FINANCIAL ACCOUNTING - I

B.Com., General & Computer Applications, First Year, Paper –II

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BOOKS RECOMMENDED :

1. A.N. Agarwal	:	Higher Science of Accountancy
2. T.S. Grewal	:	Introduction to Accountancy
3. R.L. Gupta & V.K- Gupta	:	Principles and Practice of Accounting
4. M.C. Shukia & I.S. Grewal	:	Advanced Accountancy
5. S.P. Jain & K.L. Narang	:	Advanced Accountancy
6. R.L. Gupta & Radhaswamy	:	Advanced Accountancy
7. S.P. Iyengar	:	Advanced Accountanty
8. Patil & Korlahalli	:	Principles & Practice of Accounting
9. Tulasian	:	Financial Accounting

LESSON - 1A

ACCOUNTING, INTRODUCTION

1A.0 Objectives : After going through this less on the student will know, what is Accountancy? what is the need for recording the business transactions in the books ? What is the difference between book keeping and Accountancy ? What are the things which should be bear in mind while recording business transaction in the books.

Structure :

1.1 Introduction to Accountancy - Scope

Accounting is as old as money itself. In the early days, the number of transactions to be recorded were so small then each business man was able to record and check for himself all his transactions. The modern system of accounting based on the principles of Double Entry system owes its origin to luco pacio who first published the principles of Double Entry system in 1494 at VENICE in Italy.

In the recent years large scale production, cut throat competition, widening of the market and changes in the technology have brought remarkable changes in the field of accounting.

A business consists of a series of transactions. These business transactions are to be identified, classified, recorded, summarised, analysed, interpreted and communicated to interested parties so as to serve as a basis for decision marking. In fact, modern accounting serves as the “eyes and ears” of the management.

The main purpose of accounting is to ascertain profit or loss during a specified period to show financial condition of the business on a particular date and to have control over the firms property. Such accounting records are required to be maintained to measure the income of the business and communicate the information so it may be used by managers, owners and other parties.

1.2 Definition :

Different people have defined Accountancy in deferent ways by going through these we can understand the nature of Accountancy.

The American institute of certified public Accounting has defined financial accounting as “the art of recording, classifying and summarising in a significant manner and in terms of money transactions and events which in part, at least of a financial character and interpreting the results there of ”

American Accounting Association defines accounting as “ the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of the information”

Accountancy is the science of recording and classifying business transactions and events primarily of a financial character and the art of making significant summaries, analysis and interpretations of those transactions and events and communication of the results to persons who must make decisions or form judgements (Smith & Ashbuns).

1.3 Need for Accounting :

It is not possible to any human being to remember all business transactions which have taken place in business - that too, over a period of time say in an year. Even if some one does really remember all the transactions, he would find it impossible to calculate the net effect of all such transactions. Hence the need for accounting is raised.

What ever may be the size of organisation whether it is a sole trading concern, partnership or joint stock company it would like to have information about

1. The nature and amount of expenditure,
2. The nature, source, cause and amount of earnings,
3. The amount and cause of losses, if any
4. The size of capital and causes for its increase or decrease,
5. The nature and value of assets possessed, and
6. The nature and value of liabilities.

Further, the business requires various types of information for both external and internal use. For example information is required for filing sales tax, income tax and other tax returns and for preparing statements for decisions to be taken by managers. The question is how to get this information. A systematic accounting record is the only answer. Thus, the need for accounting arises on account of practical needs and sometimes legal requirements.

1.4 Functions of Accounts :

1. **Recording** : Business transactions are analysed in such a way that it may be possible to determine profit or loss made by the business and its financial condition of a specified date. Business transactions may relate to the receipt and payment of cash, purchase or sale of goods on credit, incurring an expense or receiving an income.

2. **Classification** : Classification is the second function of accountancy.

   The transactions recorded in journal should be classified and the transactions of one nature should be Placed at one place which we call as ledger.

   For example : All purchases of goods placed into purchases A/C, payment of salaries to salaries A/C etc.

3. **Summarising :** The classified data should be summarised at least periodically, into a significant form.

4. **Analysing :** The summarised financial statements profit and loss account, balance sheet, statement of changes are analysed with the help of statistical tools such as averages, percentages, ratio, rates etc.

5. **Interpreting :** The information in financial statements, are interpreted in terms of set standards and conventions. Inter preting the results of accounting information involves communicating and explaining the information to interested parties and decision makers like owners, creditors, investors, government and management.

1.5 Book Keeping and Accounting :

It is necessary to distinguish between book - keeping and accounting Actually the two are very closely related and there is no universally accepted line of discrimination. Generally book - keeping involves the chronological recording of financial transactions in a systematic manner. According to Northcott “book Keeping is an art of recording in books of accounts the monetary aspect of commercial or financial transaction”

According to G.A. Lee the Accounting system has two branches : 1. The making of routine records from day - to - day in the prescribed form and according to set rules of all events which affect the financial state of the organisation and 2. The summarising of the information contained in the records, its presentation in significant form to interested parties and its inter pretation as an aid to decision-making by these parties. Branch 1. Is called book - keeping and branch 2. Is accounting.

Book - keeping is the record making phase of accounting. The recording of transactions tends to be routine, repetitive and mechanical. It is a part of accounting. Accounting includes, book - keeping, preparation of financial statements, audits, cost studies, preparation of budgets, income - tax and other taxation work, analysis and interpretation of accounting information; as an aid to decision making.

1.6 Objects of Accounting :

According to American Accounting association the objectives of accounting are to provide information for the following purposes.

1. Making decisions concerning the use or limited resources including identification of crucial decision areas and determination of objectives and goals.

2. Effectively directing the controlling of an organisation’s human and materials resources.

3. Maintaining and reporting on the custodian-ship of resources.

4. Facilitating social Functions and control.

1.7 Advantages and limitations of Accounting :

The following are the advantages of a properly maintained accounting system

1. The operating results i.e.. profit or loss and the financial state of affairs of an organisation can be known.
2. Any information required at any time can readily be had from the books of account.
3. With the help of financial statements an organization can evaluate its present performance with that in the past, and compare it with that of other organisations
4. Accounts form the basis for the settlement of tax liability such as income tax, sales tax etc.
5. In the events of the business being sold, the accounts are helpful in ascertaining the value of the business.
6. Accounting is an aid to the management. It is possible to find out exact reasons for the loss incurred or profit earned. The identification of reasons help the management in taking necessary steps to avoid losses or to further increase profits.
7. The financial information provided by the accounting system is needed to help the management in planning and controlling the activities with the help of budgets.

Limitations :

The following are the main limitations of accounting.

1. Accounting records only those transactions which can be measured in monetary terms.
2. Accounting transactions are recorded at cost in the books. The effect of price level changes is not brought into the books, with the result that comparison of the various years becomes difficult. For example the sale price of total assets in 2007 would be much higher than in 1980 due to rising prices, fixed assets being shown to cost and not at market price.
3. Accounting information may not be realist i.e. as accounting statements are prepared by following basic concepts and conventions.
4. Accounting statements are influenced by the personal judgement of the accountant. The method of depreciation, valuation of stock, treatment of deferred revenue expenditure is decided by the accountant. Such judgement if based on integrity will definitely affect the preparation of accounting statements.

1.8 Accounting process :

The accounting process begins when a financial transaction takes place. Transaction is recorded first in a book called ‘Journal’ and later posted in separate accounts maintained for the purpose in a ledger. At the end of the accounting year whether actual figures are entered accurately or not in the accounts is tested by preparing a ‘trail balance’ with the help of this trial balance and other information ‘final accounts’ are prepared to find out the financial result of the operations whether profit or loss and the financial position, assets and liabilities. In the subsequent year the accounting books are opened with the previous year’s closing balances. The process thus repeats itself like a cycle.

1.9 Branches of Accounting :

The accounting can be classified into the following categories.

1. Financial Accounting
2. Cost Accounting
3. Management Accounting
4. Inflation Accounting
5. Human resources Development Accounting

1.10. Concepts of Accounting :

Accounting is the language of business. To make the language convey the same meaning to all people, accountants all over the world have developed certain rules, procedure and conventions.

Accounting concepts may be considered as basic assumptions or conditions upon which the science of accounting is based. They are as follows.

1. Business Entity Concept : This concept implies that a business unit is separate and distinct from the persons who supply capital to it. Accounting system gives the information about business only. The entity concept regards the proprietor of the business as just a creditor having a claim over the assets of the business. The accounting equation i.e, Assets = liabilities + capital is an expression of the entity concept. In case this concept is not followed affairs of the business will be mixed up with the private affairs of the proprietor and the true picture of the business will not be available.

