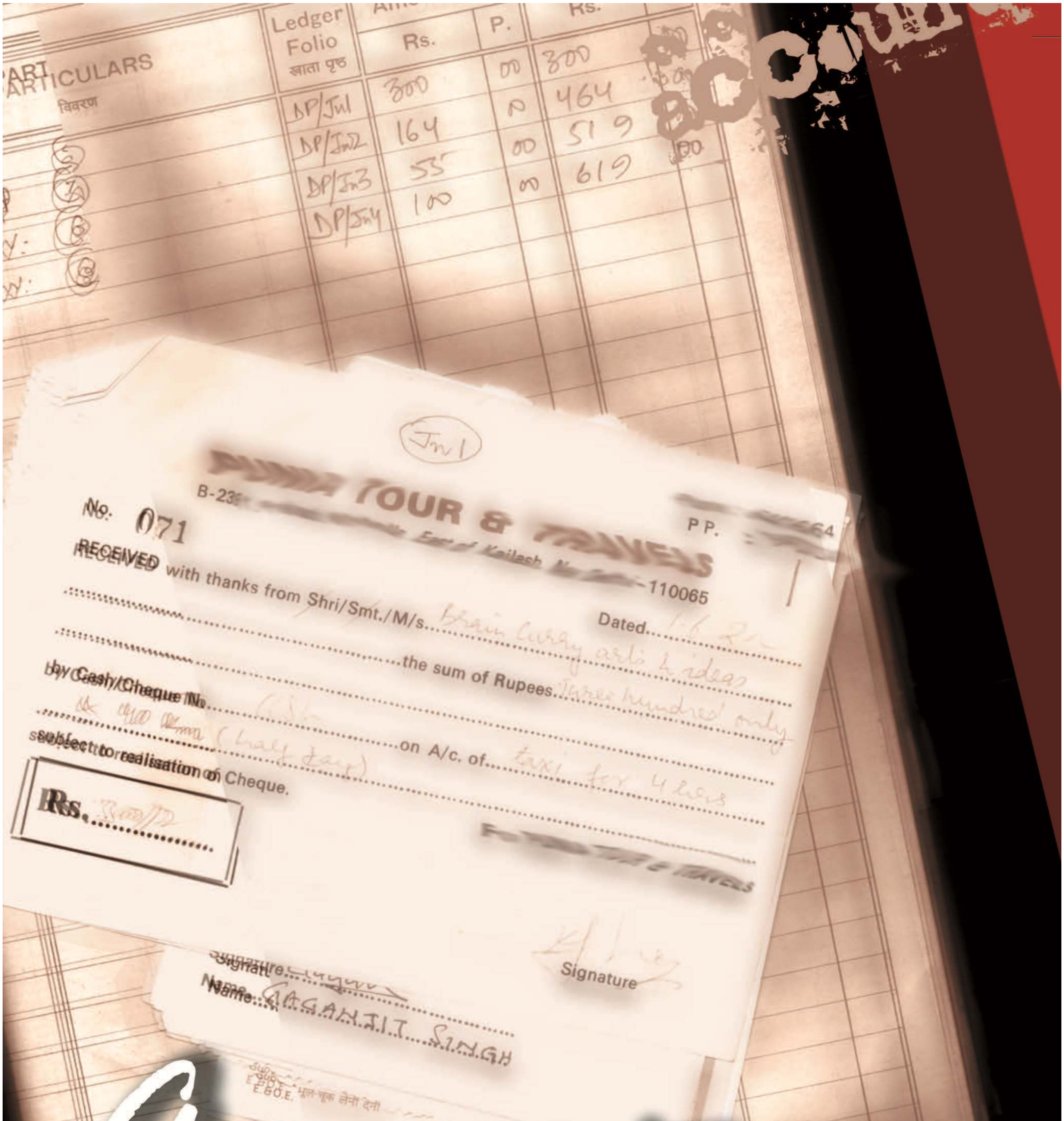

Accountancy

Financial Accounting Part - I

Textbook for Class XI

Accountancy

Financial Accounting

Part I

Textbook for Class XI

11110

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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 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
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The Council acknowledges the Contribution of Sanjeev Kumar, *Vice Principal*, Government Boys Senior Secondary School, Mata Sundari Road for reviewing and updating this textbook.

The Contribution of APC-Office, administration of DESS, Publication Department and Secretariat of NCERT in bringing out this book are also duly acknowledged.

THE CONSTITUTION OF INDIA

PREAMBLE

WE, THE PEOPLE OF INDIA, having solemnly resolved to constitute India into a [1]**[SOVEREIGN SOCIALIST SECULAR DEMOCRATIC REPUBLIC]** and to secure to all its citizens :

JUSTICE, social, economic and political;

LIBERTY of thought, expression, belief, faith and worship;

EQUALITY of status and of opportunity; and to promote among them all

FRATERNITY assuring the dignity of the individual and the [2][unity and integrity of the Nation];

IN OUR CONSTITUENT ASSEMBLY this twenty-sixth day of November, 1949 do **HEREBY ADOPT, ENACT AND GIVE TO OURSELVES THIS CONSTITUTION.**

---

1. Subs. by the Constitution (Forty-second Amendment) Act, 1976, Sec.2, for "Sovereign Democratic Republic" (w.e.f. 3.1.1977)
2. Subs. by the Constitution (Forty-second Amendment) Act, 1976, Sec.2, for "Unity of the Nation" (w.e.f. 3.1.1977)

Contents

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Introduction to Accounting

1

Learning Objectives

After studying this chapter you will be able to:

- *state the meaning and need of accounting;*
- *discuss accounting as a source of information ;*
- *identify the internal and external users of accounting information;*
- *explain the objectives of accounting;*
- *describe the role of accounting;*
- *explain the basic terms used in accounting.*

Over the centuries, accounting has remained confined to the financial record-keeping functions of the accountant. But, today's rapidly changing business environment has forced the accountants to reassess their roles and functions both within the organisation and the society. The role of an accountant has now shifted from that of a mere recorder of transactions to that of the member providing relevant information to the decision-making team. Broadly speaking, accounting today is much more than just book-keeping and the preparation of financial reports. Accountants are now capable of working in exciting new growth areas such as: forensic accounting (solving crimes such as computer hacking and the theft of large amounts of money on the internet); e-commerce (designing web-based payment system); financial planning, environmental accounting, etc. This realisation came due to the fact that accounting is capable of providing the kind of information that managers and other interested persons need in order to make better decisions. This aspect of accounting gradually assumed so much importance that it has now been raised to the level of an information system. As an information system, it collects data and communicates economic information about the organisation to a wide variety of users whose decisions and actions are related to its performance. This introductory chapter therefore, deals with the nature, need and scope of accounting in this context.

1.1 Meaning of Accounting

In 1941, The American Institute of Certified Public Accountants (AICPA) had defined accounting as the art of recording, classifying, and summarising in a significant manner and in terms of money, transactions and events which are, in part at least, of financial character, and interpreting the results thereof'. With greater economic development resulting in changing role of accounting, its scope, became broader. In 1966, the American Accounting Association (AAA) defined accounting as 'the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of information'.

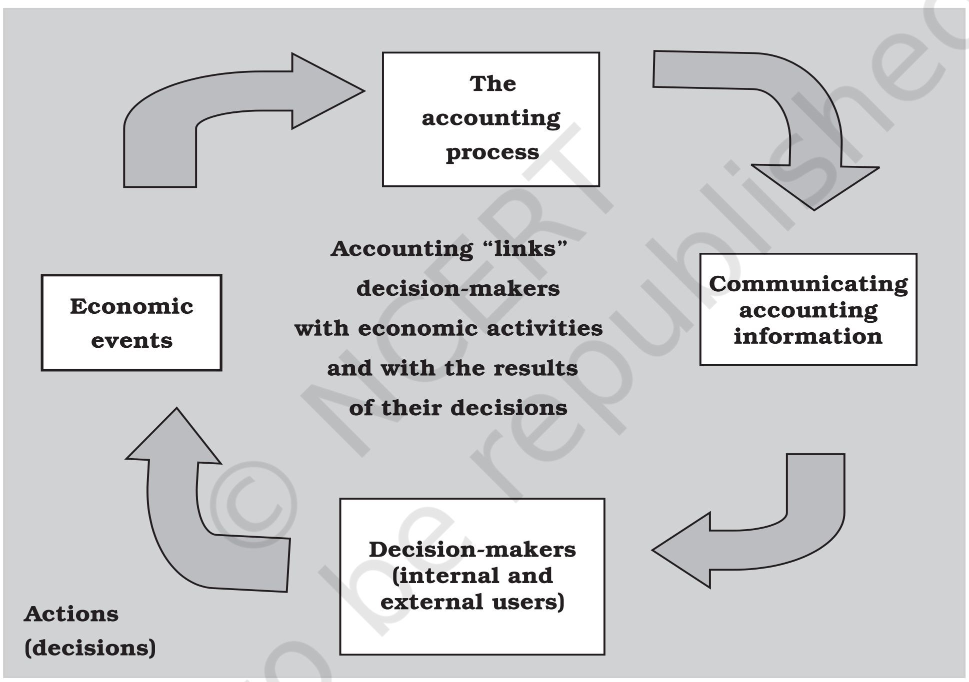

Fig. 1.1 : *Showing the process of accounting*

In 1970, the Accounting Principles Board of AICPA also emphasised that the function of accounting is to provide quantitative information, primarily financial in nature, about economic entities, that is intended to be useful in making economic decisions.

Accounting can therefore be defined as the process of identifying, measuring, recording and communicating the required information relating to the economic events of an organisation to the interested users of such information. 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 book-keeping. 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.

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 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-for-profit 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, Debenture-holders 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.

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-to-time.

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;

- 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 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 prominence.

Let's Do It

Many People in today's society think of an accountant as simply a glorified book-keeper. 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).

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.

