Renewals 2,000 Legal charges 700 Trade taxes 1,200 Trade expenses 4,500 Outstanding interest on loan 5,500 Commission 1,250 Travelling expenses 1,230 Discount on debtors 1,450 Depreciation on Plant and 6,000 Machinery Depreciation on Land and 15,300 Building Bad debts 2,000 Add Further bad debts 2,500 Add New provision 3,553

8,053 Less Old provision (1,000) 7,053 Net Profit (transferred to 10,217 capital account) 65,200 65,200 2022-23 394 Accountancy Balance Sheet as at March 31, 2017 Liabilities Amount Assets Amount ` ` Creditors 50,000 Debtors 75,000 Bills payable 50,000 Less Further (2,500) Loan 1,10,000 bad debts 72,500 Add Outstanding interest 5,500 1,15,500 Less Discount (1,450) General reserve 50,000 71,050 Capital 2,70,000 Less New Provision (3,553) 67,497 Add Net Profit 10,217 Investment 65,000 2,80,217 Outstanding interest 2,600 on investment Less Drawings (20,020) Insurance pre-paid 500 2,60,197 Less Interest on drawings 1,200 2,58,997 Plant and Machinery 1,14,000 Outstanding salary 200 Land and Building 2,39,700 Outstanding wages 100 Closing stock 35,500 5,24,797 5,24,797 Illustration 6 From the following balances of M/s Keshav Bros. You are required to prepare trading and profit and loss account and a balance sheet of March 31, 2017. Debit balances Amount Credit balances Amount ` ` Plant and Machinery 1,30,000 Sales 3,00,000 Debtors 50,000 Return outwards 2,500 Interest 2,000 Creditors 2,50,000 Wages 1,200 Bills payable 70,000 Salary 2,500 Provision for bad debts 1,550 Carriage inwards 500 Capital 2,20,000 Carriage outwards 700 Rent received 10,380 Return inwards 2,000 Commission received 16,000 Factory rent 1,450 Office rent 2,300 Insurance 780 Furniture 22,500 Buildings 2,80,000 Bills receivable 3,000 Cash in hand 22,500 Cash at bank 35,000 Commission 500 Opening stock 60,000 Purchases 2,50,000 Bad debts 3,500 8,70,430 8,70,430 2022-23 Financial Statements - II 395 Adjustment (i) Provision for bad debts @ 5% and further bad debts ` 2,000. (ii) Rent received in advance ` 6,000. (iii) Prepaid insurance ` 200. (iv) Depreciation on furniture @ 5%, plant and machinery @ 6%, building @ 7%. Solution Books of Keshav Bros. Trading and Profit and Loss Account for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenue/Gains Amount ` ` Opening stock 60,000 Sales 3,00,000 Purchases 2,50,000 Less Return (2,000) 2,98,000 Less Returns (2,500) 2,47,500 Closing stock 70,000 Wages 1,200 Carriage inwards 500 Factory rent 1,450 Gross profit c/d 57,350 3,68,000 3,68,000 Interest 2,000 Gross profit b/d 57,350 Salary 2,500 Rent received 10,380 Carriage outwards 700 Less Advance rent (6,000) 4,380 Office Rent 2,300 Commission received 16,000 Insurance 780 Less Prepaid insurance (200) 580 Depreciation on furniture 1,125 Depreciation on Plant and 7,800 Machinery Depreciation on building 19,600 Commission 500 Bad debts 3,500 Add Further bad debts 2,000 Add New provision 2,400 7,900 Less Old provision (1,550) 6,350 Net Profit (transferred to 34,275 capital account) 77,730 77,730 2022-23 396 Accountancy Balance Sheet as at March 31, 2017 Liabilities Amount Liabilities Amount ` ` Creditors 2,50,000 Cash In hand 22,500 Bills payable 70,000 Cash at bank 35,000 Advance rent 6,000 Bills receivable 3,000 Capital 2,20,000 Add Net profit 34,275 2,54,275 Prepaid insurance 200 Debtors 50,000 Less Further (2,000) bad debts 48,000 Less New provision (2,400) 45,600 Plant and Machinery 1,22,200 Furniture 21,375 Buildings 2,60,400 Closing stock 70,000 5,80,275 5,80,275 Illustration 7 The following information have been taken from the trial balance of M/s Fair Brothers Ltd. You are required to prepare the trading and profit and loss account and a balance sheet as at March 31, 2017. Debit Balances Amount Credit balances Amount ` ` Cash 20,000 Sales 3,61,000 Wages 45,050 Loan 12% (1.7.2016) 40,000 Return outwards 4,800 Discount received 1,060 Bad debts 4,620 Return (Purchase) 390 Salaries 16,000 Creditors 60,610 Octroi 1,000 Capital 75,000 Charity 250 Machinery 32,000 Debtors (Including a 60,000 dishonoured bill of `1,600) Stock 81,600 Purchases 2,60,590 Repairs 3,350 Interest on loan 1,200 Sales tax 1,600 Insurance 2,000 Rent 4,000 5,38,060 5,38,060 2022-23 Financial Statements - II 397 Adjustments 1. Wages include ` 4,000 for erection of new machinery on April 01, 2016. 2. Provide 5% depreciation on furniture. 3. Salaries unpaid `1,600. 4. Closing stock ` 81,850. 5. Create a provision at 5% on debtors. 6. Half the amount of bill is recoverable. 7. Rent is paid up to July 30, 2017. 8. Insurance unexpired ` 600. Books of Fair Brothers Ltd. Trading and Profit and Loss Account for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenue/Gains Amount ` ` Opening stock 81,600 Sales 3,61,000 Purchases 2,60,590 Less Sales return (4,800) 3,56,200 Less Purchases return (390) 2,60,200 Closing stock 81,850 Wages 45,050 Less Prepaid wages (4,000) 41,050 including erection of machines Octroi 1,000 Gross profit c/d 54,200 4,38,050 4,38,050 Salaries 16,000 Gross profit b/d 54,200 Add Outstanding salary 1,600 17,600 Discount received 1,060 Repairs 3,350 Bad debts 4,620 Add Further bad debts 800 Add New provision 2,960 8,380 Interest on loan 1,200 Add Outstanding interest 2,400 3,600 Sales tax 1,600 Insurance 2,000 Less Prepaid insurance (600) 1,400 Charity 250 Rent 4,000 Less Prepaid rent 1,000 3,000 Depreciation on machinery 1,800 Net profit (transferred to 14,280 capital account) 55,260 55,260 2022-23 398 Accountancy Balance Sheet as at March 31, 2017 Liabilities Amount Assets Amount ` ` Creditors 60,610 Cash 20,000 Outstanding salaries 1,600 Debtors 60,000 Loan 40,000 Less Bad debts (800) Outstanding interest 2,400 Less Provision 2,960 56,240 Capital 75,000 Prepaid rent 1,000 Add Net profit 14,280 89,280 Unexpired insurance 600 Machinery 32,000 Add Erection 4,000 Wages 36,000 Less Depreciation (1,800) 34,200 Closing stock 81,850 1,93,890 1,93,890 Illustration 8 From the following balance extracted from the books of of M/s Hariharan Brother, you are require to prepare the trading and profit and loss account and a balance sheet as on December 31, 2017. Debit balance Amount Credit balance Amount ` ` Opening stock 16,000 Capital 1,00,000 Purchases 40,000 Sales 1,60,000 Return inwards 3,000 Return outwards 800 Carriage inwards 2,400 Apprenticeship premium 3,000 Carriage outwards 5,000 Bills payable 5,000 Wages 6,600 Creditors 31,600 Salaries 11,000 Rent 2,200 Freight and Dock 4,800 Fire Insurance premium 1,800 Bad debts 4,200 Discount 1,000 Printing and Stationery 500 Rates and Taxes 700 Travelling expenses 300 Trade expenses 400 Business premises 1,10,000 Furniture 5,000 Bills receivable 7,000 Debtors 40,000 Machine 9,000 Loan 10,000 Investment 6,000 Cash in hand 500 Cash at bank 7,000 Proprietor’s withdrawal 6,000 3,00,400 3,00,400 2022-23 Financial Statements - II 399 Adjustments 1. Closing stock ` 14,000. 2. Wages outstanding ` 600, Salaries Outstanding ` 1,000, Rent outstanding ` 200. 3. Fire Insurance premium includes ` 1,200 paid in July 01, 2016 to run for one year from July 01, 2016 to June 30, 2017. 4. Apprenticeship Premium is for three years paid in advance on January 01, 2016. 5. Stationery bill for ` 60 remain unpaid. 6. Depreciation on Premises @ 5%, furniture @ 10%, Machinery @ 10%. 7. Interest on loan given accrued for one year @ 7%. 8. Interest on investment @ 5% for half year to December 31, 2016 has accrued. 9. Interest on capital to be allowed at 5% for one year. 10. Interest on drawings to be charged to him ascertained for the year ` 160. Solution Books of Hariharan Bros. Trading and Profit and Loss Account for the year ended December 31, 2017 Dr. Cr. Expenses/Losses Amount Revenue/Gains Amount ` ` Opening stock 16,000 Sales 1,60,000 Purchases 40,000 Less Sales return (3,000) 1,57,000 Less purchases return (800) 39,200 Closing stock 14,000 Wages 6,600 Add Outstanding Wages 600 7,200 Carriage inwards 2,400 Freight and Dock 4,800 Gross profit c/d 1,01,400 1,71,000 1,71,000 Salaries 11,000 Gross profit b/d 1,01,400 Add Outstanding salary 1,000 12,000 Apprenticeship 3,000 Carriage outwords 5,000 premium Rates and Taxes 700 Less Advance premium (2,000) 1,000 Printing and Stationery 500 Accrued interest on loan 700 Add Outstanding bill 60 560 Interest on drawings 160 Trade expenses 400 Accrued interest on 150 Travelling expenses 300 investment Fire insurance 1,800 Less Prepaid insurance (600) 1,200 Bad debts 4,200 Rent 2,200 Add Outstanding rent 200 2,400 Interest on capital 5,000 Depreciation on premises 5,500 Depreciation on furniture 500 Depreciation on machinery 900 Discount 1,000 Net profit (transferred to 63,750 capital account) 1,03,410 1,03,410 2022-23 400 Accountancy Balance Sheet as at December 31, 2017 Liabilities Amount Assets Amount ` ` Capital 1,00,000 Premises 1,10,000 Add Interest on capital 5,000 Less Depreciation (5,500) 1,04,500 Add Net profit 63,750 1,68,750 Furniture 4,500 Less drawings (6,000) 1,62,750 Machinery 8,100 Less Interest on drawings (160) 1,62,590 Creditors 31,600 Debtors 40,000 Bills payable 5,000 Bills receivable 7,000 Outstanding wages 600 Cash in hand 500 Outstanding salaries 1,000 Cash at bank 7,000 Outstanding rent 200 Loan 10,000 Outstanding stationery 60 Add accrued interest 700 10,700 Apprenticeship premium (advance) 2,000 Investments 6,000 Add accrued interest 150 6,150 Pre-paid insurance 600 Closing stock 14,000 2,03,050 2,03,050 Illustration 9 The following balances have been extracted from the trial balance of M/s Kolkata Ltd. You are required to prepare the trading and profit and loss account on dated March 31, 2017. Also prepare balance sheet on that date. Debit balances Amount Credit balances Amount ` ` Opening stock 6,000 Capital 20,000 Furniture 1,200 Sales 41,300 Drawings 2,800 Purchases return 4,000 Cash in hand 3,000 Bank overdraft 4,000 Purchases 24,000 Bad debts provision 400 Sales return 2,000 Creditors 5,000 Establishment expenses 4,400 Commission 100 Bad debts 1,000 Bills payable 5,000 Debtors 10,000 Apprenticeship premium 500 Carriage 1,000 Bills receivable 6,000 Bank deposits 8,000 Wages 1,000 Trade expenses 500 Bank charges 400 General expenses 1,000 Salaries 2,000 Insurance 1,500 Postage and Telegram 500 Rent, Rates and Taxes 2,000 Coal, Gas, Water 2,000 80,300 80,300 2022-23 Financial Statements - II 401 Adjustments 1. Outstanding salaries ` 100. Rent and taxes ` 200, Wages ` 100. 2. Unexpired insurance ` 500. 3. Commission is received in advances ` 50. 4. Interest ` 500 is to be received on bank deposits. 5. Interest on bank overdraft ` 750. 6. Depreciation on furniture @ 10%. 7. Closing stock ` 9,000. 8. Further bad debts ` 200 New provision @ 5% on debtors. 9. Apprenticeship premium received in advance ` 100. 10. Interest on drawings @ 6%. Solution Books of Kolkata Ltd. Trading and Profit and Loss Account for the year ended as at March 31, 2017 Dr. Cr. Expenses /Losses Amount Revenue/Gains Amount ` ` Opening stock 6,000 Sales 41300 Purchases 24,000 Less sales return (2,000) 39,300 Less purchases return (4,000) 20,000 Closing stock 9,000 Wages 1,000 Add Outstanding wages 100 1,100 Coal, Gas, Water 2,000 Gross profit c/d 19,200 48,300 48,300 Establishment expenses 4,400 Gross profit b/d 19,200 Carriage 1,000 Commission 100 Trade expenses 500 Less Advance commission(50) 50 Bank charges 400 Accrued interest on 500 deposits General expenses 1,000 Apprenticeship premium 500 Salaries 2,000 Less Advance received 100 400 Add Outstanding salary 100 2,100 Interest on drawings 168 Insurance 1,500 Less Prepaid insurance (500) 1,000 Postage and Telegram 500 Rent, rates and Taxes 2,200 Interest on bank overdraft 750 Bad debts 1,000 Add Further bad debts 200 Add New provision 490 1,690 Less Old provision (400) 1,290 Depreciation on furniture 120 Net profit (transferred to 5,058 capital account) 20,318 20,318 2022-23 402 Accountancy Balance Sheet as at March 31, 2017 Liabilities Amount Assets Amount ` ` Capital 2,00,00 Insurance prepaid 500 Net profit 5,058 Bank deposits 8,000 25,058 Less Drawings (2,800) Add outstanding interest 500 8,500 22,258 Less Interest on drawings (168) 22,090 Furniture 1,080 Creditors 5,000 Cash in hand 3,000 Commission received in advance 50 Debtors 10,000 Apprenticeship premium 100 Less Further (200) bad debts 9,800 Outstanding wages 100 Less Provision for (490) 9,310 doubtful debts Outstanding salaries 100 Bills receivable 6,000 Outstanding rent, 200 rates, taxes Closing stock 9,000 Bank overdraft 4,000 Add Outstanding interest 750 4,750 Bills payable 5,000 37,390 37,390 Illustration 10 Prepare the trading and profit and loss account of M/s Roni Plastic Ltd. from the following trial balance and a balance sheet as at March 31, 2017. Debit balances Amount Credit balances Amount ` ` Drawings 6,000 Creditors 16,802 Sundry debtors 38,200 Capital 60,000 Carriage outwards 2,808 Loan on mortgage 17,000 Establishment expenses 16,194 Bad debts provision 1,420 Interest on loan 400 Sales 2,22,486 Cash in hand 6,100 Purchases return 2,692 Stock 11,678 Discount 880 Motor car 18,000 Bills payable 5,428 Cash at bank 9,110 Rent received 500 Land and Buildings 24,000 Bad debts 1,250 Purchases 1,34,916 Sales return 15,642 Advertisement 4,528 Carriage inward 7,858 Rates, taxes, insurance 7,782 General expenses 8,978 Bills receivable 13,764 3,27,208 3,27,208 2022-23 Financial Statements - II 403 Adjustments 1. Depreciation on land and building at @ 5% and Motor vehicle at @ 15%. 2. Interest on loan is @ 5% taken on April 01, 2016. 3. Goods costing Rs1,200 were sent to a customer on sale on return basis for ` 1,400 on March 30, 2017 and has been recorded in the books as actual sales. 4. Salaries amounting to ` 1,400 and Rates amounting to ` 800 are due. 5. The bad debts provision is to be brought up to @ 5% on sundry debtors. 6. Closing stock was ` 13,700. 