2. Going concern concept : According to this concept it is assumed that business entity will go on for ever. Transactions are recorded in the books keeping inview the going concern aspect of the business unit. This assumption provides much of the justification for recording fixed assets at original cost without reference to their current realisable value. Similarly the going concern concept supports the treatment of prepaid expenses as assets even though they may be unsaleable. Prepaid expenses are made assets on the assumption that the business entity will continue in future and the benefit of prepaid expenses will be utilised in future.

3. Money measurement concept : Money is the only practical unit of measurement that can be employed to achieve homogenity of financial data. The advantage of expressing business transactions in terms of money is that money serves a common denominator by means of which heterogeneous facts about a business can be expressed in terms of numbers, i.e. money, which are capable of additions and subtractions.

The money measurement concept restricts the scope of accounting because it is not capable of recording transactions which cannot be expressed in terms of money. For example : if there is a strike in the factory or the production manager is not in good terms with the sales manager, as these can not be measured in money terms. Accounting therefore can not record them. Similarly it does not take care of the effects of inflation because it assumes a stability of the money measurement unit.

Cost Concept : All assets are recorded in the books at the price paid to acquire it. Its value is systematically reduced by charging depreciation. The market value of an asset may change with the passage of time but for accounting purpose it continues to be shown in the books at its book value i.e. the cost at which it was purchased minus depreciation provided up to date. The cost concept has the advantage of bringing objectivity in the accounts. Information given in the financial statements is not influenced by the personal bias or judgement of those who furnish such statements.

Dual Aspect Concept :

This is the basic concept of accounting. According to this concept every financial transaction involves a two - fold aspect. 1) Yielding of a benefit and 2) Giving of that benefit. For example, if a business has acquired as asset, it must have given up some other asset such as cash. There must be a double entry to have a complete record of each business transaction, an entry being made in the receiving account and an entry of the same amount in the giving account. The receiving account is termed as debtor and the giving account is called creditor. Thus every debit must have a corresponding credit and vice versa and upon this dual aspect has been raised the whose superstructure of Double Entry System of Accounting. The Accounting Equation is based on dual aspect concept.

Assets = Liabilities + Capital

Accounting equation demonstrates the fact that for every debit there is an equivalent credit.

Accounting period Concept : Even though it is assumed that the business will continue for a long period, almost indefinitely; the businessman cannot postpone the ascertainment of its profit and financial position indefinitely. So it is reasonable to devide the life of the business into accounting periods so as to be able to know the profit or loss of each such period and the financial position at the end of such a period. Normally accounting period adopted is one year. However for internal purposes accounts can be prepared even for shorter periods.

The principal of segregating capital expenditure from revenue expenditure is based on the accounting period concept. The revenue expenditure for a particular period is transferred to the P & L A/c of that period whereas capital expenditure is carried forward to the extent to which its benefit extents in future accounting periods.

Realisation Concept : According to this concept, revenue is considered as being earned on the date at which it is realised, Take into account realised profit but donot take into account unrealised profit is the summary of this concept

1.11. Conventions of Accounting :

The terms conventions denotes customs or traditions which guide the accountant while preparing the accounting statements the following are the important accounting conventions.

1. Convention of Consistency

2. Convention of full disclosure

3. Convention of conservation

4. Convention of Materiality.

Convention of Consistency : Accounting rules, practices and conventions should be continuously observed. The results of different years will be comparable only when accounting rules are continuously adhered from year to year. For example the principle of “valuing stock at cost or market price which ever is lower should be followed year after year to get comparable results.

Convention of full Disclosure : According of this convention all accounting statements should be honestly prepared and all significant information should be made. All information which is of material interest to proprietors, creditors and investors should be disclosed in accounting statements. The convention is becoming popular these days because most of big business units are in the form of joint stock companies here ownership is diverse from management. The companies Act 1956 makes simple provisions for the disclosure of essential information that there is no change of any material information being left out.

Convention of conservatism : Conservatism means taking the gloomy view of a situation. It compels the business man to take all precautions for risks of future. It says anticipate no profits but provide for all possible losses. For ex. closing stock is valued at cost or market price whichever is lower. If market price is higher than the cost the higher amount is ignored in accounts and closing stock will be valued at cost which is lower than the market price and vice versa.

Thus the principle of conservation is inherent in the valuation of stock.

Convention of Materiality : Whether something should be disclosed or not in the financial statements will depend on whether it is material or not Materiality depends on the amount involved in the transaction. For ex. Minor expenditure of Rs 10 for the purchase of a waste basket may be treated as an expense of the period rather than an asset.

The term materiality is a subjective term. The accountant should record an item as material even though it is of small amount if its knowledge seems to influence the decision of the proprietors or auditors or investors.

Parties interested in Accounting information :

Accounting information is useful to various parties. They are :

1. Owners : Owners assume the primary risk of business by investing their funds in it. Naturally they are interested in obtaining information about the operations of their business how much profit it earned and what is the position of their capital. They also use the accounting to evaluate the managements performance and to compare their enterprise with others.

Managers : Accounting reports are important to manager for basing their decisions or for evaluation, the result of their decisions or for controlling the activities of the business. In addition to external financial statements managers need detailed internal reports, production wise, sales wise etc. Accounting reports for managers are prepared much more frequency than external reports and are usually available only for internal purposes.

Creditors and Bankers : Creditors and Bankers want to know the solvency of the concern so as to satisfy themselves that their money will be safe and that they can expect repayment in time.

Prospective Investors : Prospective investors who wants to invest their money in the firm wants to make a careful analysis of the financial statements of that business so as to know how safe and rewarding the proposed investments will be.

Employees : The employees of large organisation are interested in the results of their organisation operations. They use the accounting data to know whether they are getting a fair shape of the resources distributed by the organisation.

Governments : Numerous governmental agencies, both state and central are interesting in the accounts of concerns for the purpose of collecting taxes, for exercising control, for granting licenses or loans, for determining whether welfare measures and social security benefits to their employees are observed or not etc.

Financial analysts : Many investment decisions are made on the advice of financial analysts who are experts in analysing accounting reports.

Researchers : Financial statements are of immense use to research scholars who want to make a study of financial operations.

Consumers : Consumers do too, are interested in knowing about the concern's pricing policy, quality of goods etc.

1.12. Summary :

Business is a bundle or a series of transactions. The effects of these transactions must be brought into books of accounts and summarised so as to find out the result of the operations and the financial state of affairs of the business. Accounting involves different types of work like identifying the transactions, measures in terms of money, classifying according to their nature and recording in the books of accounts. These recorded transactions are summarised periodically in the form of financial statements, and analysing them with the help of statistical tools, Interpreting according to conventions and communicating to the interested parties in the form of reports.

1.13. Self Assessment Questions

1. What are the functions of the Accountancy ?
2. Write about the Accounting concepts.
3. Comment on the following.

   a) Realisation concept

   b) Consistency and conservatism of Accounting.
4. What is the difference between Accounting and Book keeping ?
5. Discuss Money measurement concept and material concept as applied in Financial Accounting.
6. What are different branches of accounting ?
7. Define Accounting state its functions and branches. How is it different from book - keeping.
8. Explain accounting, principles briefly.
9. Limitations of Accounting.

10. Define Accountancy.
11. Scope of Accounting.
12. What is accounting process ?
13. Write about the accounting conventions.

1.14 SUGGESTED READINGS :

Financial Accountancy	**:**	**Shukla Grewal**
Financial Accountancy	**:**	**Jain and Narang**
Financial Accountancy	**:**	**R.L. Gupta & V.K. Gupta**

- Dr. Ch. Suravinda

LESSON - 1 B

DOUBLE ENTRY SYSTEM

1. b.0. Objects :

By going through this lesson the student can know about Single entry system, Double entry system, Accounts and its classification structure.

structure

Business transactions can be recorded in the books in two methods. 1. Single entry system. 2. Double entry system

1.b.1 Single entry system

Single entry means that it is a method of maintaining accounts which does not exactly follow the principles of double entry system. It does not mean that there is one entry for each transaction. But it simply means that principles of the double entry system are not being followed for all transactions. Under this method usually the personal accounts of the debtors and creditors are kept and impersonal accounts - real and nominal accounts may not be maintained in the books. Single entry is not any particular system of accounting but rather, the double entry system in an incomplete and disjointed form.

1.b.2. limitation of single entry system :

Following are the limitations of single entry.

1. It is not a scientific method of accounting because it does not record the two - fold aspect of each transaction.
2. No trial balance can be prepared as it does not record the dual aspect of each transaction so the arithmetical accuracy of the books cannot be checked.
3. In the absence of nominal accounts, trading and profit and loss account cannot be prepared.
4. In the absence of real accounts, it is not possible to know the exact financial position of the business on any particular day by preparing a balance sheet.