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

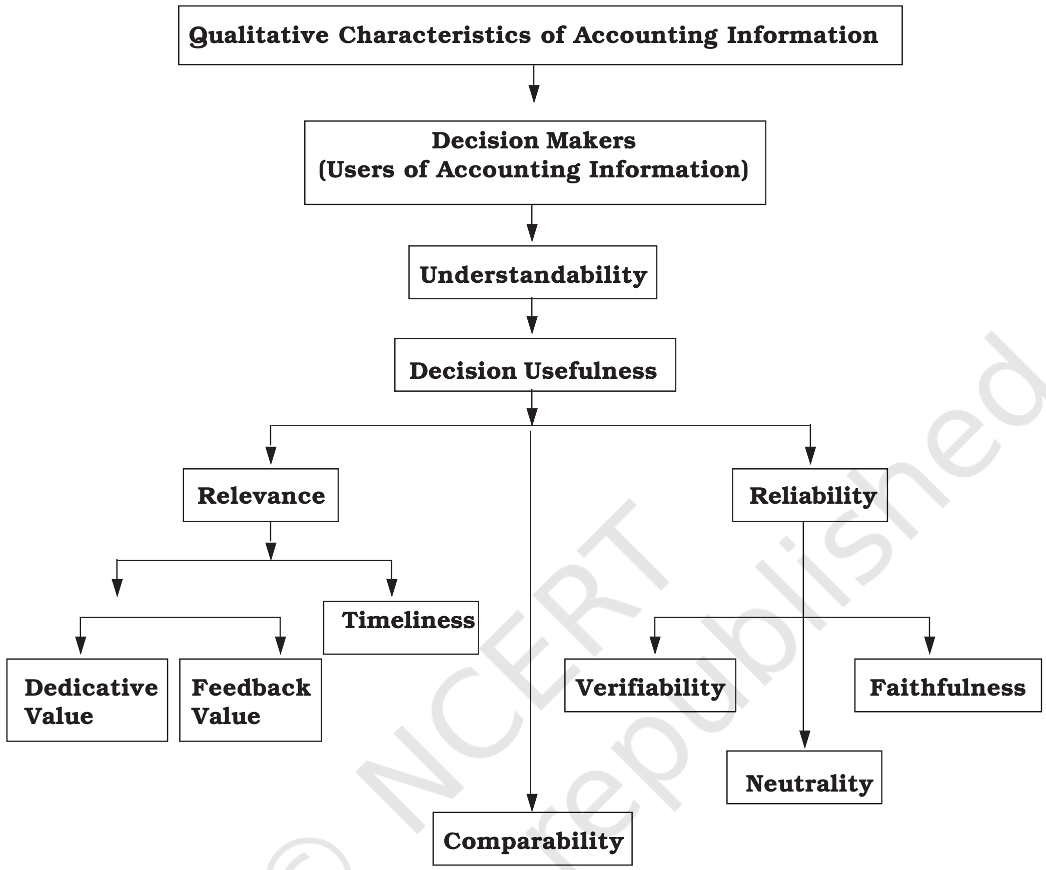

Fig. 1.3 : *The qualitative characteristics of accounting information*

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) 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.

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

Box 4

Different Roles of Accounting

- ✓ As a language – it is perceived as the language of business which is used to communicate information on enterprises;
- ✓ As a historical record- it is viewed as chronological record of financial transactions of an organisation at actual amounts involved;
- ✓ 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;
- ✓ 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;
- ✓ 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).

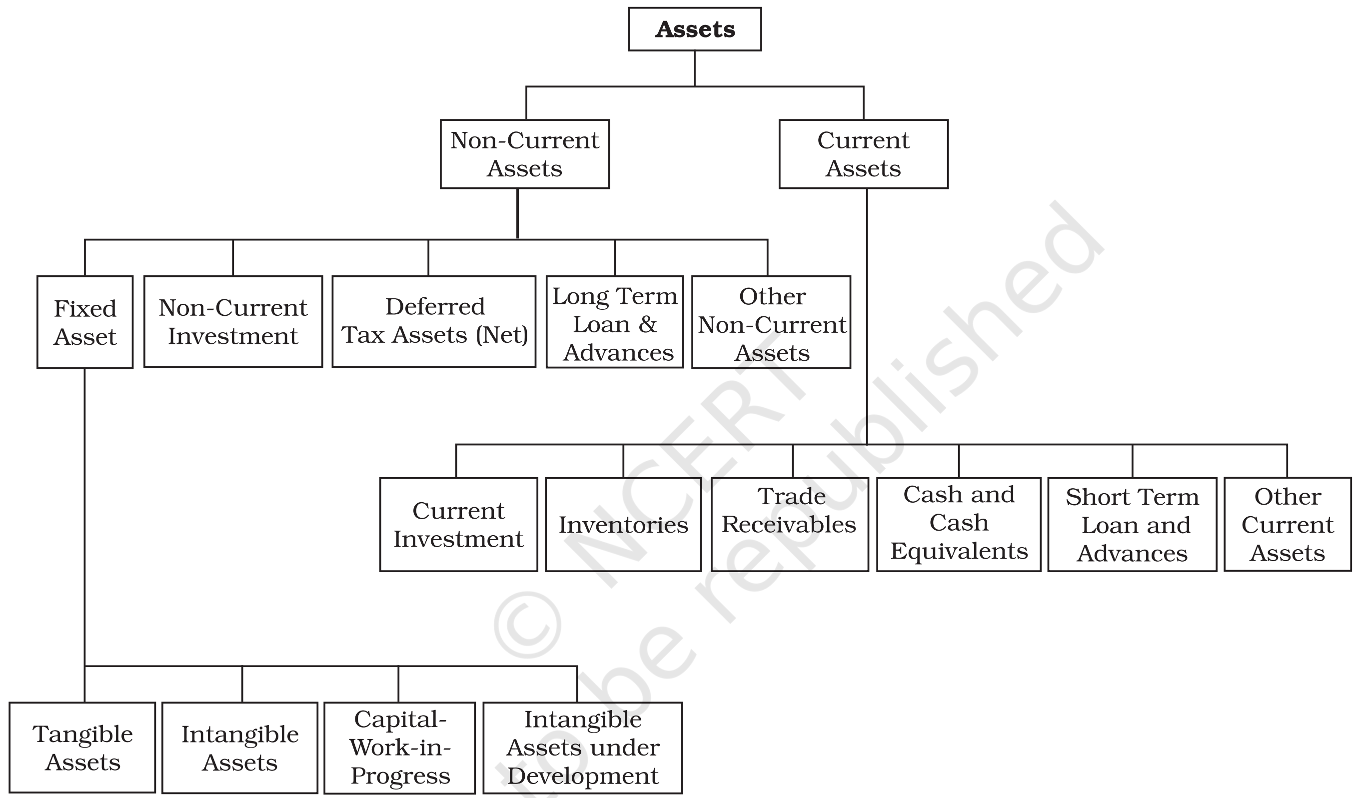

Figure 1.4 : *Classification of Assets*

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).

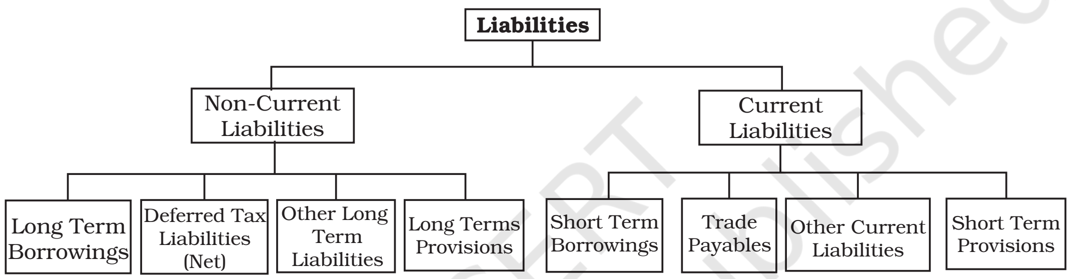

Figure 1.5 : *Classification of Liabilities*

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

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.

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.

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

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 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 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 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.

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
   - Relevance
   - Understandability
   - 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.

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)

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 (✓) the appropriate one:

Items	Current Assets	Non-Current Assets	Current Liabilities	Non-Current 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				

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Theory Base of Accounting

2

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.*

As 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 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 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 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 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

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 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.

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 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.

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.

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 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.

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.

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

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	AS	Title
1	Presentation of Financial Statements	1	Disclosure of accounting policies
		—-	Framework for preparation and presentation of financial statements
2	Inventories	2	Valuation of inventories
7	Cash Flow Statements	3	Cash flow statements
8	Accounting Policies, Changes in Accounting Estimates and Errors	5	Net profit or loss for the period, prior period items and changes in accounting policies
10	Events after the Balance Sheet Date	4	Contingencies and events occurring after the balance sheet date
11	Construction Contracts	7	Construction contracts
12	Income Taxes	22	Accounting for taxes on income
16	Property, Plant and Equipment	10	Accounting for fixed assets
		6	Depreciation accounting
17	Leases	19	Leases
18	Revenue	9	Revenue recognition
19	Employee Benefits	15	Employee Benefits
20	Accounting for Government Grants and Disclosure of Government Assistance	12	Accounting for government grants
21	The Effects of Changes in Foreign Exchange Rates	11	The effects of changes in foreign exchange rates
23	Borrowing Costs	16	Borrowing Costs
24	Related Party Disclosures	18	Related Party Disclosures

27	Consolidated and Separate Financial Statements	21	Consolidated Financial Statements
28	Investments in Associates	23	Accounting for Investment in Associates in CFS
29	Financial Reporting in Hyperinflationary Economics	—-	
31	Interests in Joint Ventures	27	Financial reporting of interest in joint venture
32	Financial Instruments: Presentation	31	Financial instrument: Presentation
33	Earnings Per Share	20	Earnings Per Share
34	Interim Financial Reporting	25	Interim Financial reporting
36	Impairment of assets	28	Impairment of Asset
37	Provisions, contingent liabilities and contingent assets	29	Provisions, contingent liabilities and contingent assets
38	Intangible assets	30	Intangible assets
39	Financial instruments: Recognition and measurement	13	Financial instruments: Recognition and measurement
		13	Accounting for investments
40	Investment property	13	Accounting for investments
101	First time adoption of international financial reporting standards	---	
102	Share-based payments	---	G.N. on employee share based payment
103	Business combinations	14	Accounting for amalgamations
104	Insurance Contracts	—-	
105	Non-current Assets held for Sale and Discontinued Operations	24 —-	Discontinuing Operation
106	Exploration for and Evaluation of Mineral Resources	---	
107	Financial Instruments: Disclosures	32	Financial Instrument : Disclosure
108	Operating Segments	17	Segment Reporting

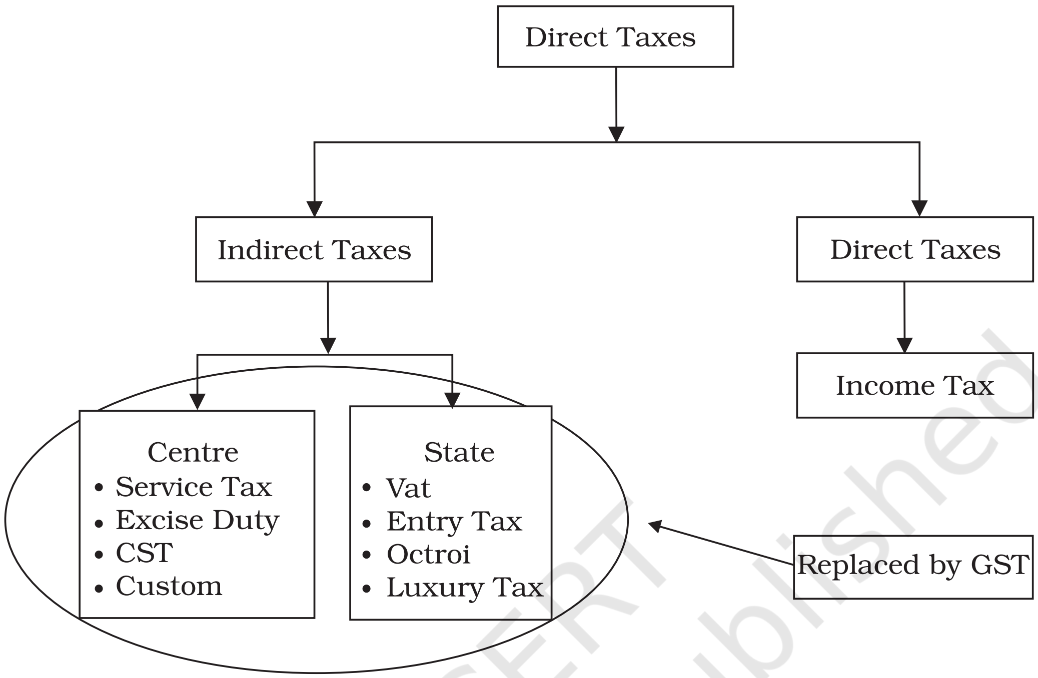
Goods and Services Tax
(One Country One Tex)

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.



