# Contents

**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 as provided by the Companies Act 1956 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 ..................... transactions.

(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 recorded 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 provided by the firm and

*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 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 returns on investments;
- 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 Rs.10,000 for business
   b. Paid for salaries of employees Rs.5,000
   c. Paid sons fees from his personal bank account Rs.20,000
   d. Paid sons fees from the business Rs 2,000
2. Deepti wants to buy a building for his business today. Which of the following is the relevant data for his decision?
   a. Similar business acquired the required building in 2000 for Rs. 10,00,000
   b. Building cost details of 2003
   c. Building cost details of 1998
   d. Similar building cost in August, 2005 Rs. 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

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 Rs. 5,00,000 as an initial investment. Of which he paid Rs.1,00,000 for furniture, Rs. 2,00,000 for buying stationery items. He employed a sales person and clerk. At the end of the month he paid Rs.5,000 as their salaries. Out of the stationery bought he sold some stationery for Rs.1,50,000 for cash and some other stationery for Rs.1,00,000 on credit basis to Mr.Ravi. Subsequently, he bought stationery items of Rs.1,50,000 from Mr. Peace. In the first week of next month there was a fire accident and he lost Rs. 30,000 worth of stationery. A part of the machinery, which cost Rs. 40,000, was sold for Rs. 45,000.

From the above, answer the following :

1. What is the amount of capital with which Mr. Sunrise started business.
2. What are the fixed assets he bought?
3. What is the value of the goods purchased?
4. Who is the creditor and state the amount payable to him?
5. What are the expenses?
6. What is the gain he earned?
7. What is the loss he incurred?
8. Who is the debtor? What is the amount receivable from him?
9. What is the total amount of expenses and losses incurred?
10. Determine if the following are assets, liabilities, revenues, expenses or none of the these: sales, debtors, creditors, salary to manager, discount to debtors, drawings by the owner.

***Summary with Reference to Learning Objectives***

1. *Meaning of Accounting* : Accounting is a process of identifying, measuring, recording the business transactions and communicating thereof the required information to the interested users.
2. *Accounting as a source of information* : Accounting as a source of information system is the process of identifying, measuring, recording and communicating the economic events of an organisation to interested users of the information.

3. *Users of accounting information* : Accounting plays a significant role in society by providing information to management at all levels and to those having a direct financial interest in the enterprise, such as present and potential investors and creditors. Accounting information is also important to those having indirect financial interest, such as regulatory agencies, tax authorities, customers, labour unions, trade associations, stock exchanges and others.
4. *Qualitative characteristics of Accounting* : To make accounting information decision useful, it should possess the following qualitative characteristics.
   - Reliability
   - Understandability
   - Relevance
   - Comparability
5. *Objective of accounting* : The primary objectives of accounting are to :
   - maintain records of business;
   - calculate profit or loss;
   - depict the financial position; and
   - make information available to various groups and users.
6. *Role of accounting* : Accounting is not an end in itself. It is a means to an end. It plays the role of a :
   - Language of a business
   - Historical record
   - Current economic reality
   - Information system
   - Service to users



### *Questions for Practice*

*Short Answers*

1. Define accounting.
2. State what is end product of financial accounting.
3. Enumerate main objectives of accounting.
4. List any five users who have indirect interest in accounting.
5. State the nature of accounting information required by long-term lenders.
6. Who are the external users of information?
7. Enumerate informational needs of management.
8. Give any three examples of revenues.
9. Distinguish between debtors and creditors.
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
    - Gain
    - Profit
    - Revenue
    - Expenses
    - Short-term liability
    - Capital
14. How will you define revenues and expenses?

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 (GAAP)

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.

### *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 Rs. 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 Rs. 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 Rs. 10,000 every year for 5 years from the profit and loss account. In case the continuity assumption is not there, the whole cost (Rs. 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 1956 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 Rs. 50 lakh by Shiva Enterprise, which is into the business of manufacturing detergent powder. An amount of Rs. 10,000 was spent on transporting the plant to the factory site. In addition, Rs. 15,000 was spent on repairs for bringing the plant into running position and Rs. 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. Rs. 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 Rs. 2.5 crore, the 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.

## 2.5 Accounting Standards

As discussed in the preceding section, the Generally Accepted Accounting Principles in the form of Basic Accounting Concept have been accepted by the accounting profession to achieve uniformity and comparability in the financial statement. This is aimed at increasing the utility of these statement to various users of the accounting information. But the difficulty is that GAAP permit a variety of alternative treatments for the same item. For example, various methods of calculation of cost of inventory are permissible which may be followed by different enterprises. This may cause problem to the external users of information, which becomes inconsistent and incomparable. This necessitates brining in uniformity and consistency in the reporting of accounting information.

Recognising this need, the Institute of Charted Accountants of India (ICAI) constituted an Accounting Standards Board (ASB) in April, 1977 for developing Accounting Standards. The main function of ASB is to identify areas in which uniformity in standards is required and develop draft standards after wide discussion with representative of the Government, public sector undertakings, industry and other organisations. ASB gives due consideration to the International Accounting Standards as India is a member of International Account Setting Body. ASB submits the draft of the standards to the Council of the ICAI, which finalises them and notifies them for use in the presentation of the financial statements. ASB also makes a periodic review of the accounting standards.