7. Goods costing ` 1,000 were taken away by the proprietor for his personal use but not entry has been made in the books of account. 8. Insurance pre-paid ` 350. 9. Provide the manager's commission at @ 5% on Net profit after charging such commission. Solution Books of Roni's Plastic Ltd. Trading and Profit and Loss Account for the year ended March 31, 2017 Dr. Cr. Expenses/Losses Amount Revenue/Gains Amount ` ` Opening stock 11,678 Sales 2,22,486 Purchases 1,34,916 Less Sales 15,642 return 2,06,844 Less Purchases return 2,692 Less Return basis (1,400) 2,05,444 1,32,224 Less Goods withdrawn (1,000) 1,31,224 Closing stock 13,700 Carriage inwards 7,858 Gross profit c/d 68,384 2,19,144 2,19,144 Outstanding salaries 1,400 Gross profit b/d 68,384 Carriage outwards 2,808 Discount 880 Establishment expenses 16,194 Rent 500 Bad debts 1,250 Add New provision 1,840 3,090 Less Old provision (1,420) 1,670 Rates and Taxes 7,782 Less Prepaid (350) 7,432 Add Outstanding 800 8,232 Advertisement 4,528 Interest on loan 400 Add Outstanding Interest 450 850 General expenses 8,978 Depreciation on : Land and Building 1,200 Motor car 2,700 3,900 Manager commission 1,010 Net profit (transferred to 20,194 capital account) 69,764 69,764 2022-23 404 Accountancy Balance Sheet as at March 31, 2017 Liabilities Amount Assets Amount ` ` Capital 60,000 Cash in hand 6,100 Add Net profit 20,194 80,194 Cash at bank 9,110 Less Drawings (6,000) (74,194) Bills receivable 13,764 Less Goods withdrawn 1,000 73,194 Debtors 38,200 loan 17,000 Less sales (1,400) return basis 36,800 Add interest 450 17,450 Less New provisions (1,840) 34,960 Bills payable 5,428 Land and Building 24,000 Less Depreciation (1,200) 22,800 Creditors 16,802 Motor car 18,000 Less Depreciation (2,700) 15,300 Outstanding Salaries 1,400 Prepaid insurance 350 Outstanding Rates Taxes 800 Closing stock 13,700 Manager commission 1,010 1,16,084 1,16,084 Do it yourself 1. From the following Trial Balance of M/s Karan on March 31, 2017, prepare a Trading and Profit and Loss Account and a Balance Sheet: Particulars Dr. (`) Cr. (`) Creditors/Debtors 2,05,000 96,000 Bills Payable/Bills Receivables 10,000 9,600 15% Loan — 50,000 Sales/Purchases 2,80,000 12,00,000 Discount 4,000 3,000 Bad Debt Recovered/Bad Debt 5,000 14,000 Interest on Investments — 6,000 Interest on Loan 8,000 4,000 Vehicles 6,50,000 — Stock 3,00,000 — 10% Investments (Purchased on 30th September, 2016) 1,80,000 — Cash in hand 20,000 — Cash at bank 37,000 — 2022-23 Financial Statements - II 405 Capital /Drawings 9,000 4,50,000 Carriage on Purchases 1,600 — Carriage on sales 4,400 — Primary Packing Expenses 2,000 — Rent 3,000 7,000 Insurance 3,600 — Office & Administrative Expenses 4,000 — Discount 2,000 3,000 10% Loan 60,000 — Delivery Expenses 4,000 — Selling and Distribution Expenses 10,000 — Income Tax 2,000 — Outstanding Salary — 1,000 Sales Tax Collected — 3,000 Apprenticeship Premium — 6,000 Returns 1,000 4,000 Live Stock 53,000 — Commission 10,000 12,000 18,68,600 18,68,600 (I) Additional Information (a) The cost of closing stock was ` 50,000 but the market value was ` 40,000. (b) Rent is due but not yet paid for March 2017 ` 500. (c) Insurance carried forward ` 900. (d) 1/3 of the commission received is in respect of work to be done in next year and commission paid represents only 1/4 of the actual commission to be paid during the year. (e) Vehicles were valued at 90% of the book value. (f) The Horse worth ` 30,000 was donated to a charitable organization. (II) Name the accounting concept followed while treating the adjustment (a), (b) and (d) above? 2022-23 406 Accountancy 2. The following balances were extracted from the books of Avika Enterprises on 31st March 2017. Particulars Dr. (`) Cr. (`) Capital — 24,500 Drawings 2,000 — General Expenses 2,500 — Buildings 21,000 — Machinery 9,340 — Stock (1.4.2016) 16,200 — Power 2,240 — Taxes and Insurance 1,315 — Wages 7,200 — Debtors and Creditors 6,280 2,500 Charity 105 — Bad debts 550 — Bank Overdraft — 11,180 Sales and Purchases 13,500 65,360 Stock (31.03.2017) 23,500 — Motor Vehicles 2,000 — Motor Vehicle expenses 500 — Provision for doubtful debts — 900 Commission — 1,320 Trade expenses 1,280 — Bills payable — 3,850 Cash 100 — Total 1,09,610 1,09,610 You are required to : (i) Prepare final accounts for the year ended March 31, 2017 after giving effect to the following adjustments: (a) 1/5th of General expenses and Taxes & Insurance to be charged to factory and the balance to the office. (b) Write off a further Bad debts of ` 160 and maintain the provision for doubtful debts at 5% and create a provision for discount on Debtors at 10%. (c) Depreciate Machinery at 10% and Motor Vehicles by ` 240 (d) Provide ` 700 for interest on Bank Overdraft to be paid. (e) ` 50 is to be carried forward to next year out of Insurance. (f) Provide for Manager's Commission at 10% on the Net Profit after charging such commission. (ii)

Name the accounting concepts which are followed while treating the adjustment (a), (b) and (d) above? 2022-23 Financial Statements - II 407 3. The following balances were extracted from the books of Anushka Enterprises on March 31, 2017. Particulars Amount (`) Creditors 2,00,000 Loan from SBI 2,00,000 Sales 12,30,000 Debtors 2,00,000 Dividend Received on Shares 20,000 Bad Debt 2,000 Bad Debt Recovered 12,000 Bills Receivables 1,50,000 Interest on Loan 50,000 Goodwill 4,00,000 Purchases 2,10,000 Stock (1.4.2016) 1,00,000 Cash at Bank 3,00,000 Factory Repairs 40,000 Capital 7,24,000 Audit Fees 6,000 Petty Expenses 4,000 Salary 70,000 Life Insurance Premium 15,000 Premises 4,00,000 Insurance 25,000 Sales Returns 12,000 Employees Provident Fund 60,000 Provision for Doubtful Debts 75,000 Delivery Expenses 8,000 Dock Charges (Outward) 6,000 Packing Charges 17,000 Advance Salary 30,000 Warehouse Insurance 13,000 Loss in Exchange 9,000 Bank Charges 5,000 Bonus from Suppliers 3,45,000 Purchases Returns 10,000 Machinery 8,00,000 Discounting of Bills of Exchange 1,000 2022-23 408 Accountancy You are required to : (i) Prepare final accounts for the year ended March 31, 2017 after giving effect to the following adjustments: (a) Insurance is due but not yet paid for 31 March 2017 ` 500. (b) Salary Unexpired ` 900. (c) Write off a further Bad debts ` 2,000 and maintain the provision for bad debts at 5% on Debtors. (d) Machinery is to be valued at 90% less than the book value. (e) Goods kept in warehouse worth ` 10,0000 were used for staff welfare. (f) Half of the Bills Receivable were irrecoverable. (h) Closing Stock is ` 40,000 (ii) Name the accounting concepts which will be followed while treating the adjustment (a), (b), (c) and (d) above? 4. The following balances were extracted from the books of Ankita Enterprises on March 31, 2017. Particulars Dr. (`) Cr. (`) Capital — 1,92,680 Cash — 60 Purchases 17,980 — Sales — 22,120 Bank 1,770 — Plant 450 — Freehold Land 3,000 — Heating and Lighting 130 — Bills Receivables — 1,650 Return Inwards — 60 Salaries 2,150 — Creditors — 63,780 Debtors 11,400 — Stock (as on 01.04.2016) 6,000 — Printing 450 — Bills Payable 3,750 — Taxes 380 — Discount Received 890 — Commission (Dr.) — 800 Trucks 25,000 — Furniture — 12,000 Wages 2,00,000 — Drawings — 340 Returns Outward 400 — 2,73,750 2,93,490 2022-23 Financial Statements - II 409 Key Terms Introduced in the Chapter • Outstanding /Accrued expenses • Prepaid/Unexpired expenses • Accrued Incomes • Income received in advance • Depreciation • Bad Debts • Provision for doubtful debts • Provision for discount on debtors • Managers Commission • Interest on Capital Summary with Reference to Learning Objectives 1. Need for adjustments : For the preparation of financial statements, it is necessary that all the adjustments arising out of the accrual basis of accounting are made at the end of the accounting period. Another important consideration in the preparation of final accounts with adjustments, is the distinction between capital and revenue items. Entries which are recorded to give effect to these adjustments are known as adjusting entries. 2. Outstanding expenses : At the end of the accounting period sometimes a business enterprises is left with some unpaid expenses due to one reason or another. Such expenses are termed as outstanding expenses. You are required to : (i) Redraft the Trial Balance. (ii) Prepare final accounts for the year ended March 31, 2017 after giving effect to the following adjustments: (a) Taxes are paid for 10 months only. (b) Creditors worth ` 780 have accepted bills payables. (c) Depreciate furniture by 10%. (d) Trucks were depreciated to the extent of ` 21,000. (e) Wages includes ` 2,000 for the making of Furniture. (f) Closing Stock is of ` 20,000. (g) Provide for Manager's Commission at 10% on the Net Profit before charging such commission. (h) Land was acquired on 1st April, 2016 by paying a claim at 50% less than market value to the owner. (iii) Name the accounting principles which will be followed while treating the adjustment (a), (c) and (e) above? (Correct total of Trial Balance ` 2,83,620) 2022-23 410 Accountancy 3. Prepaid expenses : At the end of the accounting year, it is found that the benefits of some expenses have not been fully received; a portion of total benefits would be received in the next accounting year. That portion of the expense, the benefit of which will be received during the next accounting period is known as 'prepaid expenses'. 4. Accrued Income : These are certain items is received by a business enterprise but the whole amount of it does not belong to the next period. Such portion of income which belongs to the next accounting period is income received in advance and is known as “unearned income”. 5. Depreciation : Depreciation is the decline in the value of an asset an account of wear and tear or passage of time or with. It actually amounts to writing off a portion of the cost of an asset which has been used in the business for the purpose of earning profits. In the balance sheet, the asset is shown at loss minus the amount of depreciation. 6. Provisions for bad and doubtful debts : It is a normal feature of business operations that some debts prove irrecoverable which means that the amount to the realised from them becomes had to view of this. An attempt is made to bring in a certain element of certainty in the amount in respect of bad debts charged every year against incomes. Questions for Practice Short Answers 1. Why is it necessary to record the adjusting entries in the preparation of final accounts? 2. What is meant by closing stock? Show its treatment in final accounts? 3. State the meaning of: (a) Outstanding expenses (b) Prepaid expenses (c) Income received in advance (d) Accrued income 4. Give the Performa of income statement and balance in vertical form. 5. Why is it necessary to create a provision for doubtful debts at the time of preparation of final accounts? 6. What adjusting entries would you record for the following : (a) Depreciation (b) Discount on debtors (c) Interest on capital (d) Manager’s commission 7. What is meant by provision for discount on debtors? 8. Give the journal entries for the following adjustments : (a) Outstanding salary ` 3,500. (b) Rent unpaid for one month at ` 6,000 per annum. (c) Insurance prepaid for a quarter at ` 16,000 per annum. (d) Purchase of furniture costing ` 7,000 entered in the purchases book. 2022-23 Financial Statements - II 411 Long Answers 1. What are adjusting entries? Why are they necessary for preparing final accounts? 2. What is meant by provision for doubtful debts? How are the relevant accounts prepared and what journal entries are recorded in final accounts? How is the amount for provision for doubtful debts calculated? 3. Show the treatment of prepaid expenses depreciation, closing stock at the time of preparation of final accounts when: (a) When given inside the trial balance? (b) When given outside the trial balance? Numerical Questions 1. Prepare a trading and profit and loss account for the year ending March 31, 2017. from the balances extracted of M/s Rahul Sons. Also prepare a balance sheet at the end of the year. Account Title Amount Account Title Amount ` ` Stock 50,000 Sales 1,80,000 Wages 3,000 Purchases return 2,000 Salary 8,000 Discount received 500 Purchases 1,75,000 Provision for doubtful debts 2,500 Sales return 3,000 Capital 3,00,000 Sundry Debtors 82,000 Bills payable 22,000 Discount allowed 1,000 Commission received 4,000 Insurance 3,200 Rent 6,000 Rent Rates and Taxes 4,300 Loan 34,800 Fixtures and fittings 20,000 Trade expenses 1,500 Bad debts 2,000 Drawings 32,000 Repair and renewals 1,600 Travelling expenses 4,200 Postage 300 Telegram expenses 200 Legal fees 500 Bills receivable 50,000 Building 1,10,000 5,51,800 5,51,800 Adjustments 1. Commission received in advance `1,000. 2. Rent receivable ` 2,000. 3. Salary outstanding ` 1,000 and insurance prepaid ` 800. 2022-23 412 Accountancy 4. Further bad debts ` 1,000 and provision for doubtful debts @ 5% on debtors and discount on debtors @ 2%. 5. Closing stock ` 32,000. 6. Depreciation on building @ 6% p.a. (Ans : Gross loss `17,000 ; Net loss `43,189 ; Total balance sheet `2,83,611) 2. Prepare a trading and profit and loss account of M/s Green Club Ltd. for the year ending March 31, 2017. from the following figures taken from his trial balance : Account Title Amount Account Title Amount ` ` Opening stock 35,000 Sales 2,50,000 Purchases 1,25,000 Purchase return 6,000 Return inwards 25,000 Creditors 10,000 Postage and Telegram 600 Bills payable 20,000 Salary 12,300 Discount 1,000 Wages 3,000 Provision for bad debts 4,500 Rent and Rates 1,000 Interest received 5,400 Packing and Transport 500 Capital 75,000 General expense 400 Insurance 4,000 Debtors 50,000 Cash in hand 20,000 Cash at bank 40,000 Machinery 20,000 Lighting and Heating 5,000 Discount 3,500 Bad debts 3,500 Investment 23,100 3,71,900 3,71,900 Adjustments 1. Depreciation charged on machinery @ 5% p.a. 2. Further bad debts `1,500, discount on debtors @ 5% and make a provision on debtors @ 6%. 3. Wages prepaid `1,000. 4. Interest on investment @ 5% p.a. 5. Closing stock 10,000. (Ans. : Gross Profit `79.000 ; Net Profit `52,565 ; Total Balance Sheet