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.

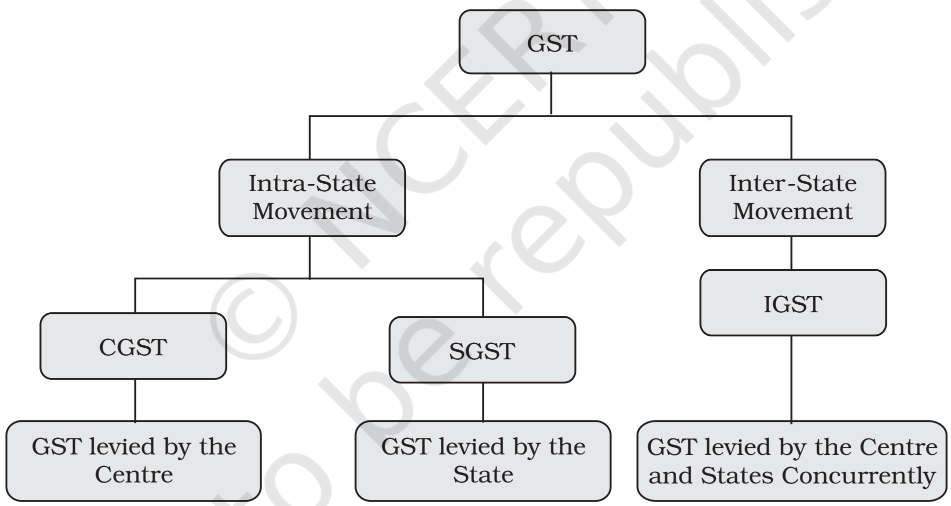
Do it yourself

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.

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.



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

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

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.

(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 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

Recording of Transactions-I

3

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.*

In 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 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 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*

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;

- 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.

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.

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

The summary of effects of transactions on accounting equation is in the following analysis table:

(Figures in rupees)

Transaction No.	*Cash*	*Bank*	*Assets Debtors*	*Goods (Stock)*	*Furniture*	*Plant and Machinery*	*Total Assets*	*Liabilities*	*Capital*	*Total*
	5,00,000						5,00,000	....	5,00,000	5,00,000
1.	(4,80,000)	4,80,000					....		....	....
Post Trans. Equation	20,000	4,80,000					5,00,000		5,00,000	5,00,000
2.	....	(60,000)			60,000		....		....	....
Post Trans. Equation	20,000	4,20,000			60,000		5,00,000		5,00,,000	5,00,000
3.	(10,000)					1,25,000	1,15,000	1,15,000		1,15,000
Post Trans. Equation	10,000	4,20,000			60,000	1,25,000	6,15,000	1,15,000	5,00,000	6,15,000
4.				55,000			55,000	55,000		55,000
Post Trans. Equation	10,000	4,20,000		55,000	60,000	1,25,000	6,70,000	1,70,000	5,00,000	6,70,000
5.			35,000	(25,000)			10,000		10,000	10,000
Final Equation	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

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) + Debit	**(Decrease) – Credit**

Liabilities

(Decrease) – Debit	**(Increase) + Credit**

Capital

(Decrease) – Debit	**(Increase) + Credit**

Expenses/Losses

(Increase) + Debit	**(Decrease) – Credit**

Revenues/Gains

(Decrease) – Debit	**(Increase) + Credit**

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.

Cash Account

(1) 5,00,000	

Capital Account

	(1) 5,00,000
	(6) 10,000

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.

Cash Account

(1) 5,00,000	**(2) 4,80,000**

Bank Account

(2) 4,80,000	

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.

Furniture Account

(1) 60,000	

Bank Account

(2) 4,80,000	**(3) 60,000**

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	(2) 4,80,000
	(4) 10,000

Plant and Machinery Account

(4) 1,25,000	

Ramjee Lal's Account

	(4) 1,15,000

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.

Purchases Account

(5) 55,000	

Sumit Traders Account

	(5) 55,000

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.

Sales Account

	(6) 35,000

Rajani Enterprises Account

(6) 35,000	

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.

Rent Account

(7) 2,500	

Cash Account

(7) 5,00,000	(2) 4,80,000
	(4) 10,000
	(7) 2,500

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.

Salary Account

(8) 5,000	

Cash Account

(1) 5,00,000	(2) 4,80,000
	(4) 10,000
	(7) 2,500
	(8) 5,000

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.

Rajani Enterprises Account

(6) 35,000	**(9) 35,000**

Bank's Account

(2) 4,80,000	(3) 60,000
(9) 35,000	

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.

(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 Machinery	+ Bank		=	
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.

₹

Assets Cash	+ Inventory	+ Plant and Machinery		+ Bank	+ Furniture	= **Liabilities**	+ **Capital**
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 Cash	+ Inventory	+ Plant and Machinery	+ Bank	+ Furniture	= **Liabilities**	+ **Capital**
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 Cash	+ Inventory	+ Plant and Machinery	+ Bank	+ Furniture	= **Liabilities**	+ **Capital**
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 Cash	+ Inventory	+ Plant and Machinery	+ Bank	+ Furniture	+ Debtors	= **Liabilities**	+ **Capital**
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.

₹

Assets						**= Liabilities**	**+ Capital**
Cash	+ Inventory	+ Plant and Machinery	+ Bank	+ Furniture	+ Debtors		
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 Machinery	+ Bank	+ Furniture	+ Debtors		
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 Machinery	+ Bank	+ Furniture	+ Debtors		
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 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 B*ook 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 Amount* ₹	*Credit 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 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 Amount* ₹	*Credit 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 :

Journal

Date	*Particulars*		*L.F.*	*Debit Amount ₹*	*Credit Amount ₹*
2017 July 4	Office Furniture A/c	Dr.		25,000	
	To Cash A/c				5,000
	To Modern Furniture A/c				20,000
	(Purchase of office furniture from Modern Furnitures)				

Now refer to example 1*on page 46* again and observe how the transactions listed are recorded in the journal:

Books of Rohit
Journal

Date	*Particulars*		*L.F.*	*Debit Amount ₹*	*Credit 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

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 Amount* ₹	*Credit 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

	Total b/f		1,88,200	1,88,200
Apr.02	Bank A/c Dr. To Cash A/c (Opened a bank account with SBI)		35,000	 35,000
Apr.02	Priya A/c Dr. To Sales A/c (Goods sold to Priya On Credit)		16,000	 16,000
Apr.03	Bank A/c Dr. To Priya A/c (Cheque Received from Priya)		16,000	 16,000
Apr.05	Nidhi A/c Dr. To Sales A/c (Sale of goods to Nidhi on credit)		14,000	 14,000
Apr.08	Cash A/c Dr. To Nidhi A/c (Cash received from Nidhi)		14,000	 14,000
Apr.10	Purchases A/c Dr. To Ritu A/c (Purchase of goods on credit)		20,000	 20,000
Apr.14	Insurance Premium A/c Dr. To Bank A/c (Payment of Insurance premium by cheque)		6,000	 6,000
Apr.18	Rent A/c Dr. To Cash A/c (Rent paid)		2,000	 2,000
Apr.20	Charity A/c Dr. To Purchases A/c (Goods given as charity)		1,500	 1,500
Apr.24	Furniture A/c Dr. To Cash A/c (Purchase of office furniture)		11,200	 11,200
Apr.29	Drawings A/c Dr. To Cash A/c (With drawl of cash from the business for personal use of the proprietor)		5,000	 5,000
Apr.30	Cash A/c Dr. To Interest received A/c (Interest received)		1,200	 1,200
Apr.30	Cash A/c Dr. To Sales A/c (Sale of goods for cash)		2,300	 2,300
	Total c/f		3,32,400	3,32,400

	Total c/f		3,32,400	3,32,400
Apr.30	Commission A/c Dr. To Bank A/c (Commission paid by cheque)		3,000	 3,000
Apr.30	Telephone expenses A/c Dr. To Cash A/c (Payment of telephone bill)		2,000	 2,000
Apr.30	Salaries A/c Dr. To Cash A/c (Payment of salary to the office persons)		12,000	 12,000
	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 Amount* ₹	*Credit Amount* ₹
(i)	Cash A/c Dr. To Capital A/c (Business started with cash)		6,00,000	 6,00,000
(ii)	Bank A/c Dr. To Cash A/c (Cash deposited into the bank)		4,50,000	 4,50,000
	Total c/f		10,50,000	10,50,000

	Total c/f		10,50,000	10,50,000
(iii)	Plant and Machinery A/c Dr. To Cash A/c To Creditors A/c (Purchase of plant and machinery by paying ₹ 30,000 cash and balance on a later date)		2.30,000	 30,000 2,00,000
(iv)	Purchases A/c Dr. To Cash A/c To Creditors A/c (Bought goods for cash as well as on credit)		85,000	 40,000 45,000
(v)	Creditor's A/c Dr. To Bank A/c (Payment made to the supplier of plant and machinery)		2,00,000	 2,00,000
(vi)	Cash A/c Dr. To Sales A/c (Sold goods on profit)		70,000	 70,000
(vii)	Drawings A/c Dr. To Cash A/c (Withdrew cash for personal use)		35,000	 35,000
(viii)	Insurance A/c Dr. To Bank A/c (Paid insurance by cheque)		2,500	 2,500
(ix)	Salary A/c Dr. To Outstanding salary A/c (Salary outstanding)		5,500	 5,500
(x)	Furniture A/c Dr. To Cash A/c (Furniture purchased for cash)		30,000	 30,000
	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

Statement showing the effect of various transaction on accounting equation

(Figures in rupees)

No.	Cash	Bank	Stock	Furniture	Plant and Machinery	Total	=	Non-trade Creditors	Trade Creditors	Capital	Total
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

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 No.	*Name of Accounts Affected*		*Type of Accounts (Assets, Liabilities Capital, Revenues and Expenses)*		*Affected Accounts Increase/Decrease*	
	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

Solution

Journal

Date	*Particulars*	*L.F.*	*Debit Amount* ₹	*Credit 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.		6,750[3]	
	Output SGST A/c Dr.		6,750[4]	
	To Input CGST A/c			6,000[1]
	To Input SGST A/c			6,000[2]
	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 = ₹6,000[1]
Total Input SGST = ₹ 5,000 + ₹ 400 + ₹500 + ₹100 = ₹6,000[2]
Total Output CGST = ₹ 6,750[3]
Total Output SGST = ₹ 6,750[4]
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.

Solution

Books of Suman
Journal

Date	*Particulars*	*L.F.*	*Debit Amount* ₹	*Credit 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)			

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.