Accounting standards are written statements of uniform accounting rules and guidelines or practices for preparing the uniform and consistent financial statements and for other disclosures affecting the user of accounting information. However, the accounting standards cannot override the provision of applicable laws, customs, usages and business environment in the country.

The Institute tries to persuade the accounting profession for adopting the accounting standards, so that uniformity can be achieved in the presentation of financial statements. In the initial years the standards are of recommendatory in nature. Once an awareness is created about the requirements of a standard, steps are taken to enforce its compliance by making them mandatory for all companies to comply with. In case of non-compliance, the companies are required to disclose the reasons for deviations and the financial effect, if any, arising due to such deviation.

The list of accounting standards is given in the appendix to this chapter.

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.

***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?

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 (Rs.) :**
**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

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 |

**Statement showing the effect of various transaction on accounting equation**

*(Figures in rupees)*

| No. | *Cash* | *Bank* | *Stock* | *Fur-niture* | *Plant and Machinery* | *Total* | = | *Non-trade Creditors* | *Trade Creditors* | *Capital* | *Total* |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | 6,00,000 | | | | | 6,00,000 | = | | | 6,00,000 | 6,00,000 |
| 2 | 6,00,000 | - | - | - | - | 6,00,000 | = | - | - | 6,00,000 | 6,00,000 |
| | (4,50,000) | 4,50,000 | | | | | | | | | |
| 3 | 1,50,000 | 4,50,000 | -- | -- | - | 6,00,000 | = | - | - | 6,00,000 | 6,00,000 |
| | (30,000) | - | - | - | 2,30,000 | 2,00,000 | | 2,00,000 | - | - | 2,00,000 |
| 4 | 1,20,000 | 4,50,000 | - | - | 2,30,000 | 8,00,000 | = | 2,00,000 | - | 600,000 | 8,00,000 |
| | (40,000) | - | 85,000 | - | - | 45,000 | | - | 45,000 | - | 45,000 |
| 5 | 80,000 | 4,50,000 | 85,000 | - | 2,30,000 | 8,45,000 | = | 2,00,000 | 45,000 | 600,000 | 8,45,000 |
| | - | (2,00,000) | - | - | - | (2,00,000) | | (2,00,000) | - | - | (2,00,000) |
| 6 | 80,000 | 2,50,000 | 85,000 | - | 2,30,000 | 6,45,000 | = | - | 45,000 | 6,00,000 | 20,000 |
| | 70,000 | - | (50,000) | - | | 20,000 | | - | - | 20,000 | 20,000 |
| 7 | 1,50,000 | 2,50,000 | 35,000 | - | 2,30,000 | 6,65,000 | = | - | 45,000 | 6,20,000 | 6,65,000 |
| | (35,000) | - | - | | | (35,000) | | | | (35,000) | (35,000) |
| 8 | 1,15,000 | 2,50,000 | 35,000 | - | 2,30,000 | 6,30,000 | = | - | 45,000 | 5,85,000 | 6,30,000 |
| | | (2,500) | | | | (2,500) | | | | (2,500) | (2,500) |
| 9 | 1,15,000 | 2,47,500 | 35,000 | - | 2,30,000 | 6,27,500 | = | - | 45,000 | 5,82,500 | 6,27,500 |
| | | | | | | | | 5,500 | - | (5,500) | |
| 10 | 1,15,000 | 2,47,500 | 35,000 | - | 2,30,000 | 6,27,500 | = | 5,500 | 45,000 | 5,77,000 | 6,27,500 |
| | (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. | | | | | | |



## 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.

**Discount Received Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J.F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| *2005* Dec.20 | Lara India | | 500 | | | | |

**Purchases Return Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J.F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| | | | | *2005* Dec.22 | Taranum | | 1,500 |

**Stationery Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J.F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| *2005* Dec. | Cash | | 1,200 | | | | |



**Rent Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J.F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| *2005* Dec. 28 | Bank | | 4,000 | | | | |

**Drawings Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J.F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| *2005* Dec. 29 | Cash | | 10,000 | | | | |

**Rupak Traders Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J.F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| *2005* Dec. 31 | Sales | | 11,000 | | | | |

### *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. States 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.

(e) Rahul become insolvent, who owed is Rs. 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 | Rs. 500 |
| (b) | Goods given as charity | Rs. 2,000 |
| (c) | Interest charge on capital @7% p.a. when total capital were | Rs. 70,000 |
| (d) | Received Rs.1,200 of a bad debts written-off last year. | |
| (e) | Goods destroyed by fire | Rs. 2,000 |
| (f) | Rent outstanding | Rs. 1,000 |
| (g) | Interest on drawings | Rs. 900 |
| (h) | Sudhir Kumar who owed me Rs. 3,000 has failed to pay the amount. He pays me a compensation of 45 paise in a rupee. | |
| (i) | Commission received in advance | Rs. 7,000 |

*Posting*

16. Journalise the following transactions, post to the ledger:

| 2005 | | Rs. |
|---|---|---|
| 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.

| 2006 | | Rs. |
|---|---|---|
| Jan. 01 | Started business with cash | 1,65,000 |

## 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* | *Particulars* | *L.F.* | *Amount Rs.* | *Date* | *Particulars* | *L.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| | | | | | | | |