5. Internal check is not possible so the possibility of Fraud or misappropriation is greater in case of single entry than in the case of double entry system.
6. Accounts prepared on the basis of the single entry do not inspire confidence in out siders owing to the lack of any test for their arithmetical accuracy. So, information obtained from accounts maintained on the basis of the single entry will be taken with doubt.

7. It is difficult to ascertain the value of the business specially of goodwill if the propriter wishes to sell his business.

Double Entry System :

We have seen earlier that every business transaction has two aspects i.e when we receive something we give something else in return For example when we purchase goods for cash we receive goods and give cash in return ; similarly in credit sale of goods, goods are given to the customer and the customer becomes debtor for the amount of goods sold to him. This method of writing every transaction in two accounts is known as double entry system of Accounting one account is given debit while the other account is given credit with equal amount. Thus, on any date, the total of all debits must be equal to the total of all credits because every debit has a corresponding credit.

An account is a summarised record of transitions relating to particular person or thing. Accounts are classified as personal Accounts and impersonal Accounts. Impersonal Accounts are further classified as real Accounts and Nominal Accounts.

1. **Personal Accounts :** Accounts which relate to persons, both natural and artificial are called personal Accounts. They show dealings with persons. A separate account is maintained for each person. For example, Ganesh Account, Andhra Bank Account etc.

2. **Real Accounts :** Accounts which show dealing in assets or properties are called 'Real Account'. A separate account is kept for each property some examples are Machinery Account, Furniture account, cash Account etc. They are called 'real' accounts and they represent things of value owned by the business.

3. **Nominal Accounts :** Nominal Accounts record expenses, losses and incomes. Separate accounts are maintained for each item of expenses or incomes. example, salaries, wages, Rent etc. They are called 'Nominal' accounts because they are accounts only for names sake.

Rules of the Double Entry system :

There are separate rules of the double entry system in respect of personal, real and nominal accounts which are discussed below.

1. Personal Accounts :

As we have already seen these accounts record a business dealings with persons or firms. The person receiving something is given credit. For example if Anil sells goods to Ajay on credit Ajay Account will be given debit (in Anil books) as he is the receiver of goods and Anil's Account will be credited (in Ajay books) as he is the giver of goods. When Ajay makes the payment for these goods Anil's Account will be debited in Ajay's books as he is the receiver of cash and Ajay's Account will be given credit in Anil's books as he is the giver of cash. So the rule is Debit the receiver and credit the giver.

2. Real Accounts :

These are the accounts of assets. Asset entering the business is given debit and asset leaving the business is given credit. For example, when goods are sold for cash, cash account will be given debit as cash comes in and goods Account will be credited as goods go out. So the rule is debit what comes in and credit what goes out.

3. Nominal accounts :

These accounts deal with expenses, incomes, profits and losses. Accounts of expenses and losses are debited and accounts of incomes and gains are credited. For example, When salary is paid to employee, salary Account will be debited as it is an expense and cash Account will be credited as it goes out, similarly, when Interest is received, cash account will be debited as cash is received and Interest Account will be credited as it is an income. Thus the rule is debit all expenses and losses and credit all incomes and gains.

The rules of double entry system are shown in the following chart.

RULES OF DOUBLE ENTRY

Personal Accounts		Real Accounts		Nominal Accounts	
Debit	Credit	Debit	Credit	Debit	Credit
Receiver	giver	What comes in	What goes Out	Expenses and losses	Incomes and gains

Analysis of Transaction :

To make a correct record of the transactions, each transaction must be analysed. The following questions may be asked in this respect.

1. Which are the two accounts involved in the transaction to be recorded ?
2. Whether the two accounts involved in the transaction are personals, real or nominal ?
3. What rules of debit and credit are applicable to the accounts involved.
4. Which account should be debited or credited?

The above method will make the recording of transactions more simple and easy. The following chart explains the procedure of analysing the transactions.

Analysis of Transactions :

	Transaction	Two Accounts Involved	Classification of Accounts	Rule of Debit & Credit	Account Debited Rs.	Account Credited Rs.
1.	Started business with Rs.1,00,000	Cash capital	Real personal	Debit What comes in Credit the giver	Cash	Capital
2.	Purchased Furniture for Rs 20,000	Furniture Cash	Real Real	Debit what come in Credit what goes out	Cash	Furniture
3.	Paid Salaries Rs.3,000	Salaries Cash	Nominal Real	Debit the expenses Credit what goes out	Cash	salary
4.	Commission Received Rs.2,000	Commission Cash	Normal Real	Credit the incomes Debit what comes in	Cash	Commission
5.	Goods purchased Rs.20,000	goods cash	Real Real	Debit what come in Credit what goes out	goods	cash
6.	Sold goods to Rao Rs.10,000	Rao goods	Personal Real	Debit the receiver credit what goes out	Rao	goods

Advantage of Double Entry system :

The following are the advantages of Double entry system.

1. It provides a complete record of every transaction.
2. It provides an arithmetical check on the records as the total of debit entries must be equal to the total of credit entries.
3. The amount due to the concern and amount due by the concern to outsiders can be as certain by the personal accounts.
4. With the help of nominal accounts profit and loss account can be prepared for ascertaining the profit, or loss of the concern in a particular year.
5. With the help of real accounts, Balance sheet can be prepared for knowing the financial state of affairs of the concern on the closing day of the year.
6. The scope for committing errors and frauds can be reduced to minimum level.

Difference between single entry system and Double Entry system :

The following are the main differences.

Single entry	Double entry
1. It is an incomplete and unscientific method of recording business transactions.	1. It is a complete and scientific method of recording business transactions.
2. Only personal accounts are prepared.	2. All accounts, personal real and nominal accounts are prepared.
3. It is not a reliable system of accounting	3. It is a reliable system of accounting
4. Trial balance cannot be prepared for checking the arithmetical accuracy	4. Trial balance can be prepared
5. Profit & loss account and balance sheet can not be prepared under this system.	5. Profit & loss account and Balance sheet can be prepared under this system.

1.b.7. Summary :

Business transactions can be recorded in the books in two methods. 1) Single entry, which is an incomplete and unscientific method of accounting. 2) Double entry system is a systematic way of recording business transactions. Total accounting system has classified into two groups, one is personal accounts, other is imperson accounts which is again divided into real and nominal accounts. There are three different principles to record transactions in these accounts.

1.b.8. Self Assessment Questions :

1. Write down Double entry system of book-keeping and its advantages.
2. How can you classify the accounts ? Write down the rules of debit and credit.
3. What is single entry system ? What are its limitations ?

1.B.9 SUGGESTED READINGS :

Financial Accountancy : Shukla Grewal
Financial Accountancy : Jain and Narang
Financial Accountancy : R.L. Gupta & V.K. Gupta

- Dr. Ch. Suravinda

LESSON - 2

JOURNAL

2.0 Objects : After going through this lesson the student can know how the business transactions are recorded in the journal and how the journal prepared.

Structure :

2.1. Journal :

Business transactions are recorded at first in the Journal. A transaction may be defined as a transfer of money, goods or services from one individual to an other. The term Journal is derived from the French word 'Jour' which means a day. Journal therefore, means a daily record of business transactions. Journal is a book of original entry because transaction is first written in the journal in Chronological order as they occur, from which it is posted to the ledger at the end of a week, fortnight or month. The process of recording in the 'Journal' is called 'Journalising' and the various entries made in the journal is called 'Journal Entries'.

If two or more transactions of the same nature occur on the same day then such transactions can be entered in the journal in the form of a combined journal entry instead of making a separate entry for each transaction. Such type of entry is known as a compound journal entry.

2.2. Business transactions :

Business transactions may be classified into two types 1. Cash transactions 2. Credit transactions

Cash transactions : If purchase of goods, sale of goods, expenses paid, Income received etc., are for cash then those transactions are known as cash transactions. In case of cash transactions one of the account effected will be cash Account and the other account which should be debited or credit will depends on the nature of the transaction for ex : Purchase of good from X for cash in this transaction personal account i.e. 'x' should not be taken, one account is cash and the other account is goods.

Credit transaction : If the payment is deferred for purchase of goods or sale of goods then it is known as credit transaction. In a transaction, name of the supplier or customer is give and it does not contain the word 'for cash' then it is a credit transaction. In case of credit transaction one of the account effected is personal account and the other will be decided depending upon the transaction. See the following examples. goods purchased from Moorthy. Furniture sold to Madhu are credit transactions. If the transaction is goods purchased from Moorthy for cash then it is a cash transaction.