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.

(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*.

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.

Cash Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Capital		5,00,000		Bank Plant and Machinery		4,80,000 10,000

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 Ramjee lal		10,000 1,15,000				

Ramjee Lal's Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
					Plant and Machinery		1,15,000

Purchases Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
	Sumit Traders		55,000				

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 prises		35,000

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 ....

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 Amount* ₹	*Credit Amount* ₹
2017 June 05	Cash A/c Dr. To Capital A/c (Business started with cash)		2,00,000	2,00,000
June 08	Bank A/c Dr. To Cash A/c (Opened a current account with syndicate bank)		80,000	80,000
June 12	Purchases A/c Dr. To Gulmohar Fashion House A/c (Goods purchased on credit)		30,000	30,000
June 12	Office Machines A/c Dr. To Bank A/c (Office machine purchased)		20,000	20,000
June 18	Rent A/c Dr. To Bank A/c (Rent paid)		5,000	5,000
June 20	Mohit Bros A/c Dr. To Sales A/c (Goods sold on credit)		10,000	10,000
	Total c/f		3,45,000	3,45,000

	Total b/f		3,45,000	3,45,000
June 22	Cash A/c Dr. To Sales A/c (Goods sold for cash)		15,000	15,000
June 25	Gulmohar Fashion House A/c Dr. To Cash A/c (Cash paid to Gulmohar Fashion House)		30,000	30,000
June 28	Bank A/c Dr. To Mohit Bros A/c (Payment received in full and final settlement)		10,000	10,000
June 30	Salary A/c Dr. To Cash A/c (Monthly salary paid)		6,000	6,000
	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 Fashion House		30,000
				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

Purchases Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
2017				2017			
June 12	Gulmohar Fashion House		30,000				

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

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 2017	*Details*	*Amount* ₹
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 and deposited sameday into bank	11,500
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 Amount ₹	Credit Amount ₹
2017 Dec. 01	Cash A/c Dr. To Capital A/c (Business started with cash)		1,20,000	 1,20,000
02	Bank A/c Dr. To Cash A/c (Opened a current account with ICICI bank)		40,000	 40,000
04	Purchases A/c Dr. To Cash A/c (Goods purchased for cash)		12,000	 12,000
	Total c/f		1,72,000	1,72,000

	Total b/f		1,72,000	1,72,000
10	Cartage A/c Dr. To Cash A/c (Cartage paid)		500	 500
12	Lara India A/c Dr. To Sales A/c (Goods sold on credit)		25,000	 25,000
14	Cash A/c Dr. To Lara India A/c (Cash received from Lara India)		10,000	 10,000
16	Sales Return A/c Dr. To Lara India A/c (Goods returned from Lara India)		3,000	 3,000
18	Trade Expenses A/c Dr. To Cash A/c (Trade expenses paid)		700	 700
19	Purchases A/c Dr. To Tranum's A/c (Goods purchased on credit)		32,000	 32,000
20	Bank A/c Dr. Discount A/c Dr. To Lara India A/c (Cheque received for final settlement)		11,500 500	 12,000
22	Taranum's A/c Dr. To Purchase Return's A/c (Goods returned to Tranum)		1,500	 1,500
24	Stationery A/c Dr. To Cash A/c (Cash paid for stationery)		1,200	 1,200
26	Taranum's A/c Dr. To Bank A/c (Cheque given to Tranum)		20,000	 20,000
28	Rent A/c Dr. To Bank A/c (Rent paid by cheque)		4,000	 4,000
29	Drawings A/c Dr. To Cash A/c (Cash withdrawn for personal use)		10,000	 10,000
30	Cash A/c Dr. To Sales A/c (Goods sold for cash)		12,000	 12,000
31	Rupak Trader A/c Dr. To Sales A/c (Goods sold on credit)		11,000	 11,000
	Total		3,14,900	3,14, 900

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 Expenses		700
				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				

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 Return		1,500	Dec.19	Purchase		32,000
Dec.26	Bank		20,000				

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				

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

Key Terms Introduced in the Chapter

- Source Documents
- Accounting Equation
- Books of Original Entry
- Journalising and Posting
- Double Entry Book Keeping·
- Credit
- Debit
- Account
- Ledger
- 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.

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

(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

(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

(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 bill no. 5674)	₹9,000
(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 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

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

(c)	Interest charge on capital @7% p.a. when total capital were	₹70,000
(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

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

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

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.

3. Cash account and sales account, Assets and Revenues, Assets and Revenues increases.
4. Salaries account and cash account, Expense and Assets, Expenses increases Assets 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).

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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.*

In 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

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-for-profit. 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

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:

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 Nov. 27	 Cash Cash		 28,000 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				

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

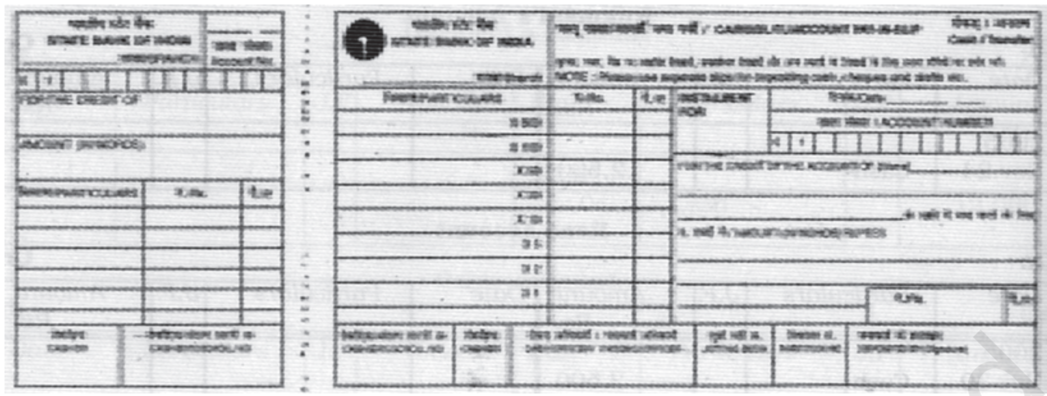

Fig. 4.2 : *A pay-in-slip*

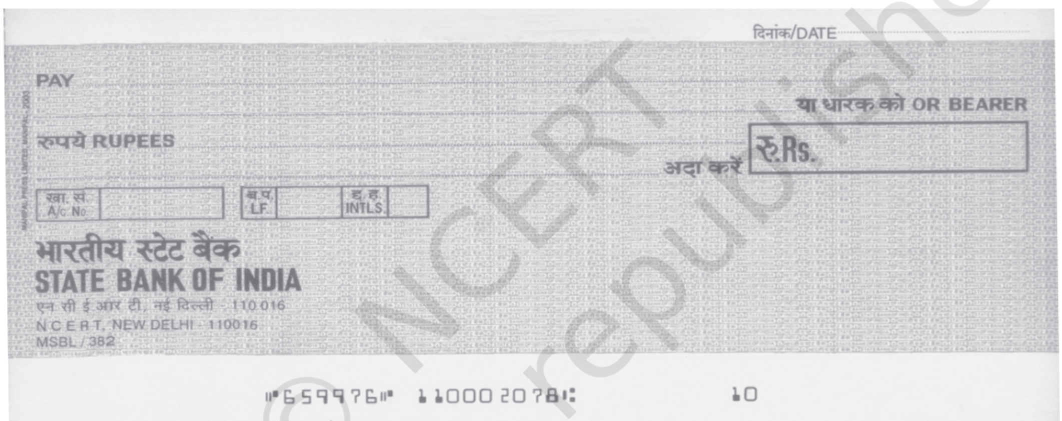
दिनांक/DATE
PAY
या धारक को OR BEARER
रुपये RUPEES
अदा करें
रु.Rs.
खा. सं. A/c No
ब.प. LF
ह.ह. INTLS
भारतीय स्टेट बैंक
STATE BANK OF INDIA
एन सी ई आर टी, नई दिल्ली - 110 016
N C E R T, NEW DELHI - 110016
MSBL / 382
⑈659976⑈ 110002078⑆ 10

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.

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.

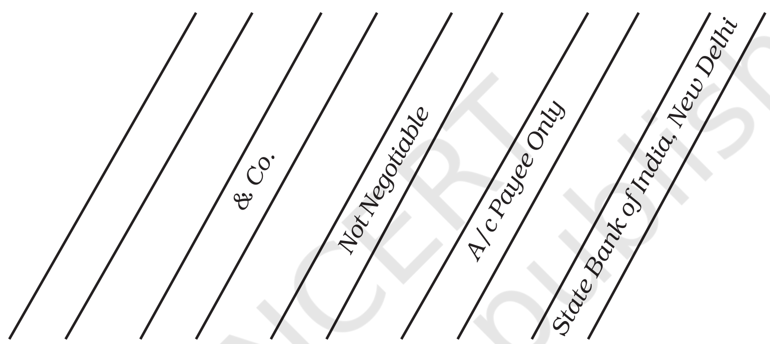

Fig. 4.4 : *Types of crossing*

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.

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*

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 Sept.					2017 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					

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				

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 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:

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.

The petty cash book for the month will be prepared as follows :

Book of Samaira Traders
Petty Cash Book

Amount Received	*Date*	*Particulars*	*Voucher No.*	*Amount paid*	*Analysis of Payments*				
₹	*2017 May*			₹	*Postage*	*Telephone & Telegram*	*Conveyance*	*Stationery*	*Misc.*
2,000	01	Cash received							
	02	Auto fare		55			55		
	03	Courier services		40	40				
	04	Postal stamps		105	105				
	05	Erasers/Sharpeners /Pencils		225				225	
	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 charges		42	42				
	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 including disinfectant (36+24)		60					60
	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							

Books of Samaira Traders
Journal

Date	Particulars		L.F.	Debit Amount ₹	Credit 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 per petty cash book		1,487
				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				

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.

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 of ₹ 12,000.	11,700
Sept. 05	Cash paid to Rukmani in full settlement of claim of ₹7,000	6,850
Sept. 06	Sold goods to Sudhir for cash	14,800
Sept. 06	Paid quarterly insurance premium on policy for proprietor's wife	2,740
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

				Sept. 24	Telephone charges		2,300
				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 and deposited the same in the bank	10,700
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

Solution

Cash Book

Dr. **Cr.**

Date	*Receipts*	*L.F.*	*Cash* ₹	*Bank* ₹	*Date*	*Payments*	*L.F.*	*Cash* ₹	*Bank* ₹
2017 Aug.					2017 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 expenses			2,300
20	John			10,700	14	Drawings			6,000
23	Michael		6,850		16	Cash	**C**		14,500
25	Kumar		4,500		24	Printing and stationery		1,800	
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

Jan. 20	Paid telephone bill by cheque	600
Jan. 25	Sale of goods and received cheque (deposited same day)	3,000
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 Jan.					2017 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 interest			200
					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				

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				

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

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 (deposited same day)	6,000
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 (deposited same day)	2,500
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 Dec.					2016 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 expenses		340	
					25	Printing		850	
					26	Insurance premium			2,150
					28	Salary			4,000
					29	Rent		3,000	

					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				

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				

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				

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 No.*	*Name of Supplier (Account to be credited)*	*L.F.*	*Amount* ₹

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.