`1,57,565). 2022-23 Financial Statements - II 413 3. The following balances has been extracted from the trial of M/s Runway Shine Ltd. Prepare a trading and profit and loss account and a balance sheet as on March 31, 2017. Account Title Amount Account Title Amount ` ` Purchases 1,50,000 Sales 2,50,000 Opening stock 50,000 Return outwards 4,500 Return inwards 2,000 Interest received 3,500 Carriage inwards 4,500 Discount received 400 Cash in hand 77,800 Creditors 1,25,000 Cash at bank 60,800 Bill payable 6,040 Wages 2,400 Capital 1,00,000 Printing and Stationery 4,500 Discount 400 Bad debts 1,500 Insurance 2,500 Investment 32,000 Debtors 53,000 Bills receivable 20,000 Postage and Telegraph 400 Commission 200 Interest 1,000 Repair 440 Lighting Charges 500 Telephone charges 100 Carriage outward 400 Motor car 25,000 4,89,440 4,89,440 Adjustments 1. Further bad debts ` 1,000. Discount on debtors ` 500 and make a provision on debtors @ 5%. 2. Interest received on investment @ 5%. 3. Wages and interest outstanding ` 100 and ` 200 respectely. 4. Depreciation charged on motor car @ 5% p.a. 5. Closing Stock ` 32,500. (Ans. : Gross profit ` 78,000 ; Net profit ` 66,010, Total balance sheet ` 2,97,350). 2022-23 414 Accountancy 4. From the following Trial Balance you are required to prepare trading and profit and loss account for the year ending March 31, 2017 and Balance Sheet on that date. Particulars Amount Particulars Amount ` ` Opening stock 25,000 Sales 7,00,000 Furniture 16,000 Creditors 72,500 Purchases 5,55,300 Bank Overdraft 50,000 Carriage Inwards 4,700 Provision for bad and 2,100 Bad debts 1,800 doubtful debts Wages 52,000 Discount 500 Debtors 80,000 Capital 2,00,000 Sales Return 15,000 Purchases Return 20,000 Rent 24,000 Miscellaneous Expenses 3,400 Salaries 68,000 Cash 8,900 Drawings 14,000 Buildings 1,60,000 Advertising 10,000 Interest on Bank Overdraft 7,000 10,45,100 10,45,100 Adjustments 1. Closing stock valued at ` 36,000. 2. Private purchases amounting to ` 5000 debited to purchases account. 3. Provision for doubtful debts @ 5% on debtors. 4. Sign board costing ` 4,000 includes in advertising. 5. Depreciate furniture by 10%. (Ans : Gross Profit `1,09,000; Net loss ` 4,600; Total balance sheet `2,98,900). 2022-23 Financial Statements - II 415 5. From the following information prepare trading and profit and loss account of M/s Indian sports house for the year ending March 31, 2017. Account Title Amount Account Title Amount ` ` Drawings 20,000 Capital 2,00,000 Sundry debtors 80,000 Return outwards 2,000 Bad debts 1,000 Bank overdraft 12,000 Trade Expenses 2,400 Provision for bad debts 4,000 Printing and Stationery 2,000 Sundry creditors 60,000 Rent Rates and Taxes 5,000 Bills payable 15,400 Feright 4,000 Sales 2,76,000 Return inwards 7,000 Opening stock 25,000 Purchases 1,80,000 Furniture and Fixture 20,000 Plant and Machinery 1,00,000 Bills receivable 14,000 Wages 10,000 Cash in hand 6,000 Discount allowed 2,000 Investments 40,000 Motor car 51,000 5,69,400 5,69,400 Adjustments 1. Closing stock was `45,000. 2. Provision for doubtful debts is to be maintained @ 2% on debtors. 3. Depreciation charged on : furniture and fixture @ 5%, plant and Machinery @ 6% and motor car @ 10%. 4. A Machine of `30,000 was purchased on October 01, 2016. 5. The manager is entitle to a commission of @ 10% of the net profit after charging such commission. (Ans. : Gross profit `1,01,000 ; Net profit `68,909 ; Total balance sheet ` 3,43,200 ; Manager's commission `6,891). 2022-23 416 Accountancy 6. Prepare the trading and profit and loss account and a balance sheet of M/s Shine Ltd. from the following particulars. Account Title Amount Account Title Amount ` ` Sundry debtors 1,00,000 Bills payable 85,550 Bad debts 3,000 Sundry creditors 25,000 Trade expenses 2,500 Provision for bad debts 1,500 Printing and Stationary 5,000 Return outwards 4,500 Rent, Rates and Taxes 3,450 Capital 2,50,000 Freight 2,250 Discount received 3,500 Sales return 6,000 Interest received 11,260 Motor car 25,000 Sales 1,00,000 Opening stock 75,550 Furniture and Fixture 15,500 Purchases 75,000 Drawings 13,560 Investments 65,500 Cash in hand 36,000 Cash in bank 53,000 4,81,310 4,81,310 Adjustments 1. Closing stock was valued ` 35,000. 2. Depreciation charged on furniture and fixture @ 5%. 3. Further bad debts ` 1,000. Make a provision for bad debts @ 5% on sundry debtors. 4. Depreciation charged on motor car @ 10%. 5. Interest on drawing @ 6%. 6. Rent, rates and taxes was outstanding `200. 7. Discount on debtors 2%. (Ans. : Gross loss Rs,17,050 ; Net loss `27,482 ; Total balance sheet ` 3,18,894). 2022-23 Financial

Statements - II 417 7. Following balances have been extracted from the trial balance of M/s Keshav Electronics Ltd. You are required to prepare the trading and profit and loss account and a balance sheet as on March 31, 2017. Account Title Amount Account Title Amount ` ` Opening stock 2,26,000 Sales 6,80,000 Purchases 4,40,000 Return outwards 15,000 Drawings 75,000 Creditors 50,000 Buildings 1,00,000 Bills payable 63,700 Motor van 30,000 Interest receivced 20,000 Freight inwards 3,400 Capital 3,50,000 Sales return 10,000 Trade expense 3,300 Heat and Power 8,000 Salary and Wages 5,000 Legal expense 3,000 Postage and Telegram 1,000 Bad debts 6,500 Cash in hand 79,000 Cash at bank 98,000 Sundry debtors 25,000 Investments 40,000 Insurance 3,500 Machinery 22,000 11,78,700 11,78,700 The following additional information is available : 1. Stock on March 31, 2017 was ` 30,000. 2. Depreciation is to be charged on building at 5% and motor van at 10%. 3. Provision for doubtful debts is to be maintained at 5% on Sundry Debtors. 4. Unexpired insurance was ` 600. 5. The Manager is entitled to a commissiion @ 5% on net profit after charging such commission. (Ans. : Gross profit `,37,600 ; Net profit ` 25,381 ; Total balance sheet `4,15,350 ; Manager's commission `1,269). 2022-23 418 Accountancy 8. From the following balances extracted from the books of Raga Ltd. prepare a trading and profit and loss account for the year ended March 31, 2017 and a balance sheet as on that date. Account Title Amount Account Title Amount ` ` Drawings 20,000 Sales 2,20,000 Land and Buildings 12,000 Capital 1,01,110 Plant and Machinery 40,000 Discount 1,260 Carriage inwards 100 Apprentice premium 5,230 Wages 500 Bills payable 1,28,870 Salary 2,000 Purchases return 10,000 Sales return 200 Bank charges 200 Coal, Gas and Water 1,200 purchases 1,50,000 Trade Expenses 3,800 Stock (Opening) 76,800 Cash at bank 50,000 Rates and Taxes 870 Bills receivable 24,500 Sundry debtors 54,300 Cash in hand 30,000 4,66,470 4,66,470 The additional information is as under : 1. Closing stock was valued at the end of the year `, 20,000. 2. Depreciation on plant and machinery charged at 5% and land and building at 10%. 3. Discount on debtors at 3%. 4. Make a provision at 5% on debtors for doubtful debts. 5. Salary outstanding was `100 and Wages prepaid was ` 40. 6. The manager is entitled a commission of 5% on net profit after charging such commission. (Ans. : Gross profit `,21,240 ; Net profit `12,664 ; Total balance sheet ` 2,23,377 ; Manager's commission `633). 2022-23 Financial Statements - II 419 9. From the following balances of M/s Jyoti Exports, prepare trading and profit and loss account for the year ended March 31, 2017 and balance sheet as on this date. Account Title Debit Account Title Credit Amount Amount ` ` Sundry debtors 9,600 Sundry creditors 2,500 Opening stock 22,800 Sales 72,670 Purchases 34,800 Purchases returns 2,430 Carriage inwards 450 Bills payable 15,600 Wages 1,770 Capital 42,000 Office rent 820 Insurance 1,440 Factory rent 390 Cleaning charges 940 Salary 1,590 Building 24,000 Plant and Machinery 3,600 Cash in hand 2,160 Gas and Water 240 Octroi 60 Furniture 20,540 Patents 10,000 1,35,200 1,35,200 Closing stock `10,000. 1. To provision for doubtful debts is to be maintained at 5 per cent on sundry debtors. 2. Wages amounting to ` 500 and salary amounting to ` 350 are outstanding. 3. Factory rent prepaid ` 100. 4. Depreciation charged on Plant and Machinery @ 5% and Building @ 10%. 5. Outstanding insurance `100. (Ans : Gross profit `23,250 ; Net profit `15,895 ; Total balance Sheet ` 76,945). 2022-23 420 Accountancy 10. The following balances have been extracted from the books of M/s Green House for the year ended March 31, 2017, prepare trading and profit and loss account and balance sheet as on this date. Account Title Amount Account Title Amount ` ` Purchases 80,000 Capital 2,10,000 Bank balance 11,000 Bills payable 6,500 Wages 34,000 Sales 2,00,000 Debtors 70,300 Creditors 50,000 Cash in hand 1,200 Return outwards 4,000 Legal expenses 4,000 Building 60,000 Machinery 120,000 Bills receivable 7,000 Office expenses 3,000 Opening stock 45,000 Gas and fuel 2,700 Freight and Carriage 3,500 Factory lighting 5,000 Office furniture 5,000 Patent right 18,800 4,70,500 4,70,500 Adjustments : (a) Machinery is depreciated at 10% and buildings depreciated at 6%. (b) Interest on capital @ 4%. (c) Outstanding wages ` 50. (d) Closing stock ` 50,000. (Ans : Gross profit ` 83,750 ; Net Profit ` 52,750 ; Total balance sheet ` 3,27,700). 2022-23 Financial Statements - II 421 11. From the following balances extracted from the book of M/s Manju Chawla on March 31, 2017. You are requested to prepare the trading and profit and loss account and a balance sheet as on this date. Account Title Amount Amount ` ` Opening stock 10,000 Purchases and Sales 40,000 80,000 Returns 200 600 Wages 6,000 Dock and cleaning charges 4,000 Lighting 500 Misc. Income 6,000 Rent 2,000 Capital 40,000 Drawings 2,000 Debtors and Creditors 6,000 7,000 Cash 3,000 Investment 6,000 Patent 4,000 Land and Machinery 43,000 Donations and Charity 600 Sales tax collected 1,000 Furniture 11,300 1,36,600 1,36,600 Closing stock was ` 2,000. (a) Interest on drawings @ 7% and interest on capital @ 5%. (b) Land and Machinery is depreciated at 5%. (c) Interest on investment @ 6%. (d) Unexpired rent `100. (e) Charge 5% depreciation on furniture. (Ans. : Gross profit ` 21,900 ; Net profit ` 25,185 ; Total balance sheet ` 71,185). 2022-23 422 Accountancy 12. The following balances were extracted from the books of M/s Panchsheel Garments on March 31, 2017. Account Title Debit Account Title Credit Amount Amount ` ` Opening stock 16,000 Sales 1,12,000 Purchases 67,600 Return outwards 3,200 Return Inwards 4,600 Discount 1,400 Carriage inwards 1,400 Bank overdraft 10,000 General expenses 2,400 Commission 1,800 Insurance 4,000 Creditors 16,000 Scooter expenses 200 Capital 50,000 Salary 8,800 Cash in hand 4,000 Scooter 8,000 Furniture 5,200 Buildings 65,000 Debtors 6,000 Wages 1,200 1,94,400 1,94,400 Prepare the trading and profit and loss account for the year ended March 31, 2017 and a balance sheet as on that date. (a) Unexpired insurance ` 1,000. (b) Salary due but not paid ` 1800. (c) Wages outstanding ` 200. (d) Interest on capital 5%. (e) Scooter is depreciated @ 5%. (f) Furniture is depreciated `@ 10%. (g) Closing stock was ` 15,000. (Ans.: Gross profit ` 39,200 ; Net profit ` 22,780 ; Total balance sheet ` 1,03,280}. 2022-23 Financial Statements - II 423 13. Prepare the trading and profit and loss account and balance sheet of M/s Control Device India on March 31, 2017 from the following balance as on that date. Account Title Debit Credit Amount Amount ` ` Drawings and Capital 19,530 67,500 Purchase and Sales 45,000 1,12,500 Salary and Commission 25,470 1,575 Carriage 2,700 Plant and Machinery 27,000 Furniture 6,750 Opening stock 42,300 Insurnace premium 2,700 Interest 7,425 Bank overdraft 24,660 Rent and Taxes 2,160 Wages 11,215 Returns 2,385 1,440 Carriage outwards 1,485 Debtors and Creditors 36,000 58,500 General expenses 6,975 Octroi 530 Investment 41,400 2,73,600 2,73,600 Closing stock was valued ` 20,000. (a) Interest on capital @ 10%. (b) Interest on drawings @ 5%. (c) Wages outstanding ` 50. (d) Outstanding salary ` 20. (e) Provide a depreciation @ 5% on plant and machinery. (f) Make a 5% provision on debtors. (Ans.: Gross profit ` 29,760 ; Net loss ` 8,973 ; Total balance sheet `1,28,000) 14. The following balances appeared in the trial balance of M/s Kapil Traders as on March 31, 2017 ` Sundry debtors 30,500 Bad debts 500 Provision for doubtful debts 2,000 2022-23 424 Accountancy The partners of the firm agreed to records the following adjustments in the books of the Firm: Further bad debts `300. Maintain provision for bad debts 10%. Show the following adjustments in the bad debts account, provision account, debtors account, profit and loss account and balance sheet. (Ans : Dr. Profit and Loss account `1,820) 15. Prepare the bad debts account, provision for account, profit and loss account and balance sheet from the following information as on March 31, 2017 ` Debtors 80,000 Bad debts 2,000 Provision for doubtful debts 5,000 Adjustments : Bad debts `500 Provision on debtors @ 3%. (Ans : Credit Profit and Loss account `115) Checklist to Test Your Understanding 1. (c), 2. (d), 3. (b), 4. (a), 5. (d) 2022-23Applications of Computers in Accounting 12 C omputer technology and its usage have registered a significant development during the last three decades. Historically, computers have been used effectively in science and technology to solve the complex computational and logical problems. They have also been used for carrying out economic planning and forecasting processes. Recently, modern day computers have made their presence felt in business and industry. The most important impact of computers has been on the manner in which data is stored and processed within an organisation. Although manual data processing for Management Information System (MIS) has been quite common in the past, modern MIS would be nearly impossible without the use of computer systems. In this chapter we shall discuss the need for the use of computers in accounting, the nature of accounting information system and the types of accounting related MIS reports. 