**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 Rs.* |
|---|---|---|
| 2005 | | |
| 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 |

| *Date* | *Details* | *Amount Rs.* |
|---|---|---|
| 2005 | | |
| 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 Rs. 12,000. | 11,700 |
| Sept. 05 | Cash paid to Rukmani in full settlement of claim of Rs.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 Rs. 6,800 | 200 |
| Sept. 11 | Received from Gurmeet, discount allowed to him Rs.14,500 | 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* | *Particulars* | *L.F.* | *Amount Rs.* | *Date* | *Particulars* | *L.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2005 | | | | *2005* | | | |
| 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 Rs.* |
|---|---|---|
| 2005 | | |
| 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 |

**Pawan Electronics**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J.F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| | | | | 2005 | | | |
| | | | | Aug. 10 | Purchases | | 31,050 |
| | | | | Aug. 29 | Purchases | | 38,700 |

**Northern Electronics**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J.F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| | | | | 2005 | | | |
| | | | | Aug.18 | Purchases | | 3,06,250 |

**Purchases Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J.F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2005 | | | | | | | |
| Aug. 31 | Sundries as per Purchases Journal | | 6,18,000 | | | | |



### 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 Rs.* |
|---|---|---|---|---|
| | | | | |

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

**Raman Traders Account**

**Dr.** **Cr.**

| Date | Particulars | J.F. | Amount Rs. | Date | Particulars | J.F. | Amount Rs. |
|---|---|---|---|---|---|---|---|
| 2005 | | | | | | | |
| Apr. 06 | Sales | | 4,850 | | | | |
| Apr. 28 | Sales | | 85,000 | | | | |

**Nutan Enterprises Account**

**Dr.** **Cr.**

| Date | Particulars | J.F. | Amount Rs. | Date | Particulars | J.F. | Amount Rs. |
|---|---|---|---|---|---|---|---|
| 2005 | | | | | | | |
| Apr.01 | Sales | | 21,000 | | | | |

**Sales Account**

**Dr.** **Cr.**

| Date | Particulars | J.F. | Amount Rs. | Date | Particulars | J.F. | Amount Rs. |
|---|---|---|---|---|---|---|---|
| | | | | 2005 | | | |
| | | | | 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 Rs. |
|---|---|---|---|---|
| | | | | |

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

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* |
|---|---|
| 2005 | |
| Apr. 01 | Commenced business with cash Rs. 1,00,000. |
| Apr.02 | Deposited in bank Rs. 40,000. |
| Apr. 02 | Purchased for cash furniture Rs. 6,000; |
| | Land Rs. 42,000. |
| Apr.l 03 | Paid cheque to M/s Malika & Brothers for purchase of electric wires and plugs Rs. 17,000. |
| Apr. 04 | Bought of M/s Handa Co. vide invoice no. 544: |
| | (i) 28 Immersion Heaters 1,000 Watt of Smg. Ltd. @ Rs. 50, and |
| | (ii) 40 Tube lights @ Rs.35. trade discount @ 12.5%. |
| Apr.l 04 | Purchased stationery for cash Rs. 2,300. |
| Apr. 05 | Loan from M/s Dayal Traders @ 6% Rs. 25,000 and deposited money in the bank on the next day. |
| Apr. 05 | Paid cartage Rs. 80 and other charges Rs. 20. |
| Apr. 06 | Bought of M/s Burari. Ltd. on account vide Invoice No. 125: |
| | (i) 50 Table lamps (Universal) @ Rs. 80 : |
| | (ii) 20 Electric kettles (General) @ Rs. 125. |
| | (iii) 5 Electric iron@ Rs. 300. trade discount 20%. |
| Apr. 07 | Sales to M/s Ramneek on account vide invoice no. 871: |
| | (i) 10 Immersion heaters1000 watt @ Rs. 60. |
| | (ii) 5 Table lamps @ Rs. 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 @ Rs. 38. |
| Apr. 10 | Return inwards from Ramneek : |
| | (i) 2 Immersion heaters, |
| | (ii) 1 Electric iron. |
| Apr. 11 | Paid rent by cheque Rs. 4,000. |
| Apr. 11 | Purchased from M/s Rungta. for cash: |
| | (i) 5 Immersion heaters 1000 watt @ Rs. 45. |
| Apr. 12 | Returned goods to Burari Ltd. : |
| | (i) 3 Table lamps (Universal) |
| | (ii) 2 Electric kettles |
| | (iii) 1 Electric iron. |

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 2005:

| | | Rs. |
|---|---|---|
| 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 Rs. 13,200)

2. Record the following transaction in simple cash book for November 2005:

| | | Rs |
|---|---|---|
| 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 Rs. 12,170)

3. Enter the following transaction in Simple cash book for December 2005 :

| | | Rs. |
|---|---|---|
| 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 Rs. 6,765)

*Bank Column Cash Book*

4. Record the following transactions in a bank column cash book for December 2005:

| | | Rs. |
|---|---|---|
| 01 | Started business with cash | 80,000 |
| 04 | Deposited in bank | 50,000 |

*Illustration 3*

The bank passbook of M/s. Boss & Co. showed a balance of Rs. 45,000 on May 31, 2005.

1. Cheques issued before May 31,2005, amounting to Rs. 25,940 had not been presented for encashment.
2. Two cheques of Rs. 3,900 and Rs. 2,350 were deposited into the bank on May 31 but the bank gave credit for the same in June.
3. There was also a debit in the passbook of Rs. 2,500 in respect of a cheque dishonoured on 31.5.2005. Prepare a bank reconciliation statement as on May 31, 2005.