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 No.	Name of Supplier (Account to be credited)	L.F.	Amount ₹
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

Pawan Electronics

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
				2017 Aug. 10 Aug. 29	 Purchases Purchases		 31,050 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 per Purchases Journal		 6,12,000				

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 Note No.*	*Name of the Supplier (Account to be debited)*	*L.F.*	*Amount* ₹

Fig 4.7(a) : *Format of Purchases return (journal) book*

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*

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 Note No.*	*Name of the Supplier (Account to be debited)*	*L.F.*	*Amount ₹*
	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 Return		13,200				

Purchases Return Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount ₹*	*Date*	*Particulars*	*J.F.*	*Amount ₹*
					Sundries as per purchase returns book		13,200

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 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 No.*	*Name of the Customer (Account to be debited)*	*L.F.*	*Amount ₹*

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 No.*	*Name of the customer (Account to be debited)*	*L.F.*	*Amount ₹*
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:

Raman Traders Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
2017 Apr. 06 Apr. 28	 Sales Sales		 4,850 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 per sales book		 1,10,850

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 No.	Name of the customer (Account to be credited)	L.F.	Amount ₹

Fig. 4.9 : *Format of sales return (journal) book*

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 No.*	*Name of the customer (Account to be credited)*	*L.F.*	*Amount ₹*
	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 as per sales return book		2,100				

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 Sept. 01	Purchase of following goods on credit from M/s Ratna Traders, 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 ;

	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 No.*	*Name of the Supplier (Account to be credited)*	*L.F.*	*Amount* ₹
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 No.*	*Name of the Supplier (Account to be debited)*	*L.F.*	*Amount* ₹
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

(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 Sept. 10	Purchases return		1,440	2017 Sept.01	Purchases		19,350

Bombay Fashion House Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2017 Sept. 24	Purchases return		1,330	2017 Sept. 08	Purchases		6,650

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 return		1,900	Sept. 20	Purchases		19,000

Purchases Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2017 Sept. 30	Sundries as per purchases journal		54,350				

Purchases Return Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
				2017 Sept. 30	Sundries as per purchases return book		4,670

Illustration 6

Enter the following transactions in the Sales and Sales Return book of M/s Vineet Stores:

Date	*Details*
2017 Dec.01.	Sold goods on credit to M/s Rohit Stores as per invoice no.325 : 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

Solution

Books of Veneet Stores
Sales (Journal) Book

Date	*Invoice No.*	*Name of the Customer (Account to be debited)*	*J.F.*	*Amount ₹*
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 Note No.*	*Name of the Customer (Account to be credited)*	*L.F.*	*Amount ₹*
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

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 per sales book		14,010

Sales Return Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
2017 Dec.31	Sundries as per sales return book		653				

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%

Purchases Book (Analytical)

Date	Invoice	Name of Supplier	L.F.	Detail	Total (₹)	Purchases	CGST	SGST	IGST
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 Note No.	Name of Supplier	L.F.	Detail	Total (₹)	Purchases Return	CGST	SGST	IGST
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	–

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%

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 Note No.*	*Name of Supplier*	*L.F.*	*Detail*	*Total* (₹)	*Sales Return*	*CGST*	*SGST*	*IGST*
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.

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

(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 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.

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 No.*	*Name of the Supplier (Account to be credited)*	*L.F.*	*Amount ₹*
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

Sales (Journal) Book

Date	*Invoice No.*	*Name of the Customer (Account to be debited)*	*L.F.*	*Amount ₹*
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 (Account to be debited)*	*L.F.*	*Amount ₹*
2017				
Apr. 12		Burari Ltd.		632
Apr. 30				632

Sales Return (Journal) Book

Date	*Credit*	*Name of the customer (Account to be credited)*	*L.F.*	*Amount ₹*
2017				
Apr. 10		Ramneek		440
Apr. 30				440

Journal Proper

Date	*Particulars*	*L.F.*	*Debit Amount ₹*	*Credit 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

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 expenses		100	
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 charges		1,320	
					25	Burari Ltd.			7,728
					28	Bank	**C**	5,000	
					30	Drawings		8,000	
					30	Telephone charges			2,700
					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

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 Furniture		8,000				
			14,000				14,000

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				

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				

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 Apr. 30	Balance c/d		8,000	2017 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 Apr. 30	Balance c/d		3,200	2017 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 Apr. 30	Bank		2,450	2017 Apr. 04	Purchases		2,450
			2,450				2,450

Burari Ltd. Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
2017				2017			
Apr. 12	Purchases return		632	Apr. 06	Purchases		6,400
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

Nutan Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
2017 Apr. 23	Sales		1,200	2017 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.

(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
- Day books
- Cash book
- Petty Cash book
- Sales return (Journal) Book
- Sales (Journal) Book
- Balancing of Accounts
- Purchase (Journal) book
- Purchases 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?

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

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

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 bank same day	2,000
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

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:

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)

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 specifications	1,200
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 *less* 10% trade discount	5,700
25	Sold to Shri Chand goods *less* 5% trade discount	6600
26	Sold to Ramesh Brothers	4,000
28	Return outwards to Kirit and Co. *less* 10% trade discount	1,000
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

	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

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Bank Reconciliation Statement

5

In 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;*

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)*

DHERENDRA NATIONAL BANK
CONNAUGHT PLACE

MULTI-MODULE PACKAGE
STATEMENT OF ACCOUNT
FROM 01/08/2016 TO 30/09/2016

DATE : 30/09/2016
OP.ID : GK
PAGE NO. : 1

ACCOUNT NO. 03355
NAME : DEV PANDIT
KHADWAI, RUNAKUTA, DELHI-34

DATE	*PARTICULARS*	*CHEQUE No.*	*DEBIT ₹ P.*	*CREDIT ₹ P.*	*BALANCE ₹ P.*	*+REMARKS*
				Opening Balance :	50,782.30	+
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)*

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.

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.

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 (✓) 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.

(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.*

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.

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

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 (₹ 3,900+ ₹ 2,350)	6,250	
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.

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 sent to the bank for collection		12,400
3.	Interest on bank overdraft debited by the bank but not entered in the cash book		8,800
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

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.

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

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.

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)

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)

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).

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).

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.

(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)

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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.*

In 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 of ......as on March 31, 2014

Account Title	*L.F.*	*Debit Balance* ₹	*Credit 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).

Account Title	*L.F.*	*Debit Balance* ₹	*Credit 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 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).

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.

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				

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				

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 Title	*L.F.*	*Debit Total* ₹	*Credit 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 Balance* ₹	*Credit 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

(iii) Trial Balance as at March 31, 2014
(Using Totals-cum-Balances Method)

Account Title	*L.F.*	*Debit Total* ₹	*Credit Total* ₹	*Debit Balance* ₹	*Credit 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

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.

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 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.

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

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.

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

(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

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

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 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 amount posted short on.....		190

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 purchases book for the month of....		1,000				

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.

Sales Book (Journal)

Date	Invoice No.	Name of customers (Accounts to be debited)	L.F.	Amount ₹
		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*

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

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 posted. The accounts of individual parties are not affected. Consider the following example.

Purchases (Journal) Book

Date	*Invoice No.*	*Name of suppliers (Accounts to be credited)*	*L.F.*	*Amount* ₹
		Dheru		8,000
		Chandraprakash		7,000
		Sachin		6,000
				21,000
		Wrong total due to overcasting		22,000

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:

Suspense A/c	Dr.	1,000	
To Purchases A/c			1,000

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.

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:

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.

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).			

(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)			

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.

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).			

(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 trial balance		10,000		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)			

(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 trial balance		7,500		Furniture Sales return		4,500 3.000
			7,500				7,500

Hence, original difference in Trial Balance was ₹ 7,500 excess on the Credit side.

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)			

(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 trial balance		16,000		Purchases		1,000
					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.*

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)			

(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 trial balance		12,870
			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.

(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
- Error of Commission
- Error Omission
- Compensating Error
- Error of Principle
- Suspense Account

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

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?

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.

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.)

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).

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.

(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 errors

(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).

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.

(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

	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

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)

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Depreciation, Provisions and Reserves 7

> **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.*

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 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".

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."

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.

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 write-off ₹ 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.

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,

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 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 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).

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:

$$\text{Depreciation} = \frac{\text{Cost of asset - Estimated net residential value}}{\text{Estimated useful life of the asset}}$$

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:

$$\text{Rate of Depreciation} = \frac{\text{Annual depreciation amount}}{\text{Acquisition cost}} \times 100$$

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

$$= \frac{\text{Acqusition cost of asset} - \text{Estimated net residential value}}{\text{Estimated life of asset}}$$

$$\text{i.e.} = \frac{₹\ 2,50,000 - ₹\ 50,000}{10} = ₹\ 20,000$$

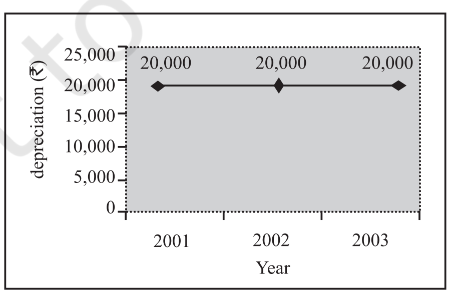

Fig. 7.1 : *Depreciation amount under straight line method*

The rate of depreciation will be calculated as :

(i) $\text{Rate of Depreciation} = \dfrac{\text{Annual depreciation amount}}{\text{Acquisition cost}} \times 100$

From point (i), the annual depreciation amounts to ₹ 20,000.

Thus, the rate of depreciation will be = $\dfrac{₹\,20,000}{₹\,2,50,000} \times 100 = 8\%$

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.

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) = $₹\ 20{,}00{,}000 \times \frac{10}{100} = ₹\ 20{,}000$

(ii) Written down value = ₹ 2,00,000 – 20,000 = ₹1,80,000
(at the end of the I year)

(iii) Depreciation (II year) = $₹\ 1{,}80{,}000 \times \frac{10}{100} = ₹\ 18{,}000$

(iv) Written down value = ₹ 1,80,000 – ₹18,000 = 1,62,000
(at the end of the II year)

(v) Depreciation (III year) = $₹\ 1{,}62{,}000 \times \frac{10}{100} = ₹\ 16{,}200$

(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 pre-determined 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.

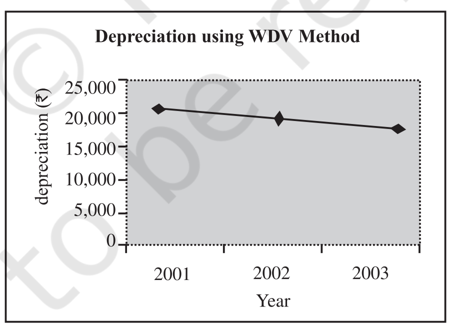

Fig. 7.2 : *Depreciation amount using written down value method*

Under written down value method, the rate of depreciation is computed by using the following formula:

$$R = \left[1 - n\sqrt{\frac{s}{c}}\right] \times 100$$

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:

$$R = \left[1 - 16\sqrt{\frac{50,000}{9,00,000}}\right] \times 100 = (1 - 0.834) \times 100 = 16.6\%$$

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 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 Method and 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.