12.1 Meaning and Elements of Computer System A computer is an electronic device, which is capable of performing a variety of operations as directed by a set of instructions. This set of instructions is called a computer programme. A computer system is a combination of six elements: 12.1.1 Hardware Hardware of computer consists of physical components such as keyboard, mouse, monitor and processor. These are electronic and electromechanical components. LEARNING OBJECTIVES After studying this chapter, you will be able to : • state the meaning, elementsand capabilities of computer system; • explain the need for computers in accounting; • describe the automation of accounting process; • explain design of accounting reports from the accounting data; • list the various Management Information System (MIS) reports and their uses; • explain the data interface between information systems. 2022-23 464 Accountancy 12.1.2 Software SoftwareSoftware A set(s) of programmes, which is used to work with such hardware is called its software. A coded set of instructions stored in the form of circuits is called firmware. There are six types of software as follows: (a) Operating System : An integrated set of specialised programmes that are meant to manage the resources of a computer and also facilitate its operation is called operating system. It creates a necessary interface that is an interactive link, between the user and the computer hardware. (b) Utility Programmes : These are a set of computer programmes, which are designed to perform certain supporting operations: such as programme to format a disk, duplicate a disk, physically reorganise stored data and programmes. (c) Application Software : These are user oriented programmes designed and developed for performing certain specified tasks: such as payroll accounting, inventory accounting, financial accounting, etc. (d) Language Processors : These are the software, which check for language syntax and eventually translate (or interpret) the source programme (that is a programme written in a computer language) into machine language (that is the language which the computer understands). (e) System Software : These are a set of programmes which control such internal functions as reading data from input devices, transmitting processed data to output devices and also checking the system to ensure that its components are functioning properly. (f) Connectivity Software : These are a set of programmes which create and control a connection between a computer and a server so that the computer is able to communicate and share the resources of server and other connected computers. 12.1.3 People People interacting with the computers are also called live-ware of the computer system. They constitute the most important part of the computer system : • System Analysts are the people who design data processing systems. • Programmers are the people who write programmes to implement the data processing system design. • Operators are the people who participate in operating the computers. People who respond to the procedures instituted for executing the computer programmes are also a part of live-ware. 12.1.4 Procedures The procedure means a series of operations in a certain order or manner to achieve desired results. There are three types of procedures which constitute 2022-23 Applications of Computers in Accounting 465 part of computer system: hardware-oriented, software-oriented and internal procedure. Hardware–oriented procedure provide details about components and their method of operation. The software-oriented procedure provides a set of instructions required for using the software of computer system. Internal procedure is instituted to ensure smooth flow of data to computers by sequencing the operation of each sub-system of overall computer system. 12.1.5 Data These are facts and may consist of numbers, text, etc. These are gathered and entered into a computer system. The computer system in turn stores, retrieves, classifies, organises and synthesises the data to produce information according to a pre-determined set of instructions. The data is, therefore, processed and organised to create information that is relevant and can be used for decisionmaking. 12.1.6 Connectivity It is being acknowledged as a sixth element of the computer system. The manner in which a particular computer system is connected to others say through telephone lines, microwave transmission, satellite link, etc. is the element of connectivity. 12.2

Capabilities of Computer System A computer system possesses some characteristics, which, in comparison to human beings, turn out to be its capabilities. These are as follows ; Speed : It refers to the amount of time computers takes in accomplishing a task or completes an operation. Computers require far less time than human beings in performing a task. Normally, human beings take into account a second or minute as unit of time. But computers have such a fast operating capability that the relevant unit of time is fraction of a second. Most of the modern computers are capable of performing a 100 million calculations per second and that is why the industry has developed Million Instructions per Second (MIPS) as the criterion to classify different computers according to speed. Accuracy : It refers to the degree of exactness with which computations are made and operations are performed. One might spend years in detecting errors in computer calculations or updating a wrong record. Most of the errors in Computer Based Information System (CBIS) occur because of bad programming, erroneous data and deviation from procedures. These errors are caused by human beings. Errors attributable to hardware are normally detected and corrected by the computer system itself. The computers rarely commit errors and perform all types of complex operations accurately. 2022-23 466 Accountancy Reliability : It refers to the ability with which the computers remain functional to serve the user. Computers systems are well-adapted to performing repetitive operations. They are immune to tiredness, boredom or fatigue. Therefore, they are more reliable than human beings. Yet there can be failures of computer system due to internal and external reasons. Any failure of the computer in a highly automated industry is unacceptable. Therefore, the companies in such situations provide for back-up facility to swiftly take over operations without loss of time. Versatility : It refers to the ability of computers to perform a variety of tasks: simple as well as complex. Computers are usually versatile unless designed for a specific application. A general purpose computer is capable of being used in any area of application: business, industry, scientific, statistical, technological, communications and so on. A general purpose computer, when installed in an organisation, can take over the jobs of several specialists because of its versatility. computer system when installed can take over the jobs of all these specialists because of being highly versatile. This further ensures fuller utilisation of its capability. Storage : It refers to the amount of data a computer system can store and access. The computer systems, besides having instant access to data, have huge capacity to store such data in a very small physical space. A CD-ROM with 4.7” of diameter is capable of storing a large number of books, each containing thousands of pages and yet leave enough space for storing more such material. A typical mainframe computer system is capable of storing and providing online billion of characters and thousands of graphic images. It is clear from the above discussion that computer capabilities outperform the human capabilities. As a result, a computer, when used properly, will improve the efficiency of an organisation. 12.3 Limitations of a Computer System In spite of possessing all the above capabilities, computers suffer from the following limitations : Lack of Commonsense : Computer systems as on date do not possess any common sense because no full-proof algorithm has been designed to programme common sense. Since computers work according to a stored programme(s), they simply lack of commonsense. Zero IQ : Computers are dumb devices with zero Intelligence Quotient (IQ). They cannot visualise and think what exactly to do under a particular situation, unless they have been programmed to tackle that situation. Computers must be directed to perform each and every action, however, minute it may be. Lack of Decision-making : Decision-making is a complex process involving information, knowledge, intelligence, wisdom and ability to judge. Computers cannot take decisions on their own because they do not possess all the essentials of decision-making. They can be programmed to take such decisions, 2022-23 Applications of Computers in Accounting 467 which are purely procedure-oriented. If a computer has not been programmed for a particular decision situation, it will not take decision due to lack of wisdom and evaluating faculties. Human beings, on the other hand, possess this great power of decision-making. 12.4 Components of Computer The functional components of computer system consist of Input Unit, Central Processing System and Output Unit. The way these components are embedded in a computer may differ from one architectural design to another, yet all of them constitute the essential building blocks of a computer system. Diagrammatically, these components may be presented as follows: Fig. 12.1 : Block diagram of main components of computer 12.4.1 Input Unit It controls various input devices which are used for entering data into the computer system. Keyboard and Mouse, for instance, are the most commonly used input device. Other such devices are magnetic tape, magnetic disk, light pen, optical scanner, Magnetic Ink Character (MICR) Recognition, Optical Character Recognition (OCR), bar code reader, smart card reader, etc. Besides, there are other devices which respond to voice and physical touch. A menu layout is displayed on a touch sensitive screen. Whenever user touches a menu item on touch-screen, the computer senses which particular menu item has been touched and accordingly performs the operation associated with that menu item. Such touch screens have been installed at major railway stations for obtaining the online information about arrival and departure of trains. 2022-23 468 Accountancy 12.4.2 Central Processing Unit (CPU) This is the main part of computer hardware that actually processes data, according to the instructions it receives. It controls the flow of data by directing the data to enter the system, places the data into its memory, retrieves the same as and when needed and directs the output of data according to a set of stored instructions. It has three main units as described below : (a) Arithmetic and Logic Unit (ALU) : It is responsible for performing all the arithmetic computations such as addition, subtraction, division, multiplication and exponentiation. In addition to this, it also performs logical operations involving comparisons among variables and data items. (b) Memory Unit : In this unit, data is stored before being actually processed. The data so stored is accessed and processed according to a set of instructions which are also stored in the memory of the computer well before such data is transmitted to the memory from input devices. (c) Control Unit : This unit is entrusted with the responsibility of controlling and coordinating the activities of all other units of the computer system. Specifically, it performs the following functions : • Read instructions out of memory unit; • Decode such instructions; • Set up the routing of data, through internal circuitry/wiring, to the desired place at right time; and • Determine the input device from where to get next instruction after the instruction in hand has been executed. 12.4.3 Output Unit After processing the data, the information produced according to a set of instruction need to be made available to user in a human readable and understandable form. A computer system, therefore, needs an output device to communicate such information to the user. Essentially, the output device is assigned the task of translating the processed data from machine coded form to a human readable form. The commonly used output devices include: external devices like monitor also called Visual Display Unit (VDU), printer, graphic plotter for producing graphs, technical drawings and charts and internal devices like magnetic storage devices. Recently, a new device being perfected is the speech synthesiser, which is capable of producing verbal output that sounds like human speech. Information: 12.5 Evolution of Computerised Accounting Manual system of accounting has been traditionally the most popular method of keeping the records of financial transactions of an organisation. 