*Solution*

**Bank Reconciliation Statement of Bose & Co as on May 31, 2005**

| | *Particulars* | *(+) Amount Rs.* | *(–) Amount Rs.* |
|---|---|---|---|
| 1. | Balance as per passbook | 45,000 | |
| 2. | Cheques deposited but not collected by the bank (Rs. 3,900+ Rs. 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, 2005, Rakesh had on overdraft of Rs. 8,000 as shown by his cash book. Cheques amounting to Rs. 2,000 had been paid in by him but were not collected by the bank. He issued cheques of Rs. 800 which were not presented to the bank for payment. There was a debit in his passbook of Rs. 60 for interest and Rs. 100 for bank charges. Prepare bank reconciliation statement.

*Illustration 6*

From the following particulars of Asha & Co. prepare a bank reconciliation statement on December 31, 2005.

| | Rs. |
|---|---|
| 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, 2005**

| | *Particulars* | *(+) Amount Rs.* | *(–) Amount Rs.* |
|---|---|---|---|
| 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, 2001.

(a) Debit balance as per cash book is Rs. 10,000.

(b) A cheque for Rs. 1,000 deposited but not recorded in the cash book.

(c) A cash deposit of Rs. 200 was recorded in the cash book if there is not bank, column therein.

(d) A cheque issued for Rs. 250 was recorded as Rs. 205 in the cash column.

(e) The debit balance of Rs. 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 Rs. 100.

(g) A cash discount allowed of Rs. 112 was recorded as Rs. 121 in the bank column.

(h) A cheque of Rs. 500 received from a debtor was recorded in the cash book but not deposited in the bank for collection.

(i) One outgoing cheque of Rs. 300 was recorded twice in the cash book.

*Solution*

**Bank Reconciliation statement as on September 30, 2004**

| | *Particulars* | *(+) Amount Rs.* | *(–) Amount Rs.* |
|---|---|---|---|
| 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, 2005.

(a) Balance as per passbook is Rs. 10,000.
(b) Bank collected a cheque of Rs. 500 on behalf of Shri Krishan but wrongly credited it to Shri Krishan's account.
(c) Bank recorded a cash book deposit of Rs. 1,589 as Rs. 1,598.
(d) Withdrawal column of the passbook under cast by Rs. 100.
(e) The credit balance of Rs. 1,500 as on the pass-book was recorded in the debit balance.
(f) The payment of a cheque of Rs. 350 was recorded twice in the passbook.
(g) The pass-book showed a credit balance. For a cheque of Rs. 100 deposited by Shri Kishan.

*Solution*

**Bank Reconciliation Statement as on March 31, 2005**

| | *Particulars* | *(+) Amount Rs.* | *(–) Amount Rs.* |
|---|---|---|---|
| 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 |

**Bank Reconciliation Statement as on Dec. 31, 2004**

| | | Rs. | Rs. |
|---|---|---|---|
| | Overdraft as per bank statement | | 10,458 |
| *Add:* | Cheque issued but not yet presented for payment | | 2,403 |
| | | | 12,861 |
| *Less:* | Cheques deposited but not yet credited | 6,858 | |
| | Cheque debited in error | 225 | 7,083 |
| | Balance as per cash book | | 5,778 |

*Illustration 10*

The bank overdraft of Smith Ltd., on December 31, 2004 as per cash book is Rs.18,000 From the following information, asscertain the adjusted cash balance and prepare bank reconciliation statement

| | | Rs. |
|---|---|---|
| (i) | Unpresented cheques | 6,000 |
| (ii) | Uncleared cheques | 3,400 |
| (iii) | Bank interest debited in the passbook only | 1,000 |
| (iv) | Bills collected and credited in the passbook only | 1,600 |
| (v) | Cheque of Arun traders dishonoured | 1,000 |
| (vi) | Cheque issued to Kapoor & Co. not yet entered in the of cash book | 600 |

**Amended Cash Book (Bank Column)**

**Dr.** **Cr.**

| Date | Particulars | L.F. | Amount Rs. | Date | Particulars | L.F. | Amount Rs. |
|---|---|---|---|---|---|---|---|
| | Bills collected as per passbook | | 1,600 | | Balance b/d | | 18,000 |
| | Balance c/d | | 19,000 | | Interest | | 1,000 |
| | | | | | Cheque dishonoured (Arun Traders) | | 1,000 |
| | | | | | Kapoor and Co. (cheque) | | 600 |
| | | | 20,600 | | | | 20,600 |
| | | | | | Balance b/d | | 19,000 |

**Bank Reconciliation Statement as on December 31, 2004**

| | | |
|---|---|---|
| | Bank overdraft as per cash book | 19,000 |
| *Add* | Uncleared cheques | 3,400 |
| | | 22,400 |
| *Less* | Unpresented cheques | 6,000 |
| | Bank overdraft as per passbook | 16,400 |

(b) The bank has credited Mr. Himanshu for Rs. 700 as interest.

(c) Cheques for Rs. 3000 were issued during the month of December but of these cheques for Rs. 1,000 were not presented during the month of December.

(*Ans:* Balance as per cash book Rs. 3,300).