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.

Basis of Difference	*Straight Line Method*	*Written Down Value Method*
1. Basis of charging depreciation	Original cost	Book Value (i.e. original cost less depreciation charged till date)
2. Annual depreciation charge	Fixed (Constant) year	Declines year after year
3. Total charge against profit and loss account in respect of depreciation and repairs	Unequal year after year. It increases in later years.	Almost equal every year.
4. Recognition by income tax law	Not recognised	Recognised
5. Suitablity	It is suitable for assets in which repair charges are less, the possibility of and obsolescence is low scrap value depends upon the time period involved.	It is suitable for assets, which are affected by technological changes and require more repair expenses with passage of 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

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.

Solution

Books of Singhania and Bros.

Journal

Date	*Particulars*	*L.F.*	*Debit Amount ₹*	*Credit Amount ₹*
2016 Apr. 01	Plant A/c Dr. To Bank A/c (Purchased plant for ₹ 5,00,000)		5,00,000	5,00,000
Apr. 01	Plant A/c Dr. To Bank A/c (Expenses incurred on installation)		50,000	50,000
2017 Mar. 31	Depreciation A/c Dr. To Plant A/c (Depreciation charged on asset)		54,000	54,000
Mar. 31	Profit and Loss A/c Dr. To Depreciation A/c (Depreciation debited to profit and loss account)		54,000	54,000

Plant Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount ₹*	*Date*	*Particulars*	*J.F.*	*Amount ₹*
2016 Apr. 01	Bank		5,00,000	2017 Mar. 31	Depreciation		54,000
	Bank (Installation expenses)		50,000		Balance c/d		4,96,000
			5,50,000				5,50,000
2017 Apr. 01	Balance b/d		4,96,000	2018 Mar. 31	Depreciation		54,000
					Balance c/d		4,42,000
			4,96,000				4,96,000
2018 Apr. 01	Balance b/d		4,42,000	2019 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				

Depreciation Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amounts ₹
2017 Mar. 31	Plant		54,000	2017 Mar. 31	Profit and Loss		54,000
2018 Mar. 31	Plant		54,000	2018 Mar. 31	Profit and Loss		54,000
2019 Mar. 31	Plant		54,000	2019 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 = $\frac{₹\,5,50,000 - ₹\,10,000}{10} = ₹\,54,000$ p.a.

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

Date	Particulars	L.F.	Debit Amount ₹	Credit Amount ₹
2016 Oct. 01	Machine A/c Dr. To Bank A/c (Purchased machine for ₹1,80,000)		1,80,000	1,80,000
Oct. 01	Machine A/c Dr. To Bank A/c (Expenses incurred on installation)		20,000	20,000

2017 Mar. 31	Depreciation A/c Dr. To Machine A/c Depreciation charged on machine)		10,000	10,000
Mar. 31	Profit and Loss A/c Dr. To Depreciation A/c (Depreciation debited to profit and loss account)		10,000	10,000
2018 Mar. 31	Depreciation A/c Dr. To Machine A/c (Depreciation charged on machine)		20,000	20,000
Mar. 31	Profit and Loss A/c Dr. To Depreciation A/c (Depreciation debited to profit and loss account)		20,000	20,000
2019 Mar. 31	Depreciation A/c Dr. To Machine A/c (Depreciation charged on machine)		20,000	20,000
Mar. 31	Profit and Loss A/c Dr. To Depreciation A/c (Depreciation debited to profit and loss account)		20,000	20,000

Books of M/s Mehra and Sons
Machine Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2016 Oct. 01	Bank		1,80,000	2017 Mar. 31	Depreciation (for 6 months)		10,000
Oct. 01	Bank (Installation expenses)		20,000	Mar. 31	Balance c/d		1,90,000
			2,00,000				2,00,000
2017 Apr. 01	Balance b/d		1,90,000	2018 Mar. 31	Depreciation		20,000
					Balance c/d		1,70,000
			1,90,000				1,90,000
2018 Apr. 01	Balance b/d		1,70,000	2019 Mar. 31	Depreciation		20,000
					Balance c/d		1,50,000
			1,70,000				1,70,000

Depreciation Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2017 Mar. 31	Machine		10,000	2017 Mar. 31	Profit & Loss		10,000
			10,000				10,000
2018 Mar. 31	Machine		20,000	2018 Mar. 31	Profit & Loss		20,000
			20,000				20,000
2019 Dec. 31	Machine		20,000	2019 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) Depreciation (2016-17) = ₹ 20,000 x $\frac{6}{12}$ =₹10,000

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 Oct. 1	Bank		1,80,000	2017 Mar. 31	Balance c/d		2,00,000
Oct. 1	Bank (Installation expenses)		20,000				
			2,00,000				2,00,000

2017 Apr. 01	Balance b/d		2,00,000	2018 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 Mar. 31	Balance c/d		10,000	2016 Mar. 31	Depreciation		10,000
			10,000				10,000
2017 Mar. 31	Balance c/d		30,000	2017 Apr. 01 Mar. 31	Balance b/d Depreciation		10,000 20,000
			30,000				30,000
2018 Mar. 31	Balance c/d		50,000	2018 Apr. 1 2017 Mar. 31	Balance b/d Depreciation		30,000 20,000
			50,000				50,000

Depreciation Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2017 Mar. 31	Provision for Deprection		10,000	2017 Mar.31	Profit & Loss		10,000
			10,000				10,000
2018 Mar. 31	Provision for Depreciation		20,000	2018 Mar.31	Profit & Loss		20,000
			20,000				20,000
2019 Mar. 31	Provision for Depreciation		20,000	2019 Mar.31	Profit & Loss		20,000
			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 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		21,000[1]
	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		18,900[2]
					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		17,010[3]
					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.

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		6,750[1]
	Bank		5,000		Balance c/d		38,250
			45,000				45,000
2015				2016			
Apr. 01	Balance b/d		38,250	Mar. 31	Depreciation		9,400[2]
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		12,770[3]
					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.

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 year	Bank		4,00,000	End of the year	Depreciation Balance c/d		90,000 3,10,000
			4,00,000				4,00,000

II year	Balance b/d		3,10,000	End of the year	Depreciation Balance c/d		90,000 2,20.000
			3,10,000				3,10,000
III year	Balance b/d		2,20,000	End of the year	Depreciation Balance c/d		90,000 1,30,000
			2,20,000				2,20,000
IV year	Balance b/d Profit and loss (Profit on sale of vehicle)		1,30,000 10,000		Depreciaton Bank		99,000 50,000
			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 year	Bank		4,00,000	End of the year	Balance c/d		4,00,000
			4,00,000				4,00,000
II year	Balance b/d		4,00,000	End of the year	Balance c/d		4,00,000
			4,00,000				4,00,000
III year	Balance b/d		4,00,000	End of the year	Balance c/d		4,00,000
			4,00,000				4,00,000
IV year	Balance b/d Profit and loss (Profit on Sale of Vehicle)		4,00,000 10,000		Provison for depreciation Bank		3,60,000 50,000
			4,10,000				4,10,000

Provision for Depreciation

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
Ist year	Balance b/d		90,000	End of year	Depreciation		90,000
			90,000				90,000

II year	Balance b/d		1,80,000	End of the year	Balance c/d Depreciation		90,000 90,000
			1,80,000				1,80,000
III year	Balance b/d		2,70,000	End of the year	Balance c/d Depreciation		1,80,000 90,000
			2,70,000				2,70,000
IV year	Machinery		3,60,000	End of the year	Balance c/d Provison for Depreciation		2,70,000 90,000
			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, being sold)
   To Asset A/c
2. Provision for Depreciation A/c Dr. (with the accumulated balance in provision for depreciation account)
   To Asset Disposal A/c
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:

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 Apr. 01	Machinery		1,00,000	2017 Apr. 01	Provision for depreciation		60,000
				Apr. 01	Bank		35,000
				2018 Mar. 31	Profit & Loss (Loss on sale)		5,000[1]
			1,00,000				1,00,000

Machinery Account

Dr. **Cr.**

Date	*Particulars*		*Amount* ₹	*Date*	*Particulars*		*Amount* ₹
2017 April 01	Balance b/d		6,00,000	2017 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

(2)	Sales value realised	(35,000)
	Loss on sale (i.e. ₹ 40,000 – ₹ 35,000)	5,000[1]

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 (Purchase of truck)		1,00,000	Dec. 31	Balance c/d		1,00,000
			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 (*Purchase of new truck*)		30,000	Dec. 31	Balance c/d		90,000
			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 Depreciation		2,000
				Jan. 01	Bank (*Sale*)		15,000
				Jan. 01	Profit & Loss (*Loss on sale*)		3,000[4]
			20,000				20,000

2017				2017			
Jul. 01	Machinery		20,000	Jul. 01	Provision for Depreciation (₹ 2,000 + 2,000 +1,000)		5,000
Jul. 01	Profit & Loss (*Profit on sale*)[5]		3,000	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		10,000[1]
			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		8,000[2]
			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)		7,750[3]
			23,750				23,750

Working Notes

1. *Calculation of amount of depreciation*

	₹
Year - 2015	
10% on ₹ 1,00,000 for one year	10,000[1]
Year - 2016	
10% on ₹ 80,000 for one year	8000[2]
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
	7,750[3]

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	3,000[4]

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		Provision for depreciation		8,000
					Profit and Loss (*Loss on sale*)		7,000[1]
				2016 March 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 (*Accumulated depreciation on furniture sold*)		8,000	Apr. 01	Balance b/d		22,000
2016				2016			
Mar. 31	Balance c/d		18,250	Mar. 31	Depreciation (₹ *3,000 + 1,250*)		4,250
			26,250				26,250

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	7,000[1]
	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 Apr. 01	Balance b/d		50,000	2015 Apr. 01	Furniture disposal		20,000
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 Oct.01	Furniture disposal		8,000	2015 Apr.01	Balance b/d		22,000
2016 Mar. 31	Balance c/d		18,250	2016 Mar.31	Depreciation		4,250
			26,250				26,250

Furniture Disposal Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particular*	*J.F.*	*Amount* ₹
2015 Oct.01	Furniture		20,000	2015 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 Jan. 01	Bank		2,15,000	2012 Dec. 31	Balance c/d		2,15,000
			2,15,000				2,15,000
2013 Jan. 01	Balance b/d		2,15,000	2013 Dec. 31	Balance c/d		2,15,000
			2,15,000				2,15,000
2014 Jan. 01	Balance b/d		2,15,000	2014 Dec. 31	Balance c/d		2,15,000
			2,15,000				2,15,000
2015 Jan. 01	Balance b/d		2,15,000	2015 Jul. 31	Plant disposal		2,15,000
			2,15,000				2,15,000

Accumulated Depreciation Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2012 Dec. 31	Balance c/d		43,000	2012 Dec. 31	Depreciation		43,000[1]
			43,000				43,000
2013 Jan. 01	Balance c/d		77,400	2013 Jan. 01	Balance b/d		43,000
					Depreciation		34,400[2]
			77,400				77,400
2014 Dec. 31	Balance c/d		1,04,920	2014 Jan. 01	Balance b/d		77,400
				Dec. 31	Depreciation		27,520[3]
			1,04,920				1,04,920
				2015 Jan. 01	Balance b/d		1,04,920
2015 Jul. 31	Plant disposal		1,17,763	July 31	Depreciation		12,843[4]
			1,17,763				1,17,763

Plant Disposal Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2015 Jul. 31	Plant		2,15,000	2015 Jul. 31	Accumulated depreciation		1,17,763
					Insurance Co.		50,000
					Profit & Loss (*Loss on sale*)		47,237[5]
			2,15,000				2,15,000

Working Notes:

1. *Calculation of Depreciation Amount* (₹)

Original cost on 01.01.2012 (2,00,000 + 10,000+ 5,000)	2,15,000
Depreciation for the year 2012 (@20% of ₹ 2,15,000)	(43,000[1])
	1,72,000

Depreciation for the year 2013	
(@20% of ₹ 1,72,000)	(34,400[2])
	1,37,600
Depreciation for the year 2014	
(@20% of ₹ 1,37,600)	27,520[3]
	1,10,080
Depreciation till 31.07.15	(12,843[4])
(@20% of ₹ 1,10,080)	97,237
Insurance claim	(50,000)
Loss on disposal	47,237[5]

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.