2022-23 Applications of Computers in Accounting 469 Conventionally, the bookkeeper (or accountant) used to maintain books of accounts such as cash book, journal and ledger so as to prepare a summary of transactions and final accounts manually. The technological innovations led to the development of various machines capable of performing a variety of accounting functions. For example, the popular billing machine was designed to typewrite description of the transaction along with names, addresses of customers. This machine was capable of computing discounts; adding the net total and posting the requisite data to the relevant accounts. The customer's bill was generated automatically once the operator has entered the necessary information. These machines combined the features of a typewriter and various kinds of calculators. With substantial increase in the number of transactions, the technology advanced further. With exponential increase in speed, storage and processing capacity, newer versions of these machines evolved. A computer to which they were connected operated these machines. The success of a growing organisation with complexity of transactions tended to depend on resource optimisation, quick decision-making and control. As a result, the maintenance of accounting data on a real-time (or spontaneous) basis became almost essential. Such a system of maintaining accounting records became convenient with the computerised accounting system. 12.5.1 Information and Decisions An organisation is a collection of interdependent decision-making units that exist to pursue organisational objectives. As a system, every organisation accepts inputs and transforms them into outputs. All organisational systems pursue certain objectives through a process of resource allocation, which is accomplished through the process of managerial decision-making. Information facilitates decisions regarding allocation of resources and thereby assists an organisation in pursuit of its objectives. Therefore, the information is the most important organisational resource. Every medium sized to large organisation has a well-established information system that is meant to generate the information required for decision-making. With the increasing use of information systems in organisations, Transaction Processing Systems (TPS) have started playing a vital role in supporting business operations. Every transaction processing system has three components: Input, Processing and Output. Since Information Technology (IT) follows the GIGO principle (Garbage in-Garbage out), it is necessary that input to the IT-based information system is accurate, complete and authorised. This is achieved by automating the input. A large number of devices are now available to automate the input process for a TPS. 2022-23 470 Accountancy 12.5.2 Transaction Processing System Transaction Processing Systems (TPS) are among the earliest computerised systems catering to the requirements of large business enterprises. The purpose of a typical TPS is to record, process, validate and store transactions that occur in the various functional areas of a business for subsequent retrieval and usage. A transaction could be internal or external. When a department requisitions material supplies from stores, an internal transaction is said to have occurred. However, when the purchase department purchases materials from a supplier, an external transaction takes place. The scope of financial accounting is confined to external transactions only. TPS involves following steps in processing a transaction. In order to understand these steps, let us consider a case wherein a customer withdraws money using the Automated Teller Machine (ATM) facility, as described below : • Data Entry : The action data must be entered into the system before it is processed. There are a number of input devices to enter data: Keyboard, mouse, etc. For example, a bank customer operates an ATM facility to make a withdrawal. The actions taken by the customer constitute data, which is processed after validation by the computerised personal banking system. • Data Validation : It ensures the accuracy and reliability of input data by comparing the same with some predetermined standards or known data. This validation is performed by error detection and error correction procedures. The control mechanism, wherein actual input is compared with the standard, is meant to detect errors while error correction procedures make suggestions for entering correct data input. The Personal Identification Number (PIN) of the customer is validated with the known data. If it is incorrect, a suggestion is made to indicate that the PIN is invalid. After validating the PIN (which is also a part of processing by TPS), the amount of withdrawal being made by the customer is also checked to ensure that it does not exceed a certain limit. • Processing and Revalidation : The processing of data, representing actions of the ATM user, occurs almost instantaneously in case of the Online Transaction Processing (OLTP) system provided a valid data representing actions of the user has been encountered. This is called check input validity. Revalidation occurs to ensure that the transaction in terms of delivery of money by ATM has been completed. This is called check output validity. • Storage : Processed actions, as described above, culminate into financial transaction data, which describe the withdrawal of money by a particular customer, are stored in transaction database of Computerised personal banking system. This implies that only valid transactions are stored in the database. • Information : The stored data is processed using the query facility to produce desired information. A database supported by DBMS is bound to have standard Structured Query Language (SQL) support. 2022-23 Applications of Computers in Accounting 471 • Reporting : Finally, reports can be prepared on the basis of the required information content according to decision usefulness of report. A simple computerised accounting system accepts the complete transaction data as input; stores such data in computer storage media (say hard disk) and retrieves the accounting data for processing as and when required for generating an accounting report, as output. The input-process-output diagram shown below indicates as to how accounting software translates data into information. This processing of data is accomplished either through Batch Processing or Real-time Processing. Batch Processing applies to large and voluminous data that is accumulated offline from various units: branches or departments. The entire accumulated data is processed in one shot to generate the desired reports according to decision requirement. Real-Time Processing provides online outcome in the form of information and reports without time lag between the transaction and its processing. The accounting reports are generated by query language popularly called Structured Query Language (SQL). It allows the user to retrieve report relevant information that is capable of being laid out in pre-designed accounting report. Accounting software may be structured with such components as provide for storage and processing of data pertaining to purchase, sales, inventory, payroll and other financial transactions (refer figure 12.2). 12.6 Features of Computerised Accounting System Accounting software is used to implement a computerised accounting system. The computer accounting system is based on the concept of databases. It does away with the concept of creating and maintaining journals, ledger, etc. which are essential while working with manual accounting system. Typicaly computerised accounting system offers the following features : • Online input and storage of accounting data. • Printout of purchase and sales invoices. • Logical scheme for codification of accounts and transactions. Every account and transaction is assigned a unique code. • Grouping of accounts is done from the very beginning. • Instant reports for management, for example – Aging Statement, Stock Statement, Trial Balance, Trading and Profit and Loss Account, Balance Sheet, Stock Valuation, GST, Returns, Payroll Report, etc. 2022-23 472 Accountancy Fig. 12.2 : Components of computerised accounting software system Test Your Understanding - I Fill in the correct words : 1. The user oriented programmes designed and developed for performing certain specific tasks are called as .... 2. Language syntax is checked by software called as .... 3. The people who write programmes to implement the data processing system design are called as .... 4. ....is the brain of the computer. 5. ....and ....are two of the important requirements of an accounting report. 6. An example of responsibility report is .... Financial Statement Income Statement Position Statement Cash Flow Statement Ratio Analysis 2022-23 Applications of Computers in Accounting 473 12.7 Management Information System and Accounting Information System In order to remain competitive, organisations depend heavily on Information Systems. Management Information System (MIS) is used the most common form of information system. A management information system (MIS) is a system that provides the information necessary to take decisions and manage an organisation effectively. MIS is supportive of the institution's long-term strategic goals and objectives. MIS is viewed and used at many levels by management: Operational, Tactical and Strategic. Accounting Information System (AIS) identifies, collects, processes, and communicates economic information about an entity to a wide variety of users. Such information is organised in a manner that correct decisions can be based on it. Every accounting system is essentially a part of the Accounting Information System (AIS) which, in turn is a part of the broader system, viz. the organisation's Management Information System. The following diagram shows the relationship of the Accounting System with the other functional management information systems. Fig. 12.3 : Relationship of the accounting system with other functional management information system The diagram shown above entails the four widely recognised functional areas of management. An organisation operates in a given environment surrounded by the suppliers and customers. The informational needs emerge from the business processes stratified into functional areas where accounting is one of them. The accounting information system (AIS) receives and provides information to the various sub-systems of the institutional/ integrated MIS. 2022-23 474 Accountancy Accounting Information System (AIS) is a collection of resources (people and equipment), designed to transform financial and other data into information. This information is communicated to a wide variety of decision-makers. Accepting information systems performs this transformation whether they are essentially manual systems or thoroughly computerised. Conventionally, MIS was also perceived as day-to-day financial accounting systems that are used to ensure basic control is maintained over financial record keeping activities, but now it is widely recognised as a broader concept and accounting system is a sub component. The reports generated by the accounting system are disseminated to the various users – internal and external to the organisation. The external parties include the proprietors, investors, creditors, financiers, government suppliers and vendors and the society at large. The reports used by these parties are more of routine nature. However, the internal parties – the employees, managers, etc. use the accounting information for decisionmaking and control. 12.7.1 Designing of Accounting Reports Data when processed becomes information. When the related information is summarised to meet a particular need, it is called as a report. The content and design of the report is expected to vary depending upon the level to which it is submitted and decision to made on the basis of the report. A report must be effective and efficient to the user and should substantiate the decision- making process. Akin to any report, every accounting report must be able to fulfil the following criterion : (a) Relevance (b) Timeliness (c) Accuracy (d) Completeness (e) Summarisation The accounting reports generated by the accounting software may be either routine reports or on the specific requirements of the user. For example, the ledger is a routine report while a report on supplies of a particular item by a given party is an on-demand report. However, from a broader perspective, the accounting related MIS reports may be of following reports : (a) Summary Reports : Summarises all activities of the organisation and present in the form of summary report. Profit and Loss account and Balance Sheet. 2022-23 Applications of Computers in Accounting 475 (b) Demand Reports : This report will be prepared only when the management requests them, e.g. Bad Debts Report for a given product, Stock Valuation Report. (c) Customer/Supplier Reports : According to the specifications of the management it will be prepared. For example, Top 10 Customers report, Interest on Customer Account/Invoices, Statement of Account, Customer Reminder Letters Outstanding/Open Delivery Order, Purchase Analysis, Vendor Analysis report. (d) Exception Reports : According to the conditions or exceptions the report is prepared. For example, Inventory Report in short supplies, Stock Status Query, Over stocked Status, etc. (e) Responsibility Reports : The MIS structure specifies the premises of management responsibilities. For example, the report on Cash Position, to be submitted by the head of Finance and Accounts department. The various steps involved in designing accounting reports from accounting data are as follows : (1) Definition of objectives : the objectives of the report must be clearly defined, who are the users of the report and the decision to be taken on the basis of report. (2) Structure of the report : the information to be contained therein and the style of presentation. (3) Querying with the database : the accounting information queries must be clearly defined and the methodology to be adopted while interacting with the database. (4) Finalising the report. 