2.3. Journal Entry :

As we have already seen that every transaction of business at first, entered in the journal in the form of a journal Entry. The ruling of the journal is as follows.

JOURNAL

Date	Particulars	L.F.	Dr. Amount Rs	Cr Amount Rs.
Year Month/Date	Name of the Account to be debited Dr. To Name of the Account credited (Narration)			

Column 1 (Date) The date of the transaction on which is takes place is written in this column. The year is written only in the first entry appearing on each page.

Column 2. (Particulars) In this column, the name of the account to be debited is written first with the word 'Dr'. In the next line, the account to be credited is written preceded by the word "To" leaving a few spaces away from the first line. Here we need not write the word 'Cr' because the word 'To' itself will indicate that the account is credited. An explanation of the entry known as "Narration" is also recorded below the line giving credit to the account.

Column 3 (L.F.) L.F. Stands for ledger folio which means page of the ledger. In this column the page numbers on which the related account appears in the ledger is entered.

Column 4 (Dr. Amount) In the column, the amount to be debited against the 'Dr' account is written

Column 5 (Cr. Amount) In this column the amount to be credited against the 'Cr' account is written

2.4. Method of writing a Journal Entry :

1. Read the transaction carefully from the business entity point of view and determine the two accounts that are affected by the transaction.
2. Find out the class to which each account relates i.e. whether it is a personal account or a real account or a nominal account.
3. Now recollect the rules of debit and credit and apply the concerned rule to decide which account is to be debited and which to be credited.

   This can be clearly understood with the following table

Transactions	Two Accounts involved	Classification of Accounts	Rule of Debit Credit	Explanation	Account to be Debited	Account to be credited
Started business with Rs.1,00,000	Cash	Real	Debit what comes in	cash entered the business	Cash A/c	---
	Capital	Personal	Credit the giver	Proprietor is giver of cash		Capital A/c
Purchased Machine for Rs.10,000	Machine	Real	Debit what comes in	Machine entered the business	Machine A/c ---	---
	Cash	Real	Credit what goes out	Cash go out of business		Cash A/c -
goods purchased from Vasu on Credit Rs.5,000	goods	Real	Debit what comes in	goods entered the business	Goods A/c	--
	Vasu	Personal	Credit the giver	Vasu is giver of goods		Vasu A/c
Sold goods Rs.3,000	Cash	Real	Debit what comes in	Cash entered the business	Cash A/c	---
	goods	Real	Credit what goes out	goods go out of business	---	Goods A/c
Paid salaries to staff Rs.5,000	Salaries	Nominal	Debit the expenses & losses	Salaries are expenses	Salary A/c	---
	Cash	Real	Credit what goes out	Cash goes out of business	---	Cash A/c
Commission Received Rs.1,000	Cash	Real	Debit what comes in	Cash comes into the business	Cash A/c	
	Commission	Nominal	Credit the incomes & gains	Commission received is an income		Commission A/c
Sold goods to	Anil	Personal	Debit the receiver	Anil is the receiver of goods	Anil A/c	---
			Credit what goes out	Goods go out of		

2.5 Advantages of Journal :

1. Journal is a self explanatory book. It explains all the business transactions.
2. As all the business transactions are entered in the chronological order of their occurrence, any transaction can be referred later easily if necessary.
3. In case of any conflict about a transaction, it act as a proof.
4. It acts as a base for the preparation of a ledger.
5. Through journal, the principle of double entry can be understood clearly with ease.

2.6. Illustrations :

Illustration I (Cash transactions)

Journalise the following transactions :

		Rs.
Jan.1	Ajay started business with	2,00,000
Jan 2	Furniture purchased for	20,000
Jan 3	Purchased goods for	50,000
Jan 4	Sold goods for	30,000
Jan 5	Goods returned to supplier	500
Jan 6	Goods returned by customer	200
Jan 7	Salary paid	2,000
Jan 8	Commission received	1,000

Date	Particulars Cr.		L.F. Amount Rs.	Dr. Amount Rs.
Jan Ist	Cash Account Dr.		2,00,000	
	To Ajay's capital Account			2,00,000
	(Being Ajay contributed Rs.2,00,000 as his capital)			
2nd	Furniture Account Dr.		20,000	
	To Cash Account			20,000
	(Being Furniture purchased for business)			
3rd	Goods Account Dr		50,000	
	To Cash Account			50,000
	(Being goods purchased for cash)			
4th	Cash Account Dr		30,000	
	To goods Account			30,000
	(Being goods sold for cash)			

5th	Supplier's Account Dr To Goods Account (Being goods returned to supplier)		500	500
6th	Goods Account Dr To customer's account (Being goods received from customers).			
7th	Salaries Account Dr To cash account (Being salaries paid)		2,000	2,000
8th	Cash account Dr To Commission account (Being commission received)		1,000	1,000

1. Illustration 2. (Credit transactions).

		Rs.
Feb 1.	Purchased Furniture from Pranav & Co.	10,000
Feb 2.	Sold goods to Pavan	7,500
Feb 3.	Bought typewriter from Godrej & Co.	10,000
Feb 4.	Bought goods from Akhil	5,000
Feb 5.	Sold goods to Nikhil on credit	12,000
Feb 6.	Bought goods from Sai on Credit	15,000
Feb 7.	Bought goods on account from Sobhan	8,000
Feb 8.	Sold goods on account to Nagesh	6,500

Solution :

Date	Particulars	L.F.	Dr. Amount Rs.	Cr. Amount Rs.
Feb 1	Furniture Accounts Dr To Pranav & Co (Being Furniture purchased on credit)		10,000	10,000
Feb 2.	Pavan Account Dr. To goods account (Being goods sold on credit)		7,500	7,500
Feb 3.	Type writer Account Dr. To Godrej & Co (Being typewriter purchased on credit)		10,000	10,000
Feb 4.	Goods Account Dr To Akhil account (Being goods purchased from		5,000	5,000

	Akhil on credit)			
Feb 5.	Nikhil account	Dr	12,000	
	To goods account			12,000
	(Being goods sold on credit)			
Feb 6	Goods Account	Dr	15,000	
	To Sai account			15,000
	(Being goods purchased from Sai on credit)			
Feb 7	Goods Account	Dr	8,000	
	To Sobhan account			8,000
	(Being goods purchased from Sobhan on credit)			
Feb 8	Nagesh account	Dr	6,500	
	To goods account			6,500
	(Being goods sold on credit to Nagesh)			

The student is advised to note the following points here,

1) When the name of the person is given in a transaction and when the word 'cash' does not appear, it is implied that it is a credit transaction. e.g. purchased furniture from P.N. Rao & Company Rs.5,000. At the same time when the name of the party does not appear it is always a cash transaction even if the word 'cash' is not mentioned in the transaction e.g. goods purchased Rs.10,000

In the illustrations given above 'goods account' is used while recording the dealings in 'goods' viz, purchases, sales, purchase returns and sale returns. In practice the 'goods account' is not maintained. Goods is valued at Market Price or cost Price which ever is less. We will discuss this principle later. Goods is devided into four accounts as, when we purchased goods, purchases account, when we sold goods sale account, when we return goods purchase returns account, when the customer return goods, sales returns account should be give affected instead of goods account.

Illustration 3. (Expenses and Incomes)
Journalise the following transactions :

		Rs.
Dec 1	Paid Salaries	10,000
Dec 2	Paid Rent to landlord Raghava	5,000
Dec 3	Paid commission	1,000
Dec 4	Received Rent	2,000
Dec 5	Received Commission	1,500

Dec 6	Stationery purchased	1,000
Dec 7	Postage paid	100

Date	Particulars		L.F.	Dr. Amount Rs.	Cr. Amount Rs.
Dec 1	Salaries Account	Dr		10,000	
	To Cash Account				10,000
	(Being salaries paid)				
Dec 2	Rent Account	Dr		5,000	
	To cash account				5,000
	(Being Rent paid)				
Dec 3	Commission paid Account	Dr		1,000	
	To cash account				1,000
	(Being Commission paid)				
Dec 4	Cash Account	Dr		2,000	
	To Rent Account				2,000
	(Being Rent Received)				
Dec 5	Cash Account	Dr		1,500	
	To Commission Received Account				1,500
	(Being Commission received)				
Dec 6	Stationery Account	Dr		1,000	
	To cash Account				1,000
	(Being Stationery paid)				
Dec 7	Postage Account	Dr		100	
	To cash Account				100
	(Being postage paid)				

Here the student is advised to note that transactions relating to payments of expenses and receipts of incomes are recorded through the 'expense account' or the 'Income account' concerned and not through the account of the person involves, since no debtor/Creditor relationship is created. In the above example rent paid to Raghava.