7. From the following particulars prepare a bank reconciliation statement showing the balance as per cash book on December 31, 2005.

(a) Two cheques of Rs. 2,000 and Rs. 5,000 were paid into bank in October, 2005 but were not credited by the bank in the month of December.

(b) A cheque of Rs. 800 which was received from a customer was entered in the bank column of the cash book in December 2004 but was omitted to be banked in December, 2004.

(c) Cheques for Rs. 10,000 were issued into bank in January 2005 but not credited by the bank on December 31, 2005.

(d) Interest on investment Rs. 1,000 collected by bank appeared in the passbook.

Balance as per Passbook was Rs. 50,000

(*Ans:* Balance as per cash book Rs. 47,800)

8. Balance as per passbook of Mr. Kumar is 3,000

(a) Cheque paid into bank but not yet cleared

Ram Kumar Rs. 1,000

Kishore Kumar Rs. 500

(b) Bank Charges Rs. 300

(c) Cheque issued but not presented

Hameed Rs. 2,000

Kapoor Rs. 500

(d) Interest entered in the passbook but not entered in the cash book Rs. 100

Prepare a bank reconciliation statement.

(*Ans:* Balance as per cash book Rs. 2,200).



9. The passbook of Mr. Mohit current account showed a credit Balance of Rs. 20,000 on dated December 31, 2005. Prepare a Bank Reconciliation Statement with the following information.

(i) A cheque of Rs. 400 drawn on his saving account has been shown on current account.

(ii) He issued two cheques of Rs. 300 and Rs. 500 on of December 25, but only the I$^{st}$ cheque was presented for payment.

(iii) One cheque issued by Mr. Mohit of Rs. 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 Rs. 18,900).

17. Prepare a bank reconciliation statement from the following particulars and show the balance as per cash book.
   (i) Balance as per passbook on December 31, 2005 overdrawn Rs. 20,000.
   (ii) Interest on bank overdraft not entered in the cash book Rs. 2,000.
   (iii) Rs. 200 insurance premium paid by bank has not been entered in the cash book.
   (iv) Cheques drawn in the last week of December, 2005, but not cleared till date for Rs. 3,000 and Rs. 3,500.
   (v) Cheques deposited into bank on November, 2005, but yet to be credited on dated December 31, 2005 Rs. 6,000.
   (vii) Wrongly debited by bank Rs. 500.

   (*Ans:* Overdraft as per cash book Rs. 17,800).

18. The passbook of Mr. Randhir showed an overdraft of Rs. 40,950 on March 31, 2005.

   Prepare bank reconciliation statement on March 31, 2005.
   (i) Out of cheques amounting to Rs. 8,000 drawn by Mr. Randhir on March 27 a cheque for Rs. 3,000 was encashed on April 03.
   (ii) Credited by bank with Rs. 3,800 for interest collected by them, but the amount is not entered in the cash book.
   (iii) Rs. 10,900 paid in by Mr. Randhir in cash and by cheques on March, 31 cheques amounting to Rs. 3,800 were collected on April, 07.
   (iv) A Cheque of Rs. 780 credited in the passbook on March 28 being dishonoured is debited again in the passbook on April 01, 2005. There was no entry in the cash book about the dishonour of the cheque until April 15.

   (*Ans:* Overdraft as per cash book Rs. 36,350)

***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)

**Purchases Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J.F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2005 | | | | | | | |
| | 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, 2005**
**(Using Totals Method)**

| *Account Title* | *L.F.* | *Debit Total Rs.* | *Credit Total Rs.* |
|---|---|---|---|
| Rawat's Capital | | | 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, 2005**
**(Using Balances Method)**

| *Account Title* | *L.F.* | *Debit Balance Rs.* | *Credit Balance Rs.* |
|---|---|---|---|
| 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 |

## 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 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 Rs. 25,000 to Preetpal Traders (a supplier of goods). This transaction was correctly recorded in the cashbook. But while

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 Rs. 10,000 were posted to his account as Rs. 7000. This is an error of commission. Mohan's account has been debited with Rs. 7,000 instead of Rs. 10,000 resulting in short debit of Rs. 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 Suspense A/c | | | 3,000 |



(*c*) Credit sales to Mohan Rs. 10,000 were posted to his account as Rs. 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 Rs. 1,000. Errors in casting of subsidiary books affect only those accounts where totals of the subsidiary books involved are

(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 Rs. 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 Rs. 16,000

(i) were not posted to sales account.
(ii) were posted as Rs. 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 Rs. 16,000 were posted to sales account as Rs. 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) | | | |

*Solution*

(i)

| | | | |
|---|---|---|---|
| Suspense A/c | Dr. | 1,000 | |
| To Sales Return A/c | | | 1,000 |
| (Sales returns book overcast by Rs. 1,000, now corrected). | | | |

(ii)

| | | | |
|---|---|---|---|
| Purchases A/c | Dr. | 600 | |
| To Suspense A/c | | | 600 |
| (Purchases book undercast by Rs. 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/overcastting. In this case, carry forward from page 4 to 5 resulted in undercasting of Rs. 200 and carry forward from page 8 to page 9 resulted in overcasting of Rs. 600. Overall overcastting being Rs. 600–200 = Rs. 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). | | | |

# 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 benefits extend for more than one accounting period then it is not justified to charge the entire cost as expense in the year in which it is incurred. Rather such a cost must be spread over the periods in which it provides benefits. Depreciation, 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 expenses. Recall that the principle of conservatism (prudence) requires that instead of ignoring such items of expenses, 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

**Test Your Understanding - III**

There are two dentists Dr. Aggarwal and Dr. Mehta in your locality who are competitors. Both of them have recently bought an equipment for treatment of patients. Dr. Aggarwal has decided to write-off an equal amount of depreciation every year while Dr. Mehta wants to write-off a larger amount in earlier years. They do not know anything about the methods of depreciation. Can you inform them more about the methods of depreciation they are applying even without knowing anything about accounting in formal. Who is more wise in your opinion? Give reasons in support of your answer.