12.7.2 Data Interface between the Information System Accounting information system is important component of the organisational MIS in an organisation. It receives information and provides information to the other functional MIS. The following examples illustrate the relationship and data interface between the various sub-components of MIS. I Accounting Information System, Manufacturing Information System and Human Resource Information System Look at figure 12.4. It depicts the relationship between the three information systems, viz. manufacturing information system, accounting information system and the human resource information system. 2022-23 476 Accountancy The manufacturing department receives the list of workers from the Human Resource (HR) department. It sends the details of production achieved by the workers on the basis of which the HR department to the finance and accounts (F&A) department to pay the wages. The details of the wages paid and statutory dues are also send by the F & A department to the production department also to the HR department to monitor the performance of workers. The HR department communicates to the other departments about the good/bad performance on the basis decision on various operational matters may be taken. Fig. 12.4 : Relationship between AIS, manufacturing information system and human resource information system II AIS and Marketing Information System Consider the business process in the Marketing and Sales department involving the following activities : • inquiry • contact creation • entry of orders • dispatch of goods • billing to customers The accounting sub-system's transaction cycle include the processing of sales orders, credit authorisation, custody of the goods, inventory position, shipping information, receivables, etc. It also keeps a track of the customer accounts, e.g. Aging Report, which should be generated by the system. 2022-23 Applications of Computers in Accounting 477 III AIS and Manufacturing Information System Similarly, business process in the production department may involve the following activities : • preparation of plans and schedules • issue of material requisition forms and job cards • issue of inventory • issue of orders for procurement of raw materials • handling of vendors invoices • payments to vendors The accounting sub-system transaction cycle would therefore include the processing of purchase orders, advance to suppliers/vendors, inventory status updation, account payable, etc. All of this information has to share with the other MIS in the organisation. Hence, the computerised accounting system as a sub component of the accounting information system transforms the financial data into meaningful information and communicates the information to the decision-makers. The report demanded may be routine or specific ones. Key Terms Introduced in the Chapter • Operating system • Management information system • Analysts • Transactions processing system • Utility programme • Accounting information system • Data • Data interface • Application software • Report Summary with Reference to Learning Objectives 1 Meaning of a Computer : Computer is an electronic device capable of performing variety of operations as desired by a set of instructions. 2 Elements of a Computer System : • Hardware • Software • People • Procedure • Data • Connectivity 3 Capabilities of a Computer : • Speed • Accuracy • Reliability • Versatility • Storage 2022-23 478 Accountancy 4 Need of Computers in Accounting : The advent of globalisation has resulted in the rise in business operations. Consequently, every medium and large sized organisations require well-established information system in order to generate information required for decision-making and achieving the organisational objectives. This made information technology to play vital role in supporting business operations. 5 MIS and Accounting Information System : A management information system provides information necessary to take decisions and manage an organisation effectively. Accounting information system on the other hand identifies, collects, processes and communicates economic information about an entity to a wide variety of users. 6 Accounting Reports : Information supplied to meet a particular need is called report. An accounting report must fulfil the following conditions : • Relevance • Timeliness • Accuracy • Completeness • Summarisation Questions for Practice Short Answers 1. State the different elements of a computer system. 2. List the distinctive advantages of a computer system over a manual system. 3. Draw block diagram showing the main components of a computer. 4. Give three examples of a transaction processing system. 5. State the relationship between information and decision. 6. What is Accounting Information System? 7. State the various essential features of an accounting report. 8. Name three components of a Transaction Processing System. 9. Give example of the relationship between a Human Resource Information System and MIS. Long Answers 1. 'An organisation is a collection of interdependent decision-making units that exists to pursue organisational objectives'. In the light of this statement, explain the relationship between information and decisions. Also explain the role of Transaction Processing System in facilitating the decision-making process in business organisations. 2. Explain, using examples, the relationship between the organisational MIS and the other functional information system in an organisation. Describe how AIS receives and provides information to other functional MIS. 3. 'An accounting report is essential a report which must be able to fulfil certain basic criteria ' Explain? List the various types of accounting reports. 4. Describe the various elements of a computer system and explain the distinctive features of a computer system and manual system. 2022-23 Applications of Computers in Accounting 479 Checklist to Test Your Understanding 1. Application software 2. Language processor 3. Programmer 4. CPU 5. Timliness, Relevance 6. Cash position, Management responsibility 2022-23480 Accountancy Computerised Accounting System 13 I n chapter 12, you have learnt about the need for use of computers in accounting the nature and use of accounting information system. In this chapter, we shall discuss the nature of computrised accounting system, its advantages, limitations and sourcing. 13.1 Concept of Computerised Accounting System A computerised accounting system is an accounting information system that processes the financial transactions and events as per Generally Accepted Accounting Principles (GAAP) to produce reports as per user requirements. Every accounting system, manual or computerised, has two aspects. First, it has to work under a set of well-defined concepts called accounting principles. Another, that there is a user-defined framework for maintenance of records and generation of reports. In a computerised accounting system, the framework of storage and processing of data is called operating environment that consists of hardware as well as software in which the accounting system, works. The type of the accounting system used determines the operating environment. Both hardware and software are interdependent. The type of software determines the structure of the hardware. Further, the selection of hardware is dependent upon various factors such as the number of users, level of secrecy and the nature of various activities of functional departments in an organisation. LEARNING OBJECTIVES After studying this chapter, you will be able to : • define a computerised accounting system; • distinguish between a manual and computerised accounting system; • highlight the advantages and limitations of computerised accounting system; and • state the sourcing of a computerised accounting system. 2022-23 Computerised Accounting System 481 Take the case of a club, for example, where the number of transactions and their variety is relatively small, a Personal Computer with standardised software may be sufficient. However, for a large business organisation with a number of geographically scattered factories and offices, more powerful computer systems supported by sophisticated networks are required to handle the voluminous data and the complex reporting requirements. In order to handle such requirements, multi-user operating systems such as UNIX, Linux, etc. are used. Modern computerised accounting systems are based on the concept of database. A database is implemented using a database management system, which is define by a set of computer programmes (or software) that manage and organise data effectively and provide access to the stored data by the application programmes. The accounting database is well-organised with active interface that uses accounting application programs and reporting system. Every computerised accounting system has two basic requirements; • Accounting Framework : It consists a set of principles, coding and grouping structure of accounting. • Operating Procedure : It is a well-defined operating procedure blended suitably with the operating environment of the organisation. The use of computers in any database oriented application has four basic requirements as mentioned below ; • Front-end Interface : It is an interactive link or a dialog between the user and database-oriented software through which the user communicates to the back-end database. For example, a transaction relating to purchase of goods may be dealt with the accounting system through a purchase voucher, which appears on the computer's monitor of data entry operator and when entered into the system is stored in the database. The same data may be queried through reporting system say purchase analysis software programme. • Back-end Database : It is the data storage system that is hidden from the user and responds to the requirement of the user to the extent the user is authorised to access. • Data Processing : It is a sequence of actions that are taken to transform the data into decision useful information. • Reporting System: It is an integrated set of objects that constitute the report. The computerised accounting is also one of the database-oriented applications wherein the transaction data is stored in well-organised database. The user operates on such database using the required and desired interface and also takes the desired reports by suitable transformations of stored data into information. Therefore, the fundamentals of computerised accounting embrace all the basic requirements of any database-oriented application in 2022-23 482 Accountancy computers. Accordingly, the computerised accounting system has the above four additional requirements. 13.2 Comparison between Manual and Computerised Accounting Accounting, by definition, is the process of identifying, recording, classifying and summarising financial transactions to produce the financial reports for their ultimate analysis. Let us understand these activities in the context of manual and computerised accounting system. • Identifying : The identification of transactions, based on application of accounting principles is, common to both manual and computerised accounting system. • Recording : The recording of financial transactions, in manual accounting system is through books of original entries while the data content of such transactions is stored in a well-designed accounting database in computerised accounting system. • Classification : In a manual accounting system, transactions recorded in the books of original entry are further classified by posting into ledger accounts. This results in transaction data duplicity. In computerised accounting, no such data duplication is made to cause classification of transactions. In order to produce ledger accounts, the stored transaction data is processed to appear as classified so that the same is presented in the form of a report. Different forms of the same transaction data are made available for being presented in various reports. • Summarising : The transactions are summarised to produce trial balance in manual accounting system by ascertaining the balances of various accounts. As a result, preparation of ledger accounts becomes a prerequisite for preparing the trial balance. However, in computerised accounting, the originally stored transactions data are processed to churn out the list of balances of various accounts to be finally shown in the trial balance report. The generation of ledger accounts is not a necessary condition for producing trial balance in a computerised accounting system. • Adjusting Entries : In a manual accounting system, these entries are made to adhere to the principle of cost matching revenue. These entries are recorded to match the expenses of the accounting period with the revenues generated by them. Some other adjusting entries may be made as part of errors and rectification. However, in computerised accounting, Journal vouchers are prepared and stored to follow the principle of cost matching revenue, but there is nothing like passing adjusting entries for errors and rectification, except for rectifying an error of principle by having recorded a wrong voucher such as using payment voucher for a receipt transaction. • Financial Statements : In a manual system of accounting, the preparation 2022-23 Computerised Accounting System 483 of financial statements pre-supposes the availability of trial balance. However, in computerised accounting, there is no