In respect of certain items like rent, commission etc, where both payments and receipts take place, two separate accounts may be maintained one for recording payments and the other for receipts e.g. commission paid account and commission Received Account.

Illustration 4. (Transactions with the proprietor)
Enter the following transactions in the journal.

	Rs.
1. Madhuri commenced business with a capital of	1,00,000
2. She withdraw for his personal use	5,000
3. She introduced additional capital	50,000
4. She took goods for personal use	1,000

Date	Particulars		L.F.	Dr. Amount Rs.	Cr. Amount Rs.
1.	Cash Account	Dr		1,00,000	
	To Capital Account				1,00,000
	(Being the business started with the capital of Rs.1,00,000)				
2.	Drawing Account	Dr.		5,000	
	To cash Account				5,000
	(Being cash withdrawn for personal use).				
3.	Cash account	Dr		50,000	
	To Capital Account				50,000
	(Being additional capital introduced)				
4.	Drawings Account	Dr		1,000	
	To Goods accounts				1,000
	(Being goods withdrawn for Personal use)				

We have seen how different types of business transactions are recorded through the Journal and shall now take up some comprehensive problems.

Illustration 5 :

Journalise the following transactions

		Rs.
Jan1	Mr. rao commenced business with	10,00,000
Jan 1	Purchased Furniture	50,000
Jan 1	Deposited into Bank	5,00,000
Jan 2	Purchased goods	50,000
Jan 2	Postage paid	1,000
Jan 2	Stationery purchased	2,000

Jan 3	Purchased goods from Arun	60,000
Jan 3	Sold goods	20,000
Jan 4	Commission paid	500
Jan 5	Cash withdrawn for personal use	10,000
Jan 6	Type writer purchased	5,000
Jan 7	Sold goods to Varun	70,000
Jan 8	Wages paid	10,000
Jan 9	Goods taken for personal use	2,000
Jan 10	goods returned to Arun	1,000
Jan 11	goods returned from Varun	1,500
Jan 12	Motor vehicle purchased from T.V.S.	50,000

Date	**Particulars**		**L.F.**	**Dr. Amount Rs.**	**Cr. Amount Rs.**
Jan 1	Cash Account	Dr		10,00,000	
	To Capital Account				10,00,000
	(Being capital introduced into business)				
Jan 1	Furniture Account	Dr		50,000	
	To Cash Account				50,000
	(Being furniture purchased)				
Jan 1	Bank Account	Dr		5,00,000	
	To Cash Account				5,00,000
	(Being cash deposited into Bank)				
Jan 2	Purchases account	Dr		50,000	
	To Cash Account				50,000
	(Being postage paid)				
Jan 2	Stationery Account	Dr		2,000	
	To Cash Account				2,000
	(Being stationery purchased)				
Jan 2	Postage Account	Dr		1,000	
	To Cash account				1,000
	(Being postage paid)				
Jan 3	Purchases Account	Dr		60,000	
	To Arun Account				60,000
	(Being goods purchased or credit)				
Jan 3	Cash Account	Dr		20,000	
	To Sales Account				20,000
	(Being goods sold)				

Jan 4	Commission Account Dr To cash Account (Being commission paid)		500	500
Jan 5	Drawings account Dr To Cash Account (Being cash withdrawn for personal use)		10,000	10,000
Jan 6	Type writer account Dr To Cash Account (Being Type writer purchased)		5,000	5,000
Jan 7	Varun Account Dr To Sales Account (Being goods sold to Varun)		70,000	70,000
Jan 8	Wages Account Dr To Cash Account (Being wages paid)		10,000	10,000
Jan 9	Drawings Account Dr To Purchases Account (Being goods taken for personal use)		2,000	2,000
Jan 10	Arun Account Dr To Purchase returns A./c (Being goods returned to Arun)		1,000	1,000
Jan 11	Sales Returns Account Dr To Varun Account (Being goods returned by Varun)		1,500	1,500
Jan 12	Motar Vehicle Account Dr To T.V.S. & Co. (Being Motar Vehicle purchased on credit)		50,000	50,000

In a going concern the balances of the previous year, appearing in various accounts are brought forward at the beginning of the new accounting year by means of a journal entry known as opening entry to incorporate the previous balances in a new set of accounts. All the Assets Accounts are debited and liabilities Accounts are credited. The difference between the assets and liabilities is credited to capital account.

Illustration 5 (Opening entry)

Pass the opening entry in the books a trader.

Jan 1. 2007

Debit balances : Cash Rs.80,000, Bank Balance 2,50,000

Stock Rs.2,00,000, Furniture Rs.14,000, Buildings Rs.5,00,000, Debtors Rs.40,000

Creditors Rs.50,000, Bill payable 40,000

Solution :

Date	Particulars		L.F.	Dr. Amount Rs.	Cr. Amount Rs.
Jan 1	Cash Account	Dr		80,000	
	Bank Account	Dr		2,50,000	
	Stock Account	Dr		2,00,000	
	Furniture Account	Dr		14,000	
	Buildings Account	Dr		5,00,000	
	Debtors Account	Dr		40,000	
	To Creditors Account				50,000
	To Bills Payable Account				40,000
	To Capital Account				9,94,000
	(Balancing fig.)				
	(Being balances brought in from last year)				

Illustration - 6

Journalise the following transactions in books of M/s Rohit & Co.

Jan, 1-2007

Assets : Furniture Rs.50,000, Machinery Rs. 1,00,000,

Stock Rs.40,000, Cash Rs.5,500 Bank Rs.75,000

Liabilities : Creditors Rs.80,000

		Rs.
Jan 1	Purchased goods from Amit	45,000
Jan 3	Sold goods	15,000
Jan 5	Paid Creditors by Cheque	5,000
Jan 10	Deposited into Bank	28,000
Jan 13	Sold goods to Ramvilas	30,000
Jan 15	Paid for postage	1,000
Jan 16	Received cash from Debtors	5,000
Jan 17	Paid telephone charges	1,000
Jan18	Cash sales	15,000
Jan19	Purchased goods	20,000
Jan 20	Bought goods from Arun for cash	30,000
Jan 21	Goods returned to Amit	1,000

Jan 22	goods returned by Arun	500	
Jan 23	Travelling expenses paid	1,000	
Jan 24	Old Furniture sold (book value is Rs.6,000)	5,000	
Jan 31	Paid Salaries	10,000	
	Wages		5,000
	Rent	4,000	

In the books of M/s. Rohit & Co
Journal

Date	Particulars		L.F.	Dr. Amount Rs.	Cr. Amount Rs.
2007					
Jan 1	Furniture Account	Dr		50,000	
	Machinery Account	Dr		1,00,000	
	Stock Account	Dr		40,000	
	Cash Account	Dr		5,500	
	Bank Account	Dr		75,000	
	Debtors Account	Dr		30,000	
	To Creditors Account				80,000
	To Capital Account				2,20,500
	(Balancing figure)				
	(Being Assets and liabilities brought forward from last year)				
Jun 1	Purchases account	Dr		45,000	
	To Amit Account				45,000
	(Being goods purchased from Amit)				
Jun 3	Cash Account	Dr		15,000	
	To Sales Account				15,000
	(Being goods sold for cash)				
Jun 5	Creditors Account	Dr		5,000	
	To Bank Account				5,000
Jun 10	Bank Account	Dr		28,000	
	To Cash Account				28,000
	(Being Cash deposited into Bank)				
Jun 13	Ram vilas Account	Dr		30,000	
	To Sales Account				30,000
	(Being goods sold on Credit)				

Jun 15	Postage Account Dr		1,000	
	To Cash Account			1,000
	(Being Postage paid)			
Jun 16	Cash Account Dr		5,000	
	To Debtors Account			5,000
	(Being cash received from Debtors)			
Jun 17	Telephone charges Account Dr		1,000	
	To Cash Account			1,000
	(Being Telephone Charges paid)			
Jun 18	Cash Account Dr		15,000	
	To Sales Account			15,000
	(Being Cash Sales)			
Jun 19	Purchases Account Dr		20,000	
	To Cash Account			20,000
	(Being goods purchased)			
Jun 20	Purchases Account Dr		30,000	
	To Cash Account			30,000
	(Being goods purchased for cash)			
Jun 21	Amit Account Dr		1,0000	
	To purchase returns account			1,000
	(Being goods returned to Amit)			
June 22	Sales returns Account Dr		500	
	To Arun Account			500
	(Being goods returned by Arun)			
June 23	Travelling expenses Account Dr		1,000	
	To Cash Account			1,000
	(Being Travelling exp. paid)			
June 24	Cash Account Dr		5,000	
	Loss on sale of furniture A/c Dr		1,000	
	To Furniture Account			6,000
	(Being old furniture sold and loss incurred)			
June 31	Salaries Account Dr		10,000	
	Wages Account Dr		5,000	
	Rent Account Dr		4,000	
	To Cash Account			19,000
	(Being various expenses paid)			

2.7 Summary :

Business transactions are at first written in a book called journal. Business transactions are of two types 1) Cash transactions 2) Credit transactions. If the name of the person is given and it does not contain the word 'for cash' then it is a credit transaction. At the same time if the name of the person does not appear it is always a cash transaction. In a going concern the balances of the previous year relating to assets and liabilities brought forward into the current years books with a journal entry called opening entry.