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		3,20,000[1]
				2016			
				Mar 31	Depreciation		1,76,000[2]
			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 = ₹ 3,20,000[1]
   (@ 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 = ₹ 1,76,000[2]
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

₹ 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 Apr. 01	Balance b/d		6,80,000	2018 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 Mar.31	Balance c/d		4,26,000	2017 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 = $2\left[\frac{20}{100}\times 6{,}80{,}000\right]$

   = **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**

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.

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 Amount* ₹	*Credit 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.

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. To Sundry debtors A/c (Bad debts written off)		8,000	8,000
Mar. 31	Profit & Loss A/c Dr. To Bad debts A/c (Bad debts debited to profit and loss account)		8,000	8,000
Mar. 31	Profit and Loss A/c Dr. To Provision for doubtful debts a/c (For creating provision for doubtful debts)		6,000[1]	6,000[1]

Working Notes

Provision for doubtful debts @10% of sundry debtors i.e.
₹ 68,000 – ₹ 8000 = ₹ 60,000

$₹\ 6000 \times \frac{10}{100} = ₹\ 6000$[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.

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 liability or expense pertaining to current accounting period, the amount of which is not certain.	It is made for strengthening the financial position of the business.Some reserves are also mandatory under law.
3. Effect on taxable profits.	It reduces taxable profits.	It has no effect on taxable profit.
4. Presentations in Balance sheet	It is shown either (i) by way of deduction from the item on the asset side for which it is created, or (ii) In the liabilities side along with current liabilities.	It is shown on the liabilities. side after capital amount.

5. Element of compulsion	Creation of provision is necessary to ascertain true and fair profit or loss in compliance 'Prudence' or 'Conservatism' concept. It must be made even if there are no profits.	Generally, creation of a Reserve is at the discretion of the management. Reserve cannot be created unless there are profits. However, in certain cases law has stipulated for the creation of specific reserves such as 'Debenture' 'Redemption ' reserve.
6. Use for the payment of dividend	It can not be used for dividend distribution.	It can be used for divided 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;

- 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 profits which arise out of normal operating activities of the business and are otherwise available for dividend distribution.	It is created primarily out of capital profit which do not arise out of the normal operating activities of the business and not available for dividend distribution. But revenue profits may also be used for this purpose.

2. Purpose	It is created to strengthen the financial position, to meet unforeseen contingencies or for some specific purposes.	It 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.	It 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.

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.

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

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.

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).

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

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).

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).

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)

Depreciation for 2 year (2015-16) = ₹ 1,00,000 – ₹ 7500 = ₹ 92,500

$$= ₹\ 92500 \times \frac{10}{100} = ₹\ 9250$$

Depreciation for 3 year (2016-17) = ₹ 92500 – 9250 = ₹ 83050

$$= ₹\ 83050 \times \frac{10}{100} = ₹\ 8305$$

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.

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Bill of Exchange

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Goods 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).

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.*

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.

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.

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.

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.

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 and Parties	It contains an order to make payment. There can be three parties to it, viz. the drawer, the drawee and the payee.	It contains a promise to make payment. There are only two parties to it, viz. the drawer and the payee.
3.	Acceptance	It requires acceptance by the drawee or someone else on his behalf.	It does not require any acceptance.
4.	Payee	Drawer and payee can be the same party.	Drawer cannot be the payee of it.
5.	Notice	In case of its dishonour due notice of dishonour is to be given by the holder to the drawer	No notice needs to be givenin case of its dishonour.

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.

- *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 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

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	

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. To Sales A/c	Purchases A/c Dr. To Creditor's A/c
Receiving/Accepting the bill	Bills Receivable A/c Dr. To Debtor's A/c	Creditor's A/c Dr. To Bills Payable A/c
Collection of the bill	Cash/Bank A/c Dr. To Bills Receivable A/c	Bills Payable A/c Dr. 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. To Sales A/c	Purchases A/c Dr. To Creditor's A/c
Receiving /Accepting the bill	Bills Receivable A/c Dr. To Debtor's A/c	Creditor's A/c Dr. To Bills Payable A/c
Sending the bill for collection	Bills sent for collection A/c Dr. To Bill Receivable A/c	*No entry*
On Receiving from the bank advice that the bill has been collected	Bank A/c Dr. To Bill Sent for Collection A/c	Bills Payable A/c Dr. To Bank 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. To Sales A/c	Purchases A/c Dr. To Creditor's A/c
Receiving /Accepting the bill	Bills Receivable A/c Dr. To Debtor's A/c	Creditor's A/c Dr. To Bills payable A/c
Discounting the bill	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c	*No entry*
On maturity of the bill	*No entry*	Bills payable A/c Dr. To Bank A/c

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. To Sales A/c	Purchase A/c Dr. To Creditor's A/c
Receiving /Accepting the bill	Bills Receivable A/c Dr. To Debtor's A/c	Creditor's A/c Dr. To Bills payable A/c
Endorsing the bill	Creditor's A/c Dr. To Bills Receivable A/c	*No entry*
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 Amount* ₹	*Credit Amount* ₹
2017 Jan 01	Sumit's A/c Dr. To Sales A/c (Sold goods to Sumit's on credit)		20,000	20,000
Jan 01	Bills Receivable A/c Dr. To Sumit's A/c (Received Sumit's acceptance payable after three months)		20,000	20,000

Apr.05	Bank A/c Dr. To Bills Receivable A/c (Sumit met his acceptance on maturity)		20,000	20,000

(ii) When the bill was discounted from the book.

Journal

Date	*Particulars*	*L.F.*	*Debit Amount* ₹	*Credit Amount* ₹
2017 Jan 01	Sumit's A/c Dr. To Sales A/c (Sold goods to Sumit's)		20,000	20,000
Jan 01	Bills Receivable A/c Dr. To Sumit's A/c (Received Sumit's acceptance three months)		20,000	20,000
Jan 01	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Sumit's acceptance discounted with the bank)		19,400 600	20,000

(iii) When Amit endorsed the bill in favour of his creditor Ankit.

Journal

Date	*Particulars*	*L.F.*	*Debit Amount* ₹	*Credit Amount* ₹
2017 Jan. 01	Sumit's A/c Dr. To Sales A/c (Sold goods to Sumit's on credit)		20,000	20,000
Jan. 01	Bills Receivable A/c Dr. To Sumit's A/c (Received Sumit's acceptance for three months)		20,000	20,000
Jan. 01	Ankit's A/c Dr. To Bills Receivable A/c (Sumit acceptance endorsed in favour of Ankit)		20,000	20,000

(iv) When the bill was sent for collection by Amit to the bank.

Journal

Date	*Particulars*	*L.F.*	*Debit Amount ₹*	*Credit Amount ₹*
2017 Jan. 01	Sumit's A/c Dr. To Sales A/c (Sold goods to Sumit's on credit)		20,000	20,000
Jan. 01	Bills Receivable A/c Dr. To Sumit's A/c (Received Sumit's acceptance payable after three months)		20,000	20,000
Mar. 31	Bills Sent for Collection A/c Dr. To Bills Receivable A/c (Bills sent for collection)		20,000	20,000
Apr. 05	Bank A/c Dr. To Bills sent for collection A/c (Bills sent for collection collected by the bank)		20,000	20,000

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 Amount ₹*	*Credit Amount ₹*
2017 Jan. 01	Purchases A/c Dr. To Amit's A/c (Purchases goods from Amit on credit)		20,000	20,000
Jan. 01	Amit's A/c Dr. To Bill's Payable A/c (Accepted bill drawn by Amit payable after three months)		20,000	20,000
Apr. 04	Bills payable A/c Dr. To Bank A/c (Met acceptance maturity)		20,000	20,000

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 Amount* ₹	*Credit 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 Amount* ₹	*Credit 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)				

Books of Poonam
Journal

Date	Particulars		L.F.	Debit Amount ₹	Credit 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:

(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 Amount* ₹	*Credit 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 Amount* ₹	*Credit 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)				

(iii) When the bill was endorsed by Shieba to Lal Chand

Journal

Date	*Particulars*	*L.F.*	*Debit Amount ₹*	*Credit Amount ₹*
2017 Jan.01	Vishal's A/c Dr. To Sales A/c (Sold goods to Vishal)		10,000	10,000
Jan. 01	Bills Receivable A/c Dr. To Vishal's A/c (Received Vishal's acceptance)		10,000	10,000
Jan. 01	Lal Chand A/c Dr. To Bills Receivable A/c (Vishal's acceptance endorsed in favour of Lal Chand)		10,000	10,000
Mar.04	Vishal's A/c Dr. To Lal Chand A/c (Endorsed bill dishonoured by Vishal)		10,000	10,000

Whereas, in the book of Vishal, the following entries will be recorded

Books of Vishal
Journal

Date	*Particulars*	*L.F.*	*Debit Amount ₹*	*Credit Amount ₹*
2017 Jan.01	Purchases A/c Dr. To Shieba's A/c (Purchased good from shieba)		10,000	10,000
Jan. 01	Shieba's A/c Dr. To Bills Payable A/c (Accepted Shieba's draft)		10,000	10,000
Mar. 04	Bills Payable A/c Dr. To Shieba's A/c (Acceptance in favour of shieba dishonoured)		10,000	10,000

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.

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:

(i) When the bill was retained till its maturity

Books of Azad
Journal

Date	*Particulars*	*L.F.*	*Debit Amount* ₹	*Credit Amount* ₹
2017 Jan.01	Bunty's A/c Dr. To Sales A/c (Sold goods to Bunty)		15,000	 15,000
Jan. 01	Bills Receivable A/c Dr. To Bunty's A/c (Received Bunty's acceptance)		15,000	 15,000
Apr. 04	Bunty's A/c Dr. To Bills Receivable A/c Dr. To Cash A/c (Bunty dishonoured his acceptance and paid ₹ 50 as noting charges)		15,050	 15,000 50

(ii) When the bill was discounted with the bank.