such requirement. The generation of financial statements is independent of producing the trial balance because such statements can be prepared by direct processing of originally stored transaction data. • Closing the Books : After the preparation of financial reports, the accountants make preparations for the next accounting period. This is achieved by posting of closing and reversing journal entries. In computerised accounting, there is year-end processing to create and store opening balances of accounts in database. It may be observed that conceptually, the accounting process is identical regardless of the technology used. 13.3 Advantages of Computerised Accounting System Computerised accounting offers several advantages vis-a-vis manual accounting, these are summarised as follows ; • Speed : Accounting data is processed faster by using a computerised accounting system than it is achieved through manual efforts. This is because computers require far less time than human beings in performing a task. • Accuracy : The possibility of error is eliminated in a computerised accounting system because the primary accounting data is entered once for all the subsequent usage and processes in preparing the accounting reports. Normally, accounting errors in a manual accounting system occur because of repeated posting of same set of original data by several times while preparing different types of accounting reports. • Reliability : The computer system is well-adapted to performing repetitive operations. They are immune to tiredness, boredom or fatigue. As a result, computers are highly reliable compared to human beings. Since computerised accounting system relies heavily on computers, they are relatively more reliable than manual accounting systems. • Up-to-Date Information : The accounting records, in a computerised accounting system are updated automatically as and when accounting data is entered and stored. Therefore, latest information pertaining to accounts get reflected when accounting reports are produced and printed. For example, when accounting data pertaining to a transaction regarding cash purchase of goods is entered and stored, the cash account, purchase account and also the financial statements (trading and profit and loss account) reflect the impact immediately. • Real Time User Interface : Most of the automated accounting systems are 2022-23 484 Accountancy inter-linked through a network of computers. This facilitates the availability of information to various users at the same time on a real time basis (that is spontaneously). • Automated Document Production : Most of the computerised accounting systems have standardised, user defined format of accounting reports that are generated automatically. The accounting reports such as Cash book, Trial balance, Statement of accounts are obtained just by click of a mouse in a computerised accounting environment. • Scalability : In a computerised accounting system, the requirement of additional manpower is confined to data entry operators for storing additional vouchers. The additional cost of processing additional transactions is almost negligible. As a result the computerised accounting systems are highly scalable. • Legibility : The data displayed on computer monitor is legible. This is because the characters (alphabets, numerals, etc.) are type written using standard fonts. This helps in avoiding errors caused by untidy written figures in a manual accounting system. • Efficiency : The computer based accounting systems ensure better use of resources and time. This brings about efficiency in generating decisions, useful informations and reports. • Quality Reports : The inbuilt checks and untouchable features of data handling facilitate hygienic and true accounting reports that are highly objective and can be relied upon. • MIS Reports : The computerised accounting system facilitates the real time production of management information reports, which will help management to monitor and control the business effectively. Debtors' analysis would indicate the possibilities of defaults (or bad debts) and also concentration of debt and its impact on the balance sheet. For example, if the company has a policy of restricting the credit sales by a fixed amount to a given party, the information is available on the computer system immediately when every voucher is entered through the data entry form. However, it takes time when it comes to a manual accounting system. Besides, the results may not be accurate. • Storage and Retrieval : The computerised accounting system allows the users to store data in a manner that does not require a large amount of physical space. This is because the accounting data is stored in hard-disks, CD-ROMs, floppies that occupy a fraction of physical space compared to books of accounts in the form of ledger, journal and other accounting registers. Besides, the system permits fast and accurate retrieval of data and information. • Motivation and Employees Interest : The computer system requires a 2022-23 Computerised Accounting System 485 specialised training of staff, which makes them feel more valued. This motivates them to develop interest in the job. However, it may also cause resistance when we switch over from a manual system to a computer system. Test Your Understanding - I 1. The framework of storage and processing of data is called as .... 2. Database is implemented using .... 3. A sequence of actions taken to transform the data into decision useful information is called....... 4. An appropriate accounting software for a small business organisation having only one user and single office location would be .... 13.4 Limitations of Computerised Accounting System The main limitations emerge out of the environment in which the computerised accounting system is made to operate. These limitations are as given below ; • Cost of Training : The sophisticated computerised accounting packages generally require specialised staff personnel. As a result, a huge training costs are incurred to understand the use of hardware and software on a continuous basis because newer types of hardware and software are acquired to ensure efficient and effective use of computerised accounting systems. • Staff Opposition : Whenever the accounting system is computerised, there is a significant degree of resistance from the existing accounting staff, partly because of the fear that they shall be made redundant and largely because of the perception that they shall be less important to the organisation. • Disruption : The accounting processes suffer a significant loss of work time when an organisation switches over to the computerised accounting system. This is due to changes in the working environment that requires accounting staff to adapt to new systems and procedures. • System Failure : The danger of the system crashing due to hardware failures and the subsequent loss of work is a serious limitation of computerised accounting system. However, providing for back-up arrangements can obviate this limitation. Software damage and failure may occur due to attacks by viruses. This is of particular relevance to accounting systems that extensively use Internet facility for their online operations. No fullproof solutions are available as of now to tackle the menace of attacks on software by viruses. • Inability to Check Unanticipated Errors : Since the computers lack capability 2022-23 486 Accountancy to judge, they cannot detect unanticipated errors as human beings commit. This is because the software to detect and check errors is a set of programmes for known and anticipated errors. • Breaches of Security : Computer related crimes are difficult to detect as any alteration of data may go unnoticed. The alteration of records in a manual accounting system is easily detected by first sight. Fraud and embezzlement are usually committed on a computerised accounting system by alteration of data or programmes. Hacking of passwords or user rights may change the accounting records. This is achieved by tapping telecommunications lines, wire-tapping or decoding of programmes. Also, the people responsible for tampering of data cannot be located which in a manual system is relatively easier to detect. • Ill-effects on Health : The extensive use of computers systems may lead to development of various health problems: bad backs, eyestrain, muscular pains, etc. This affects adversely the working efficiency of accounting staff on one hand and increased medical expenditure on such staff on the other. Do It Yourself Visit a commercial organisation where the accounting is performed manually. Observe the various accounting activities. Now list the advantages, which would have accrued, had the accounting being performed through computers. 13.5 Sourcing of Accounting Software Accounting software is an integral part of the computerised accounting system. An important factor to be considered before acquiring accounting software is the accounting expertise of people responsible in organisation for accounting work. People, not computers, are responsible for accounting. The need for accounting software arises in two situations : (a) when the computerised accounting system is implemented to replace the manual system or (b) when the current computerised system needs to be replaced with a new one in view of changing needs. 2022-23 Computerised Accounting System 487 Box 1 Accounting Software Variety of accounting software is available in the market. The most popular software used in India are Tally and Ex. The basic features of all accounting software are same on a global basis. The legal reporting requirements in a given country and the business needs affect the software contents. The other popular softwares are Sage, Wings 2000, Best Books, Cash Manager, and Ace Pays, etc. 13.5.1 Accounting Packages Every Computerised Accounting System is implemented to perform the accounting activity (recording and storing of accounting data) and generate reports as per the requirements of the user. From this perspective. The accounting packages are classified into the following categories : (a) Ready to use (b) Customised (c) Tailored Each of these categories offers distinctive features. However, the choice of the accounting software would depend upon the suitability to the organisation especially in terms of accounting needs. 13.5.2 Ready-to-Use Ready-to-Use accounting software is suited to organisations running small/ conventional business where the frequency or volume of accounting transactions is very low. This is because the cost of installation is generally low and number of users is limited. Ready-to-use software is relatively easier to learn and people (accountant) adaptability is very high. This also implies that level of secrecy is relatively low and the software is prone to data frauds. The training needs are simple and sometimes the vendor (supplier of software) offers the training on the software free. However, these software offer little scope of linking to other information systems. 13.5.3 Customised Accounting software may be customised to meet the special requirement of the user. Standardised accounting software available in the market may not suit or fulfil the user requirements. For example, standardised accounting software may contain the sales voucher and inventory status as separate options. However, when the user requires that inventory status to be updated immediately upon entry of sales voucher and report be printed, the software needs to be customised. 2022-23 488 Accountancy Customised software is suited for large and medium businesses and can be linked to the other information systems. The cost of installation and maintenance is relatively high because the high cost is to be paid to the vendor for customisation. The customisation includes modification and addition to the software contents, provision for the specified number of users and their authentication, etc. Secrecy of data and software can be better maintained in customised software. Since the need to train the software users is important, the training costs are therefore high. 13.5.4 Tailored The accounting software is generally tailored in large business organisations with multi users and geographically scattered locations. These software requires specialised training to the users. The tailored software is designed to meet the specific requirements of the users and form an important part of the organisational MIS. The secrecy and authenticity checks are robust in such softwares and they offer high flexibility in terms of number of users. To summarise, the following table represents the comparison between the various categories of accounting software : Basis Ready to use Customised Tailored Nature of business Small, conventional Large, medium Large, typical business business business Cost of installation and Low Relatively high High maintenance Expected Level of secrecy Low Relatively high Relatively high (Software and Data) Number of users and Limited As per Unlimited their interface specifications Linkage to other Restricted yes Yes information system Adaptability High Relatively high Specific Training Low Medium High requirements 13.6 Generic Considerations before Sourcing an Accounting Software The following factors are usually taken in considerations before sourcing an accounting software. 