2.8. Self Assessment Questions :

1. Write down the advantages of using a journal.
2. List out 10 Nominal accounts.
3. What are personal accounts.
4. Give the form of Journal.
5. What is narration ?
6. What are the steps to be taken for journalising.
7. What are the important points you have to bear in mind, while writing journal entries ?

2.9. Exercises :

1. **Prepare a journal for the following transactions.**

2007		Rs.
Jan 1	Introducted Capital	50,000
Jan 10	Bought goods for cash	18,000
Jan 12	Withdrew cash for personal use	5,000
Jan 15	Sold goods to Ram for cash	7,000
Jan 18	Goods taken for personal use	1,000
Jan 20	Paid Mohan his salary	2,000

2. **Journalise the following transactions.**

2007		Rs.
Jan 1	Rent Received	1,000
Jan 2	Purchased office furniture	2,000
Jan 3	Machinery installation expenses	600
Jan 4	Paid into Bank	1,500

3. **Journalise the following transactions in the books of A.**

2007		Rs.
Jan 1	Paid wages to Srinadh	3,000
Jan 2	A brought capital	1,00,000

Jan 3	Purchased Machinery	30,000
Jan 4	Paid into bank	70,000
Jan 5	Purchased furniture on credit from Z & Co	40,000
Jan 6	Paid cheque to Z	25,000

4. **Journalise the following transactions in the books of Sateesh.**

2007			Rs.
Sept. 1	Sateesh commenced business with	75.000	
Sept 2	Deposited into Bank	30,000	
Sept 5	Purchased furniture and paid by cheque	1,500	
Sept 7	Goods purchased from Sri Vidya	20,000	
Sept 9	Goods returned to Sri vidhya	400	
Sept 13	Paid to Sri vidhya in full settlement	19,500	
Sept 17	Goods sold to Prakash	500	
Sept 20	Goods distributed by way of free samples	1,000	
Sept 24	Commission received	250	
Sept 30	Paid salaries	5,000	

5. **Journalise the following transactions in the books of Rajesh.**

2007			Rs.
Mar 1	Started business with	10,000	
Mar 2	Furniture purchased paid by cheque	2,000	
Mar 3	Cash drawn from bank for personal use	500	
Mar 4	Paid to Ram lal in full settlement of his debt Rs.6,000/-	5,940	
Mar 5	Paid for stationery	200	
Mar 7	Paid salaries	2,000	

6. **Journalise the following transactions in the books of A.**

2007			Rs.
Mar 2	Paid to Satish in full settlement of his account Rs.3000	2,800	
Mar 4	Cash Purchases	2,000	
Mar 5	Cash Sales		5,000
Mar 7	Amount received from Aravind	7,000	
Mar 8	Cash with drawn from bank for personal use	1,000	
Mar 9	Stationery purchased	500	
Mar 10	Furniture purchased	5,000	
Mar 11	Wages paid		700
Mar 12	Goods sold to Rajesh	2,500	
Mar 13	Goods purchased from Akash	7,800	
Mar 15	Goods returned to Akash	150	

7. **From the following information find out the opening capital and pass opening entry.**

	Rs.
Cash in hand	1800
Stock	2,400
Bills payable	1,000
Plant and Machinery	1,000
Debtors	500
Creditors	800
Investments	2,000
Loan from X	1,500

8. **Journalise the following transactions.**

2007		Rs.
1	Interest paid on loan	750
2.	Amount received from X whose account was previously written off	5,000
3.	Interest received	2,000
4.	Purchases	1,200
5.	goods sold to Sri Ram	1,200
6.	goods purchased from Hari Ram	800
7.	Sales to Y	550
8.	goods purchased from Durga & Co for cash	750
9.	Sales to Ram Saran	600
10.	Purchases from Sai Ram	1,000
11.	Cheque Received from Y and	500
	allowed discount	50

9. **Journalise the following transactions.**

2007		Rs.
Jan 1	Commenced business with a capital	4,50,000
Jan 4	Opened current account in Bank by cheque	1,50,000
Jan 10	Cash purchases	15,000
Jan 12	goods distributed by way of samples	5,000
Jan 15	goods purchased from X	20,000
Jan 20	Paid to X in full settlement	19,000
Jan 24	Commission received	2,500
Jan 25	Withdraw from bank for office use	5,000
Jan 26	Paid commission	500
Jan 27	Paid Rent	3,000

Jan 31	Paid Salaries	2,500

10. **Journalise the following transactions in the books of a Trader. on 1-4-2007.**

Cash in hand Rs.8,000; Cash at Bank Rs.25,600/- Stock of goods Rs.20,000; Buildings Rs.14,000. Debtors Rs.8,100, Creditors Rs.18,300. Mrs Loan Rs. 10,000.

2007		Rs.
Apr. 2	Purchased goods worth	5,000
Apr. 3	Received from debtors	2,646
	Discount allowed	54
Apr. 4	Paid to Creditors	5,300
Apr. 5	Paid for Charity	100
Apr.6	Postage	200
Apr. 7	Stationery	250

11. **Journalise the following transactions.**

2007	
Aprl 1	Bought machinery for Rs. 2,40,000
Aprl 2	Installed the above machine, charges paid being Rs.3,100
Apr. 3	Withdrew cash from bank Rs.5,000 for office use.
Apr. 5	Paid salaries to staff Rs.1,700
Apr. 7	Sold goods to Shyam Rs.7,500
Apr.8	Shyam paid cash Rs.3,000 for partial settlement

12. **Pass journal entries for the following transactions.**

2007		Rs.
Sept. 1	Bought goods	10,000
Sept 2	Paid commission	200
Sept 3	Received from S, our debtor in full settlement of his account of Rs400	390
Sept 4	Cheque issued to R, our creditor	3,100
Sept 5	Bank charges	20
Sept 6	Sold goods to Ramesh	2,500
Sept 7	Sold goods	1,000
Sept 8	Purchase returns from Ramesh	100
Sept 9	Purchased Furniture	5,000
Sept 10	Paid Postage	100
Sept 11	Stationery purchased	250
Sept 12	Cash received from Ramesh	2,400

Sept 13	Cash deposited into bank	5,000
Sept 15	goods taken for personal use	500

13. Give journal entries to record the following transactions.

2007		Rs.
June 1	Misra commenced business with a capital of	2,50,000
June 1	Purchased a Motor car	1,00,000
June 2	Purchased from Amar	20,000
June 3	Sold goods	75,000
June 4	Returned goods to Amar	100
June 7	Sold goods to Badri	50,000
June 8	Badri returned	150
June 14	Purchased postage stamps	125
June 16	Paid for advertising	750
June 20	Paid office expenses	1,000
June 25	Draw cash for personal use	1,500
June 26	Cash sales	8,500
June 27	Paid insurance premium	2,900
June 30	Paid rent	6,000
June 30	Paid salaries	5,000
June 30	Electric charges	1,500
June 30	Telephone bill	2,300

2.10 SUGGESTED READINGS :

Financial Accoun tancy : Shukla Grewal
Financial Accountancy : Jain and Narang
Financial Accountancy : R.L. Gupta & V.K. Gupta

- Dr. Ch. Suravinda

Lesson-3

LEDGER

3.0 Objectives :

After going through this lesson the student can know what is a ledger ?
How different Accounts are prepared in the ledger, and How the transactions are posted into ledger Accounts from the journal and how they are balanced ? etc.

Structure :

3.1. Ledger - Introduction

3.2. Formet of Account

3.3. Posting the transactions from journal to ledger.

3.4. Balancing the ledger accounts.

3.5. Interpretation of Accounts.

3.6. Illustrations

3.7. Summary

3.8. Self Assessment Questions

3.9. Exercises

3.10 Suggested Readings

3.1. Introduction :

In the previous chapter we have seen how different transactions are recorded in the Journal. Business transactions entered in the journal in chronological order of their occurance. The transactions pertaining to a particular person, asset, expenses or income are recorded at different places in the journal as they occur on different dates. Hence journal fails to bring the similar transactions together at one place. To have a consolidated view of the similar transactions different accounts are prepared in the ledger.