Journal

Date	*Particulars*	*L.F.*	*Debit Amount* ₹	*Credit Amount* ₹
2017 Jan.01	Bunty's A/c Dr. To Sales A/c (Sold goods to Bunty)		15,000	 15,000
Jan. 01	Bills Receivable A/c Dr. To Bunty's A/c (Received Bunty's acceptance payable after three months)		15,000	 15,000
Jan. 01	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Bunty's acceptance discounted)		14,550 450	 15,000
Apr. 04	Bunty's A/c Dr. To Bank A/c (Bunty dishonoured his acceptance on maturity and bank paid noting charges)		15,050	 15,050

(iii) When the bill was endorsed to Chitra

Journal

Date	*Particulars*	*L.F.*	*Debit Amount* ₹	*Credit Amount* ₹
2017 Jan. 01	Bunty's A/c Dr. To Sales A/c (Sold goods to Bunty)		15,000	 15,000
Jan.01	Bill's Receivable A/c Dr. To Bunty's A/c (Received Bunty's acceptance)		15,000	 15,000
Jan. 01	Chitra's A/c Dr. To Bills Receivable A/c (Bunty's acceptance endorsed in favour of Chitra)		15,000	 15,000
Apr. 04	Bunty's A/c Dr. To Chitra's A/c (Bunty dishonoured his acceptance on maturity and chitra paid ₹ 50 as noting charges)		15,050	 15,050

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 Amount* ₹	*Credit Amount* ₹
2017 Jan.01	Purchases A/c Dr. To Azad's A/c (Purchase goods from Azad)		15,000	 15,000
Jan. 01	Azad's A/c Dr. To Bills Payable A/c (Accepted Azad's draft)		15,000	 15,000
Apr. 04	Bills Payable A/c Dr. Noting charges A/c Dr. To Azad's A/c (Acceptance in favour of Azed dishonoured)		15,000 50	 15,050

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. To Bills Receivable A/c	Bills Payable A/c Dr. To Drawer's A/c
Interest	Drawee's A/c Dr. To Interest A/c	Interest A/c Dr. To Drawer's A/c
New bill	Bill Receivable A/c Dr. To Drawee's A/c	Drawer's A/c Dr. 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.

Books of Ravi
Journal

Date	*Particulars*		*L.F.*	*Debit Amount* ₹	*Credit 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 Amount* ₹	*Credit 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)				

May 04	Ravi's A/c Dr. To Bills Payable A/c To Cash A/c (Accepted new bill and paid cash for interest)		15,300	 15,000 300
Jul. 07	Bill Payable A/c Dr. Bank A/c (Met acceptance of the new bill on maturity)		15,000	 15,000

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.

In the books of Amit
Journal

Date	*Particulars*	*L.F.*	*Debit Amount* ₹	*Credit 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 Jan. 01	Sales		10,000	2017 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 Jan. 01	Babli		10,000	2017 Mar 04	Cash		9,950
					Rebate on bill		50
			10,000				10,000

Book of Babli
Journal

Date	*Particulars*	*L.F.*	*Debit Amount* ₹	*Credit Amount* ₹
2017 Jan. 01	Purchases A/c Dr.		10,000	
	To Amit A/c			10,000
	(Purchased goods from Amit)			

Jan.01	Amit's A/c Dr. To Bills Payable A/c (Accepted Amit's draft payable after three months)		10,000	 10,000
Mar. 04	Bill Payable A/c Dr. To Cash A/c To Rebate on bills A/c (Acceptance in favour of Amit retired and rebate received)		10,000	 9,950 50

Amit's Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2017 Jan. 01	Bills Payable		10,000	2017 Jan. 04	Purchases		10,000
			10,000				10,000

Bills Payable Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2017 Jan. 01	Cash Rebate on bills		9950 50	2017 Jan. 01	Amit		10,000
			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 Amount* ₹	*Credit Amount* ₹
2017 Jan. 15	Narain A/c Dr. To Sales A/c (Sold goods to Narain)		 30,000	 30,000

Jan.15	Bill's Receivable A/c Dr. To Narain's A/c (Received Bunty's acceptance)		30,000	 30,000
Jan. 31	Bank A/c Dr. Discount A/c To Bill receivable A/c (Narains' acceptance discounted with bank)		29,250 750	 30,000
Apr. 19	Narain's A/c Dr. To Bank A/c To Interest A/c (Narain's acceptance cancelled)		30,500	 30,000 500
Apr.19	Bank A/c Dr. Bills Receivavble A/c Dr. To Narain A/c (Received cash from Narain and a new acceptance for the balace)		10,500 20,000	 30,500
Apr.19	Kapil A/c Dr. To Bill Receivable A/c To Discount Received A/c (Narain's acceptance endorsed in favour of kapil and he allowed discount)		20,800	 20,000 800

Books of Narain
Journal

Date	*Particulars*	*L.F.*	*Debit Amount* ₹	*Credit Amount* ₹
2017 Jan. 15	Purchases A/c Dr. To Sachin A/c (Purchased goods from sachin)		30,000	 30,000
Jan.15	Sachin A/c Dr. To Bills Payable A/c (Accepted Sachin's draft)		30,000	 30,000
Jan.19	Bill Payable A/c Dr. Interest A/c To Sachin A/c (Cancelled old bill & Sachin charged interest)		30,000 500	 30,500
Apr. 19	Sachin's A/c Dr. To Bank A/c To Bill Payable A/c (Paid Sachin and accepted a new draft for the balance)		30,500	 10,500 20,000
Apr.22	Bills Receivavble A/c Dr. To Bank A/c (Met new acceptance on Maturity)		20,000	 20,000

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 Amount* ₹	*Credit Amount* ₹
2016 Oct. 30	Bishan's A/c Dr. To Sales A/c (Sold goods to Bishan on credit)		14,000	 14,000
Oct. 30	Bills Receivable A/c Dr. To Bishan's A/c (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)		14,000	 14,000
Oct. 30	Chetan's A/c Dr. To Bills receivable A/c (Endorsed second bills in favour of creditor Chetan)		4,000	 4,000
Dec. 03	Bank A/c Dr. Discount A/c To Bill receivable A/c (Third bill discounted at 12% p.a.)		7,760 240	 8,000
2016 Jan.02	Bank A/c Dr. Bills receivable A/c (Bishan met his first acceptance on due date)		2,000	 2,000
Mar. 03	Bishan A/c Dr. To Bank A/c (Bishan dishonoured his third acceptance and bank paid ₹50 as noting charges)		8,050	 8,050

Mar. 03	Cash A/c Dr. To Bishan's A/c (Cash received from Bishan)		4,050	4,050
Mar. 03	Bishan's A/c Dr. To Interest A/c (Interest charged from Bishan for the extended period)		100	100
Mar. 03	Bills Receivable A/c Dr. To Bishan's A/c (Received new acceptance from Bishan for two months)		4,100	4,100
May 06	Bank A/c Dr. To bills Receivable A/c (Bishan met his new acceptance on maturity)		4,100	4,100

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 Amount* ₹	*Credit Amount* ₹
2016 Oct. 30	Purchases A/c Dr. To Ashok's A/c (Purchases goods on credit from Ashok)		14,000	14,000
Oct. 30	Ashok's A/c Dr. To Bills Payable A/c (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)		14,000	14,000

2017 Jan. 02	Bills Payable A/c Dr. To Bank A/c (Met first acceptance for ₹ 2,000 in favour of Ashok.)		2,000	 2,000
Mar. 03	Bill Payable A/c Dr. Noting charges A/c Dr. To Ashok A/c (Third acceptance in favour of Ashok dishonoured and noting charges ₹ 50)		8,050 50	 8,050
Mar. 03	Ashok's A/c Dr. To Cash A/c (Paid to Ashok ₹ 4,000 plus noting charges)		4,050	 4,050
Mar. 03	Interest A/c Dr. To Ashok's A/c (Interest allowed to Ashok)		100	 100
Mar. 03	Ashok's A/c Dr. To Bills Payable A/c (New draft of Ashok for two months accepted)		4,100	 4,100
May 03	Bills Payable A/c Dr. To Bank A/c (Met new acceptance for ₹ 4,100 in favour of Ashok on maturity)		4,100	 4,100

Ashok's Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount* ₹	*Date*	*Particulars*	*J.F.*	*Amount* ₹
2016 Oct. 30	Bills payable		14,000	2016 Oct. 30	Purchases		14,000
2017 Mar. 03	Cash		4,050	2017 Mar. 03	Bills Payable Noting charges		8,000 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 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 Amount* ₹	*Credit Amount* ₹
2016 Jan. 01	Bills Receivable A/c Dr. To Aakarshak's A/c (The Bill of exchange received from Aakarshak)		10,000	 10,000
Jan.01	Aakarati's A/c Dr. To Bills Receivable A/c (The bill of exchange received from Aakarshak, endorsed to Aakarati)		10,000	 10,000
Apr. 04	Aakarshak's A/c Dr. To Aakarati's A/c (Cancellation of the bill of exchange received from Aakarshak now with Aakarati)		10,000	 10,000
Apr. 04	Aakarati's A/c Dr. To Bank A/c (Payment of the amount due to Aakarati)		10,000	 10,000
Apr. 04	Aakarshak's A/c Dr. To Interest A/c (Interest due from Aakarshak on ₹10,000 for 3 months at 18% p.a.)		450	 450
Apr. 04	Bills Receivable A/c Dr. To Aakarshak's A/c (The new bill received from Aakarshak for the amountdue for him)		10,450	 10,450
July 07	Bank A/c Dr. To Bills Receivable A/c (The amount received from Aakarshak in respect of the renewed bill)		10,450	 10,450

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.

Solution

Books of Nikita
Journal

Date	*Particulars*	*L.F.*	*Debit Amount* ₹	*Credit Amount* ₹
2016 Apr. 01	Bills Receivable A/c Dr. To Ankit's A/c (Ankit's promissory note received in settlement of his account)		6,000	 6,000
Apr. 01	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Ankit's Promissory note discounted for ₹5,760)		5,760 240	 6,000
July 04	Ankit A/c Dr. To Bank A/c (The promissory note dishonoured by Ankit the amount of the bill and the noting charges recoverable from Ankit and payable to bank)		6,015	 6,015
July 04	Cash A/c Dr. To Ankit's A/c (The amount received from Ankit)		2,000	 2,000
July 04	Ankit's A/c Dr. To Interest A/c (Interest due from Ankit for the second bill)		100	 100
July 04	Bills Receivable A/c Dr. To Ankit's A/c (Ankit's acceptance for 2 monthsin settlement of amount due)		4,115	 4,115
Sept.07	Ankit's A/c Dr. To Bills Receivable A/c (The dishonour by Ankit of his acceptance)		4,115	 4,115
Sept.07	Ankit's A/c Dr. To Cash A/c (Payment of noting charges, recoverable from Ankit)		15	 15

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 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 Amount* ₹	*Credit 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)				

Book of Rohit
Journal

Date	*Particulars*	*L.F.*	*Debit Amount* ₹	*Credit 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)			

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.

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.

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.

- 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

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.

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.

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	-

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

NOTE

NOTE