## 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 'depreciation provision' or 'accumulated

*Solution*

**Books of Sahani Enterprises**
**Printing Machine Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J.F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2001 | | | | 2002 | | | |
| Jul. 01 | Bank | | 40,000 | Mar. 31 | Depreciation | | 6,750[1] |
| | Bank | | 5,000 | | Balance c/d | | 38,250 |
| | | | 45,000 | | | | 45,000 |
| 2002 | | | | 2003 | | | |
| 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 |
| 2003 | | | | 2004 | | | |
| Apr. 01 | Balance b/d | | 63,850 | Mar.31 | Depreciation | | 12,770[3] |
| | | | | | Balance c/d | | 51,080 |
| | | | 63,850 | | | | 63,850 |
| 2004 | | | | | | | |
| Apr. 01 | Balance b/d | | 51,080 | | | | |

*Working Notes*

| | (Rs.) |
|---|---|
| Original cost machine purchased on July 01,2001 | 45,000 |
| (–) Depreciation till Mar. 31, 2002 (for 9 months @ 20%) | (6,750)[1] |
| | 38,250 |
| + Cost of new machine purchased on Jan. 01,2003 | (35,000) |
| | 73,250 |
| (–) Depreciation for the year 2002-2003 | |
| (20% of 38,250 + 20% of Rs. 35,000 for 3 month) | (9,400)[2] |
| WDV on Mar. 31, 2003 | 63,850 |
| (–) Depreciation for the year 2003 – 04 (20% of Rs. 73,850) | (12,770)[3] |
| WDV on Mar. 31, 2004 | 51,080 |

**Test Your Understanding - IV**

Basaria Confectioner bought a cold storage plant on July 01, 2003 for Rs.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.

**Accumulated Depreciation Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J.F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2001 Dec. 31 | Balance c/d | | 43,000 | 2001 Dec. 31 | Depreciation | | 43,000[1] |
| | | | 43,000 | | | | 43,000 |
| 2002 Jan. 01 | Balance c/d | | 77,400 | 2002 Jan. 01 | Balance b/d | | 43,000 |
| | | | | | Depreciation | | 34,400[2] |
| | | | 77,400 | | | | 77,400 |
| 2003 Dec. 31 | Balance c/d | | 1,04,920 | 2003 Jan. 01 | Balance b/d | | 77,400 |
| | | | | Dec. 31 | Depreciation | | 27,520[3] |
| | | | 1,04,920 | | | | 1,04,920 |
| 2004 Jul. 31 | Plant disposal | | 1,17,763 | 2004 Jan. 01 | Balance b/d | | 1,04,920 |
| | | | | July 31 | Depreciation | | 12,843[4] |
| | | | 1,17,763 | | | | 1,17,763 |

**Plant Disposal Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J.F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2004 Jul. 31 | Plant | | 2,15,000 | 2004 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* (Rs.)

| | |
|---|---|
| Original cost on 01.01.2001 (2,00,000 + 10,000+ 5,000) | 2,15,000 |
| Depreciation for the year 2001 (@20% of Rs. 2,15,000) | (43,000[1]) |
| | 1,72,000 |

Additional Information

- Bad debts proved bad but not recorded amounted to Rs. 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 Rs.* | *Amount Rs.* |
|---|---|---|---|---|
| 2005 Mar. 31 | Bad debts A/c Dr.<br>To Sundry debtors A/c<br>(Bad debts written off) | | 8,000 | 8,000 |
| Mar. 31 | Profit & Loss A/c Dr.<br>To Bad debts A/c<br>(Bad debts debited to profit and loss account) | | 8,000 | 8,000 |
| Mar. 31 | Profit and Loss A/c Dr.<br>To Provision for doubtful debts A/c<br>(For creating provision for doubtful debts) | | 6,000[1] | 6,000[1] |

*Working Notes*

Provision for doubtful debts @10% of sundry debtors i.e.
(Rs. 68,000 – 8000) = Rs. 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;

years charging depreciation by fixed installment Method. Accounts are closed on December 31, every year.

(*Ans:* Balance of provision for depreciation account as on 1.01.04 Rs.18,200).

4. Berlia Ltd. Purchased a second hand machine for Rs. 56,000 on July 01, 2001 and spent Rs. 24,000 on its repair and installation and Rs. 5,000 for its carriage. On September 01, 2002, it purchased another machine for Rs. 2,50,000 and spent Rs. 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 2001 to 2004.
   (b) Prepare machinery account and depreciation account from the year 2001 to 2004, 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 1.01.05 Rs.2,54,583.
   [b] Balance of Machine account as on 1.01.05 Rs.2,62,448).