Defintion : A Ledger account may be defined as a summary statement of all the transactions relating to a person, asset, expenses or income which have taken place during a given period of time and shows their net effect.

Journal is maintained only to facilitate the passing of entries in the ledger, It cannot give answers to the following questions.

1) What are the total sales to an individual ?

2) What are the total purchases from an individual ?

3) What is the amount of profit or loss made during a particular period ?

4) What is the financial position of the firm on a particular date ?

Ledger can give answers to these questions. So every entry recorded in the journal must be posted into the ledger. For ex: all cash transactions are grouped together and are recorded at one place under Cash Account in the ledger. The process of entering the transactions, which have already been recorded in to the journal, in the ledger is technically called posting.

3.2. Form of the Ledger Account :

An account is a summarised record of transactions relating to a particular person or thing. The ruling of an account is given below.

Name of Account

Dr Cr

Date	**Particulars**	**F**	**Amount**	**Date**	**Particulars**	**F.**	**Amount**
	To Name of Credit Account				By Name of Debit Account		

Each account in the ledger is divided into two equal parts by a vertical line or the account is in the form of letter 'T'. The left hand side of the account is known as debit side and the right hand side is called credit side. Each of the two sides is further divided into four columns for date, particulars, folio and amount.

The columns of the ledger Account are explained below :

1. The date of each transaction is entered in the date column.
2. The particular column is meant for indicating the name of the account that has got the other aspect of the transaction. Thus, we write on the debit side the name of the account indiciated in the credit part of the journal entry with the word 'To' before it. On the credit side the name of the account indicated in the debit part of the journal entry is written with the word 'By' before it.
3. 'F' stands for 'Folio'. The 'Folio' column is used for writing the page number of the journal in which the transaction has been originally recorded.
4. The amount of the transaction is shown in the amount column. This can be understood by the followng illustration.

Illustration I :

2007 April 1 goods sold for cash Rs.25,000.

Journal Entry

Date	Particulars	L.F.	Dr. Amount Rs.	Cr. Amount Rs.
2007 Aprl	Cash Account Dr To Sales Account (Being goods sold for cash)		25,000	25,000

Posting is as follows :

Ledger

Dr **Cash Account** Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007 Apr.	To Sales Account		25,000				

Dr **Sales Account** Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
				2007 Apr.	By Cash Account		25,000

From the above we see that while posting from the Journal, the Debit account is debited and credit account is credited and the entry in each account indicates the account in which the corresponding Credit and Debit appears.

3.4. Balancing of Ledger Account :

For the purpose of preparation of the final accounts various ledger accounts should be balanced. Balance is the difference between the total debits and the total credits of an account. After finding out the balance it is written on the side showing the smaller total so as to make the totals of the two sides equal. This is called the ‘Balancing’ of an account. Balancing is done periodically. It may be daily, weekly, fortnightly, monthly, Quarterly or yearly when it is required.

The procedure of balancing accounts is as follows :

1. Take the totals of the two side of the account concerned.
2. Ascertain the difference between the totals of two sides.
3. Enter the difference in the amout column of the side showing less total, writing against

the difference in the particulars column " To Balance", c/d means carried down, on the debit side of the account and "By Balance c/d on the cedit side of the account. Now both sides will have the same total.

4. Write the date of balancing in the date column.
5. After entering the balance in the relevant amount column, write the total of each side. The total must be written on the same horizontal line. Draw one line above each total and two lines below the total.
6. The balance thus, entered is known as the closing balance.
7. This closing balance is now brought down and written below the total on the side having the bigger total by writing to Balance b/d or By Balance b/d.
8. Sometimes, the balance of an acount may be nil that means the totals of both sides are the same. In such cases we will only enter the totals on both sides of the account.

3.5. Interpretation of ledger Accounts :

1. **Personal accounts :** These are more frequently balanced than others so as to know the amounts owed and owing. when the account of a person shows a debit balance, it indicates that he is a debtor. If the account of a person shows a credit balance, it means that he is a creditor.
2. **Real Accounts :** Real accounts are normally balanced at the end of each accounting period i.e; before preparing the final accounts. They generally show a debit balance and are Asset accounts.
3. **Nominal Accounts :** When nominal accounts are balanced debit balances indicate expenses or losses and credit balances indicates incomes and gains. At the end of the year each and every nominal account is closed by transfering to profit and loss Account.

3.6.Illustration 2 :

Journalise the following transactions post them into the ledger and balance the accounts.

2007		
Jan 1	Balu commenced business with cash	2,00,000
Jan 2	Parchased furniture for cash from R.C Broses	20,000
Jan 2	Purchased goods from Perumal	25,000
Jan 3	Sold goods for cash	15,000
Jan 4	Paid rent	5,000
Jan 6	Sold goods to Srinivas	10,000
Jan7	Srinivas returned goods	1,000
Jan 10	Bought goods from Dayakar	40,000
Jan 11	Returned goods to Dayakar	1,500
Jan 14	Paid for Stationery	2,500
	Advertisement	3,000
	Postage	500

Jan 17	Drew for personal use	2,000	
Jan 20	Cash sales	10,000	
Jan 21	Received from Srinivas	8,000	
Jan 22	Paid to Dayakar	20,000	
Jan 24	Sold goods to Sirisha	15,000	
Jan 28	Cash sales	45,000	
Jan 31	Paid salaries	12,000	
Jan 31	Paid Municipal taxes	1,000	
Jan 31	Goods taken for personal use	1,000	
Jan 31	Paid for printing	1,500	
Jan 31	Wages paid		3,000
Jan 31	Paid Electric Charges	2,200	

Date	Particulars		L.F.	Dr. Amount Rs.	Cr. Amount Rs.
2007 Jan 1	Cash Account To capital Account (Being Capital brought into business)	Dr		2,00,000	200,000
Jan 2	Furniture Account To Cash Account (Being furniture purchased for cash)	Dr		20,000	20,000
Jan 2	Purchases Account To Perumal Account (Being goods Purchased on credit from perumal)	Dr		25,000	25,000
Jan 3	Cash Account To sales Account (Being goods sold for cash)	Dr		15,000	15,000
Jan 4	Rent Account To cash Account (Being rent paid)	Dr		5,000	5,000
2007 Jan 6	Srinivas Account To sales Account (Being goods solds on Credit)	Dr		10,000	10,000

Jan 7	Sales Ruturns Account Dr		1000
	To Srinivas Account		1000
	(Being goods returned by Srinivas)		
Jan 10	Purchases Account Dr		40,000
	To Dayakar Account		40,000
	(Being goods Purchased from Dakayar on cridit)		
Jan 11	Dayakar Account Dr		1500
	To Purchase returns Account		1500
	(Being goods returned to Dayakar)		
Jan 14	Stationery Account Dr		25,000
	Advertisement Account Dr		3,000
	Postage Account Dr		500
	To cash Account		6,000
	(Being expencses paid)		

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Date	Particulars	L.F.	Dr. Amount Rs.	Cr. Amount Rs.
Jan 17	Drawings Account Dr		2000	
	To cash Account			2000
	(Being Cash drawn for personal use)			
	Cash Account Dr		10,000	
Jan 20	To sales Account			10,000
	(Being Cash Sales)			
Jan 21	Cash Account Dr		8000	
	To Srinivas Account			8000
	(Being cash received from Srinivas)			
Jan 22	Dayakar Account Dr		20,000	
	To Cash Account			20,000
	(Being Cash paid to Dayakar)			
Jan 24	Sirisha Account Dr		45000	
	To Sales Account			15000
	(Being goods Sold for Cash)			
Jan 28	Cash Account Dr		45,000	
	To sales Account			45,000
	(Being goods sold on credit)			

Jan 31	Salaries Account	Dr	12,000	
	To cash Account			12,000
	(Being salaries paid)			
Jan 31	Municipal taxes Account	Dr	1000	
	To cash Account			1000
	(Being Municipal taxes paid)			
Jan 31	Drawings Account	Dr	1000	
	To purchases Account			1000
	(Being goods taken for personal use)			
2007	Printing Account	Dr	1,500	
Jan 31	Wages Account	Dr	3,000	
	Electric Charges Account	Dr	2,200	
	To cash Account			6,700
	(Being various expenses Paid)			