2022-23 Computerised Accounting System 489 13.6.1 Flexibility An important consideration before sourcing an accounting software is flexibility, viz. data entry and the availability and design of various reports expected from it. Also, it should offer some flexibility between the users of the software, the switch over between the accountants (users), operating systems and the hardware. The user should be able to run the software on variety of platforms and machines, e.g. Windows 98/2000, Linux, etc. 13.6.2 Cost of Installation and Maintenance The choice of the software obviously requires consideration of organisation ability to afford the hardware and software. A simple guideline to take such a decision is the cost benefit analysis of the available options and the financing opportunities available to the firm. Some times, certain software which appears cheap to buy, involve heavy maintenance and alteration costs, e.g. cost of addition of modules, training of staff, updating of versions, data failure/restoring costs. Conversely, the accounting software which appear initially expensive to buyers, may require least maintenance and free upgrading and negligible alteration costs. 13.6.3 Size of Organisation The size of organisation and the volume of business transactions do affect the software choices. Small organisations, e.g. in non-profit organisations, where the number of accounting transactions is not so large, may opt for a simple, single user operated software. While, a large organisation may require sophisticated software to meet the multi-user requirements, geographically scattered and connected through complex networks. 13.6.4 Ease of Adaptation and Training needs Some accounting software is user friendly requiring a simple training to the users. However, some other complex software packages linked to other information systems require intensive training on a continuous basis. The software must be capable of attracting users and, if its requires simple training, should be able to motivate its potential users. 13.6.5 Utilities/MIS Reports The MIS reports and the degree to which they are used in the organisation also determine the acquisition of software. For example, software that requires simply producing the final accounts or cash flow/ratio analysis may be readyto-use software. However, the software, which is expected to produce cost records needs to be customised as per user requirements. 2022-23 490 Accountancy 13.6.6 Expected Level of Secrecy (Software and Data) Another consideration before buying accounting software is the security features, which prevent unauthorised personnel from accessing and/or manipulating data in the accounting system. In tailored software for large businesses, the user rights may be restricted to purchase vouchers for the purchase department, sales vouchers to the billing accountants and petty cash module access with the cashier. The operating system also matters. Unix environment allows multi-users compared to Windows. In Unix, the user cannot make the computer system functional unless the user clicks with a password, which is not a restriction in Windows. 13.6.7 Exporting/Importing Data Facility The transfer of database to other systems or software is sometimes expected from the accounting software. Organisations may need to transfer information directly from the ledger into spreadsheet software such as Lotus or Excel for more flexible reporting. The software should allow the hygienic, untouched data transfer. Accounting software may be required to be linked to MIS software in the organisation. In some ready to use accounting softwares, the exporting, importing facility is available but is limited to MS Office modules only, e.g. MS Word, MS Excel, etc. However, tailored softwares are designed in manner that they can interact and share information with the various sub components of the organisational MIS. 13.6.8 Vendors Reputation and Capability Another important consideration is the reputation and capability of about the vendor. This depends upon how long has he been the vendor is in business of software development, whether there are other users of the software and extent of the availability of support mechanisms outside the premises of the vendor. Key Terms Introduced in the Chapter • Computerised Accounting System • Mannual Accounting System • Generally Accepted Accounting Principles • Operating Environment • Accounting Software • Accounting Packages 2022-23 Computerised Accounting System 491 Summary with Reference to Learning Objectives 1 Computerised Accounting System : A computerised accounting system is an accounting information system that processes the financial transactions and events to produce reports as per user requirements. It is based on the concept of database and has two basic requirements: (a) Accounting framework and (b) Operating Procedure. 2 Advantages of Computerised Accounting System : • Speed • Accuracy • Reliability • Up-to-date • Scalability • Legibility • Efficiency • Quality Report • MIS Reports • Real time user interface • Storage and Retrieval • Motivation and Employees interest • Automated document production 3 Limitations of Computerised Accounting System : • Cost of training • Staff Opposition • Disruption • System failure • Breache of security • Ill-effects on health • Inability to check unanticipated errors 4 Categories of Accounting Packages : • Ready-to-Use • Customised • Tailored Questions for Practice Short Answers 1. State the four basic requirements of a database applications. 2. Name the various categories of accounting package. 3. Give examples of two types of operating systems. 4. List the various advantages of computerised accounting systems. 5. Give two examples each of the organisations where 'ready-to-use', 'customised', and 'tailored' accounting packages respectively suitable to perform the accounting activity. 6. Distinguish between a 'ready-to-use' and 'tailored' accounting software. Long Answers 1. Define a computerised accounting system. Distinguish between a manual and computerised accounting system. 2. Discuss the advantages of computerised accounting system over the manual accounting system. 3. Describe the various types of accounting software along with their advantages and limitations. 4. ‘Accounting software is an integral part of the computerised accounting system’ Explain. Briefly list the generic considerations before sourcing an accounting software. 5. ‘Computerised Accounting Systems are best form of accounting system’. Do you agree? Comment. Checklist to Test Your Understanding 1. Operating environment 2. DBMS 3. Data Processing 4. Ready to use 2022-23 APPENDIX Description of Commonly Used Functions in Access There are three types of functions that are used to set the Control Source property of calculated controls and/or to form part of calculated field expression in SQL statement. A brief description of the commonly used functions is below : A-1. Domain Aggregate Functions These functions are used to perform calculations based on values in a field of a table or query. Criteria to select the set of records in the table or query that is desired to be used for calculations may also be specified. The criteria, if not specified, imply that all the records of the table or query specific to the field are used for computation. All the domain aggregate functions use the same syntax as is given hereunder : DFunction (“FldName”, “TblName” or “QryName”, “SrchCond”) Wherein DFunction refers to a named domain aggregate function. A brief description of its input arguments is given below: FldName : It refers to the name of field that is to be searched in a table or query, which is specified as an argument. TblName (or QueryName) : It refers to the name of a table or query that contains the field specified as second input argument. SrchCond : It refers to the search condition on the basis of which the relevant record is searched. Some of the important domain aggregate functions have been described as below : (a) DLookup : This function is meant to look up information that is stored in a table or query, which is not the underlying source of Access Form or Report. It is used to set the Control Source property of a calculated control to display data from other table or query. Consider the following example: DLookup (“Name”, “Accounts”, “Code = ‘110001’”) In the above example, this function has been applied to search the name of account (in Accounts table) whose code is ‘110001’. (b) DMax and DMin : These functions are used to retrieve respectively the maximum and minimum values in the specified field. Consider the following example : DMin (“Amount”, “Vouchers”, “Debit = ‘711001’”) Dmax (“Amount”, “Vouchers”, “Debit = ‘711001’”) In the above examples, the amount of minimum purchase transaction and maximum purchase transaction is retrieved and reported. It may also be noted that ‘711001’ is the code of Purchase account in Accounts table (c) DSum : This function computes and returns the sum of the values in the specified field or expression. For Example, in a table : Sales that contains 2022-23 Appendix 493 ItemCode, Price and Quantity as fields, the total amount of sales may be computed by using the DSum () function as follows : DSum (“Price*Quantity”, “Sales”) However, if the total sales is to computed for a particular item coded as 1678, the DSum () function shall be applied as follows : DSum (“Price*Quantity”, “Sales”, “ItemCode = 1678”) (d) DFirst and DLast : These functions are used to retrieve respectively the values in the specified field from first and last physical records. Consider the following application examples : DFirst (“Name”, “Accounts”) DLast (“Name”, “Accounts”) In the above examples, the name first and last account that physically exists in Accounts table is retrieved and reported. (e) DCount : This function is meant to compute the number of records with non-null values in the specified field. Consider the following application example : DCount (“*”, “Accounts”) In the above example, The number of records in accounts table are counted and reported by DCount () function. A-2. SQL Aggregate Functions The SQL aggregate functions have the functionality similar to that of domain aggregate function. However, unlike domain aggregate functions, these functions cannot be called directly into controls used in Forms and Reports of Access. These functions are used in SQL statements that provide the underlying record source of Forms and Reports. All these functions, when used require the GROUP BY clause in SQL statement : (a) Sum : This function is used to compute and return the sum of a set of values. For Example, consider the following SQL statement that has been used in Chapter-V to prepare the underlying information source of Trial Balance

(Model-I.). SELECT Debit As Code, SUM (Amount) AS Total FROM VOUCHERS GROUP BY Debit ; In the above SQL statement, Sum () has been used to compute the total amount by which the transacted accounts have beeen debited. (b) Min and Max : These functions are used to retrieve respectively the minimum and maximum of value set with respect to field or query expression. For Example, the following SQL statement is capable of returning the amount of minimum and maximum sales transaction in Model-I : SELECT Min (Amount) As MinSales, Max (Amount) As MaxSales FROM Vouchers WHERE Credit = ‘811001’ ; 2022-23 494 Accountancy It may be noted that the sales account that is coded as ‘811001’ is credited as and when a sales transaction is recorded. (c) Count : This function counts the number of records returned by a query. The number of times a sales transaction has occurred and recorded in books of accounts can be known by executing the following SQL statement. SQL statement. SELECT count (*) FROM Vouchers WHERE Credit = ‘811001’ In the above SQL statement, the Credit field stores the account code of sales when a sales transaction occurs. The WHERE clause restricts the number of records returned by the above SQL to those in which credit field has the account code of sales. Accordingly, the count () function returns the count value of records returned by the above SQL statement. (d) First and Last : These functions are meant to retrieve the first and last record of a value set pertaining to a field or query expression. A-3. Other Functions (a) IIF : The purpose of this function is to provide a value to the field from a mutually exclusive set of values. Its syntax is as given below : IIIF (, Value-1, Value-2) Wherein refers to any logical expression in which a comparison is made by using following comparison operators : = equal to greater than <= less than or equal to >= greater than or equal to The condition formed by the above comparison operators is evaluated to result into TRUE or FALSE. This value is returned by IIF() function to the field, if the condition turns out to be TRUE This value is returned by IIF() function to the field, if the condition turns out to be FALSE Example : Suppose a field Type is to return the string of characters “Debit” when its value is 0 and “Credit” when its value is 1, IIF() function is used as shown below : IIF (Type = 0, “Debit”, “Credit”) (b) Abs : The purpose of this function is to return absolute value, This function receives a numeric value as its input argument and returns an absolute value. Consider the following examples on use of Abs ( ) function : When – 84 is given as input argument to Abs(– 84), it returns 84 2022-23 Appendix 495 When 84 is given as input argument to Abs(84), it returns 84 (c) Val : The purpose of this function is to return the numbers contained in a string as a numeric value of appropriate type. Its Syntax is Val(string) The string argument of the above Val( ) function is any valid string expression. The Val( ) function stops reading the string at the first character that cannot be recognised as number. For example, Val(“12431”) returns the value 12431 by converting the enclosed string of numerals into value. However, Val (“12,431”) returns the numeric value 12 because comma after 12 in the enclosed string of characters in Val ( ) function is not recognised as number. 2022-23 496 Appendix NOTE 2022-23