5. Ganga Ltd. purchased a machinery on January 01, 2001 for Rs. 5,50,000 and spent Rs. 50,000 on its installation. On September 01, 2001 it purchased another machine for Rs. 3,70,000. On May 01, 2002 it purchased another machine for Rs. 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 2001, 2002, 2003 and 2004.
   (b) If depreciation is accumulated in provision for Depreciation account then prepare machine account and provision for depreciation account for the years 2001, 2002, 2003 and 2004.

   (*Ans:*[a] Balance of machine account as on 01.01.05 Rs. 12,22,666.
   [b] Balance of provision for dep. account as on 01.01.05 Rs. 5,87,334).



6. Azad Ltd. purchased furniture on October 01, 2002 for Rs. 4,50,000. On March 01, 2003 it purchased another furniture for Rs. 3,00,000. On July 01, 2004 it sold off the first furniture purchased in 2002 for Rs. 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 31,2003, March 31,2004 and March 31,2005. Also give the above two accounts if furniture disposal account is opened.

   (*Ans.*Loss on sale of furniture Rs.1,14,915,
   Balance of provision for depreciation account as on 31.03.05 Rs. 85,959.)

7. M/s Lokesh Fabrics purchased a Textile Machine on April 01, 2001 for Rs. 1,00,000. On July 01, 2002 another machine costing Rs. 2,50,000 was purchased . The machine purchased on April 01, 2001 was sold for Rs. 25,000 on October 01, 2005. The company charges depreciation @15% p.a. on straight line method. Prepare machinery account and machinery disposal account for the year ended March 31, 2006.

   (*Ans.* Loss on sale of Machine account Rs.7,500.
   Balance of machine account as on 1.04.05 Rs.1,09,375).

**Test Your Understanding - II**

*Fill in the blanks with suitable word(s)*

(i) The person to whom the amount mentioned in the promissory note is payable is known as ____________.

(ii) Transfer of a negotiable instrument to another person by signing on it, is known as ____________.

(iii) In a promissory note, the person who makes the promise to pay is called as ___________.

(iv) A person who endorses the promissory note in favour of another is known as___________.

## 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 Instrument 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 Rs.20,000 became due for payment, Since April 08, has been declared a holiday under the Negotiable Instruments Act, therefore, April 08, 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.

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

(i) When the bill kept by Shieba till its maturity;
(ii) When the bill is discounted by Shieba for Rs. 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 Rs.* | *Credit Amount Rs.* |
|---|---|---|---|---|---|
| 2006 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 Rs.* | *Credit Amount Rs.* |
|---|---|---|---|---|---|
| 2006 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) | | | | |

The bills receivable book, like any other subsidiary book, is totaled periodically. This total is debited to the "Bills Receivable Account" whereas the account of every individual debtor whom the bills received is credited in the ledger. The Bills Receivable Account is the account of an asset and would always have a debit balance. This balance on any date would represent the amount of bills receivable unmatured and on hand.

### *8.11.2 Bills Payable Book*

It is maintained like a bills receivable book. It is meant to record all the details, relating to the bills accepted by a person or a party, which are retained for being use in the future, in case of need.
The proforma of a bills payable book is given in Fig.8.4

**Bills Payable Book**

| No. of Bill | Date of Bill | To Whom given | Drawer | Payee | Where payable | Term | Due date | Ledger Folio | Amount paid | Date | Cash Book Folio | Remarks |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | | | |



**Fig. 8.4:** *Showing specimen Bills Payable Book*

The postings from this books are made to the debit of the account of every creditor to whom acceptance has been given and the periodical total of the books is credited to the 'Bills Payable Account' in the ledger. The bills payable account representing the liability of the acceptor in respect of bills accepted by him, always has a credit balance, if any. The credit balance of this account on any particular date must be the same as the total amount worth of bills payable yet to be presented for payment as ascertained from the bills payable book. For example, consider the following transactions and observe how these are recorded in bill receivable and bills payable book along with postings in the ledger accounts.

2006

(i) Jan. 07
Received from S. Mitra bill duly accepted for Rs. 1,32,500 dated January 04, payable three months after date.

(ii) Jan. 09
Accepted S. Warden's draft for Rs. 9,70,000 at two months.

(iii) Jan. 13
Pradhan drew on his trader at three months date and the same was accepted for Rs. 39,000.

(iv) Jan. 14
Drew on R. Rakesh at one month for Rs.25,000 and he accepted the next day.

(v) Jan. 18
Gave acceptance at two months for Rs.42,000 to S. Parkar.

(vi) Jan. 21
Received from G.Ghosh his acceptance for Rs.31,000 at two months.

(vii) Jan. 22
Received from D.Dhiman, A.Vakil's acceptance for Rs.20,000 at three months from Jan. 17.

(viii) Jan. 23
K. Kanga accepted my draft at one month for Rs.30,000.

(ix) Jan. 27
Received from C.Shah bill for Rs. 35,000 dated January 20, accepted by P. Parson and drawn by M.Meyers., payable two months after date.

(x) Jan. 31
Gave acceptance for Rs. 21,500 at one month to A. Roberts.

Posting of recorded entries are as follow:

**S. Mitra's Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J. F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2006 Jan. 01 | Sales | | 1,32,500 | 2006 Jan. 07 | Bills Receovable | | 1,32,500 |
| | | | 1,32,500 | | | | 1,32,500 |



**R. Rakesh's Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J. F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2006 Jan. 14 | Sales | | 25,000 | 2006 Jan. 15 | Bill Receivable | | 25,000 |
| | | | 25,000 | | | | 25,000 |

**G. Ghosh's Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J. F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2006 Jan. 21 | Sales | | 31,000 | 2006 Jan. 21 | Bills Receivable | | 31,000 |
| | | | 31,000 | | | | 31,000 |

**D. Dhiman's Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J. F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2006 Jan. 17 | Sales | | 20,000 | 2006 Jan. 22 | Bills Receivable | | 20,000 |
| | | | 20,000 | | | | 20,000 |

**K. Kanga's Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J. F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2006 Jan. 23 | Sales | | 30,000 | 2006 Jan. 23 | Bills Receivable | | 30,000 |
| | | | 30,000 | | | | 30,000 |

**C. Shah's Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J. F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2006 Jan. 20 | Sales | | 35,000 | 2006 Jan. 27 | Bill Receivable | | 35,000 |
| | | | 35,000 | | | | 35,000 |



**Bill Receivables Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J. F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2006 Jan. 31 | Sundries | | 2,73,500 | 2006 Jan. 31 | Balance c/f | | 2,73,500 |
| | | | 2,73,500 | | | | 2,73,500 |

**S. Warden's Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J. F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2006 Jan. 09 | Bills payable | | 97,000 | 2006 Jan. 09 | Purchases | | 97,000 |
| | | | 97,000 | | | | 97,000 |

**Pradhan's Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J. F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2006 Jan. 13 | Bills payable | | 39,000 | 2006 Jan. 13 | Purchases | | 39,000 |
| | | | 39,000 | | | | 39,000 |

**S. Parkar's Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J. F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2006 Jan. 18 | Bills payable | | 42,000 | 2006 Jan. 18 | Purchases | | 42,000 |
| | | | 42,000 | | | | 42,000 |

**A. Robert's Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J. F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2006 Jan. 31 | Bills payable | | 21,500 | 2006 Jan. 31 | Purchases | | 21,500 |
| | | | 21,500 | | | | 21,500 |



**Bill Payables Account**

**Dr.** **Cr.**

| *Date* | *Particulars* | *J. F.* | *Amount Rs.* | *Date* | *Particulars* | *J.F.* | *Amount Rs.* |
|---|---|---|---|---|---|---|---|
| 2006 Jan. 01 | Balance c/d | | 1,99,500 | 2006 Jan. 04 | Sundries Receivable | | 1,99,500 |
| | | | 1,99,500 | | | | 1,99,5000 |

*Note:* The drawing and acceptance of a bill always pre-supposes some background of sale or purchase transaction. Therefore, in posting bill transactions from the two books to the accounts of debtors and creditors, it is supposed that the necessary sales and purchases entries have been duly recorded.

*Illustration 4*

On Jan. 15, 2006 Sachin sold goods Rs.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 Rs.29,250 on Jan. 31, 2006. on maturity the bill was dishonoured. He further agreed to pay Rs.10,500 in cash including Rs. 500 interest and accept a new bill for two months for the remaining Rs.20,000. the new bill was

| | | | | |
|---|---|---|---|---|
| Jan.15 | Sachin A/c Dr.<br>To Bills Payable A/c<br>(Accepted Sachin's draft) | | 30,000 | <br>30,000 |
| Jan.19 | Bill Payable A/c Dr.<br>Interest A/c<br>To Sachin A/c<br>(Cancelled old bill & Sachin charged interest) | | 30,000<br>500 | <br><br>30,500 |
| Apr. 19 | Sachin's A/c Dr.<br>To Bank A/c<br>To Bill Payable A/c<br>(Paid Sachin and accepted a new draft for the balance) | | 30,500 | <br>10,500<br>20,000 |
| Apr.22 | Bills Receivavble A/c Dr.<br>To Bank A/c<br>(Met new acceptance on Maturity) | | 20,000 | <br>20,000 |

*Illustration 5.*

Ashok sold goods Rs.14,000 to Bishan on October 30, 2005 and drew three bills for Rs.2,000, Rs.4,000 & Rs.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, 2005 at 12% p.a. The first and second bills were duly met on maturity but the third bill was dishonoured and the bank paid Rs.50 as noting charges. On March 03, 2006 Bishan paid Rs.4,000 and noting charges in cash and accepted a new bill at two months after date for the balance plus interest Rs.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 Rs.* | *Credit Amount Rs.* |
|---|---|---|---|---|
| 2005<br>Oct. 30 | Bishan's A/c Dr.<br>To Sales A/c<br>(sold goods to Bishan on credit) | | 14,000 | <br>14,000 |
| Oct. 30 | Bills Receivable A/c Dr.<br>To Bishan's A/c<br>(Received three acceptances from Bishan. First for Rs. 2,000 payable after two months, second for Rs. 4,000 payable after three months and the third for Rs. 8,000 payable after four months) | | 14,000 | <br>14,000 |

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. *Features 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 or 5. Briefly explain the purpose and benefits of retiring a bill of exchange to the debtor and the creditor.



## ***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. What is meant by insolvency?
15. Give the meaning of rebate.
16. 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?