LEDGER

Dr. **Cash Account** Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007							
Jan 1	To Capital A/c		2,00,000	Jan 2	By Furniture A/c		20,000
Jan 3	To Sales A/c		15,000	Jan 4	By Rent A/c		5,000
Jan 20	To Sales A/c		10,000	Jan14	By Stationery A/c		2,500
Jan 21	To Srinivas A/c		8,000	"	By Advertisement A/c		3,000
Jan 28	To Sales A/c		15,000	"	By Postage A/c		500
				Jan 17	By Drawings A/c		2,000
				Jan 22	By Dayakar A/c		20,000
				Jan 31	By Salaries A/c		12,000
				"	By Municipal taxes A/c		1,000
				"	By Printing A/c		1,500
					By Wages A/c		3,000
					By Electric charges A/c		
2,200							
					By Balance c/ld		1,75,300
			2,48,000				2,48,000
Feb 1	To Balance b/d		1,75,300				

Dr. Capital A/C Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
				2007 Jan 1	By Cash A/c		2,00,000

Dr. Furniture A/C Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007 Jan2	To Cash A/c		20,000				

Dr. Purchases A/C Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007 Jan2	To Perumal A/c		25,000	2007 Jan 31	By Drawings		1,000
Jan 10	To Dayakar A/C		40,000	Jan 31	By Balance c/d		64,000
			65,000				**65,000**
Fe 1	To Bal b/d		64,000				

Dr. Perumal A/C Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007 Jan 31	To Balance c/d		25,000	2007 Jan 2	By Purchases A/c		25,000
			25,000				**25,000**
				Feb 1	By Balance b/d		25,000

Dr. **Sales A/C** Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 31	To Balance c/d		95,000	Jan 3	By Cash A/c		15,000
				Jan 6	By Srinivas A/c		10,000
				Jan 20	By Cash A/c		10,000
				Jan 24	By Sirisha A/c		15,000
				Jan 28	By Cash A/c		45,000
			95,000				**95,000**
				Feb 1	By Balance b/d		95,000

Dr. **Rent A/C** Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 4	To Cash A/c		5,000	Jan 31	By Balance c/d		5,000
			5,000				**5,000**
Feb 1	To Balance b/d		5,000				

Dr. **Srinivas A/C** Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 6	To Sales A/c		10,000	Jan 7	By Sales Returns		1,000
				Jan 21	By Cash A/c		8,000
				Jan 31	By Balance c/d		1,000
			10,000				**10,000**
Feb 1	To Balance b/d		1,000				

Dr. Sales Returns A/C Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 7	To Srinivas		1,000	Jan 31	By Balance c/d		1,000
			1,000				**1,000**
Jan 31	To Balance b/d		1,000				

Dr. Dayakar A/C Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 11	To Purchase returns		1,500	Jan 10	By Purchases		40,000
Jan 22	To Cash A/c		20,000				
Jan 31	To Balance c/d		18,500				
			40,000				**40,000**
				Feb1	By Balance b/d		18,500

Dr. Purchase Returns A/C Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 31	To Balance c/d		1,500	Jan 11	By Dayakar		1,500
			1,500				**1,500**
				Feb 1	By Balance b/d		1,500

Dr. Stationery A/C Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 14	To Cash A/c		2,500	Jan 31	By Balance c/d		2,500
			2,500				**2,500**
Feb 1	To Balance b/d		2,500				

Dr. **Advertisement A/C** **Cr**

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 14	To Cash A.c		3,000	Jan 31	By Balance c/d		3,000
			3,000				**3,000**
Feb 1	To Balance b/d		3,000				

Dr. **Postage A/C** **Cr**

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 14	To Cash A/c		500	Jan 31	By Balnce c/d		500
			500				**500**
Feb 1	To Balanceb/d		500				

Dr. **Drawings A/C** **Cr**

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 17	To Cash A/c		2,000	Jan 31	By Balance c/d		3,000
Jan 31	To Purchases a/c		1,000				
			3,000				**3,000**
Feb 1	To Balance b/d		3,000				

Dr. **Sirisha A/C** **Cr**

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 24	To sales A/c		15,000	Jan 31	By Balnce c/d		15,000
			15,000				**15,000**
Feb 1	To Balance b/d		15,000				

Dr. Salaries A/C Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 31	To Cash		12,000	Jan 31	By Balance c/d		12,000
			12,000				**12,000**
Feb 1	To Balance b/d						

Dr. Muncipal Taxes A/C Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 31	To Cash		1,000	Jan 31	By Balnace c/d		1,000
			1,000				**1,000**
Feb 1	To Balance b/d		1,000				

Dr. Printing A/C Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 31	To Cash A/c		1,500	Jan 31	By Balance c/d		1,500
			1,500				**1,500**
Feb 1	To Balance b/d		1,500				

Dr. Wages A/C Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 31	To Cash A/c		3,000	Jan 31	By Balance c/d		3,000
			3,000				**3,000**
Feb 1	To Balance b/d		3,000				

Dr. Electric Charges A/C Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 31	To Cash A/c		2,200	Jan 31	By Balance c/d		2,200
			2,200				**2,200**
Feb 1	To Balance b/d		2,200				

3.7 Summary :

After journalising the transactions relating to a particular account are brought together and recorded at one place in another book called the 'ledger' the process of entering the transactions in the ledger is technically called posting. The two aspects of every transaction have to be posted to the respective accounts in the ledger.

3.8. Questions :

1. What is a ledger ?
2. What is balance ?
3. Write a note on ledger posting with an example ?
4. Write the procedure followed for balancing an account with an example ?
5. Give form of the ledger Account.

3.9 Exercises :

1. **Journalise the following transactions, post them into ledger ascertain the balances.**

2007		Rs
Mar 1	Vishal started business with	80,000
Mar 4	Paid into Bank	25,000
Mar 7	Purchased goods for cash	10,000
Mar 9	Purchased goods from Ramana	8,000
Mar 11	goods sold for cash	16,000
Mar 14	goods returned to Ramana	500
Mar 19	Purchased furniture and paid by cheque	750
Mar 21	goods sold to Raja	1,000
Mar 23	goods returned by Raja	400
Mar 25	Paid wages	100
Mar 27	with drew from bank	2,000
Mar 28	Paid discount	1,000
Mar 31	Paid salaries	5,000
Mar 31	commission received	6,000

2. **Journalise the following transactions, post them into the ledger and balance the accounts.**

2007		Rs
Jan 1	Saroja commence business with20,000	
Jan 2	Purchased furniture for cash	4,000
Jan 2	Purchased goods for cash	1,800
Jan 4	Paid rent	1,500
Jan 6	Sold goods to	1,500
Jan 7	C retuned goods	175

Jan 10	Brought goods from D	5,000
Jan 11	Returned goods to D	200
Jan 14	Paid for advertising	350
Jan 15	Paid for stationery	150
Jan 17	Drew for personal use	500
Jan 20	cash sales	16,000
Jan 21	Received from C	525
Jan 23	Paid to B	3,000
Jan 24	Sold goods to E	3,500
Jan 28	Cash sales	2,000
Jan 31	Paid salaries	2,000
Jan 31	Paid Municipal taxes	300

3. **Journalise the following transactions, post them into the ledger and balance the accounts.**

2007			Rs
Jan 1		Nageswara Rao commenced	
	business with cash		40,000
Jan 2		Purchased furniture for	
	Cash from A & Co		11,000
Jan 3		Sold goods for cash	6,000
Jan 4		Paid rent	3,000
Jan 4		Sold goods to C	12,500
Jan 7		C returned goods	100
Jan 10	Bought goods from D		17,500
Jan 11	Returned goods to D		150
Jan 14	Paid for Advertising		750
Jan 15	Paid for stationary		2,000
Jan 17	Drew for personal use		1,500
Jan 20	Cash sales		2,500
Jan 21	Received from C in full settlement of his account		12,000
Jan 23	Paid to B		2,500
Jan 24	Sold goods to E		5,000
Jan 28	Cash sales		2,000
Jan 31	Paid salaries		2,000
Jan 31	Paid Municipal taxes		250
Jan 31	Paid printing charges		500

4. **Give journal entries to record the following transactions.**

2007		Rs
June1	Madhuri commenced business with cash	2,50,000

June1	Purchased a Motar truck	100,000
June2	Purchased goods from Gopal	30,000
June3	Sold goods	2,000
June4	Returned goods to Amar	1,000
June7	sold goods to chandra	3,500
June8	Chandra returned goods	150
June11	Cash purchases	6,000
June14	Purchased postage stamps	100
June16	Paid for advertising	1,000
June 20	Paid office expenses	400
June 25	Drew cash for personal use	2,000
June 26	Cash sales	1,800
June 27	Paid insurance premium	250
June 30	Paid rent	2,000
June 30	Paid salaries	7,000

3. **Journlise the following transactions post them into the ledger and balance the accounts.**

2007		Rs.
Sep 1	Manohar started business with	2,50,000
Sep 1	Brought Machinery	1,00,000
Sep 2	Brought furniture from	15,000
Sep 3	Purchased goods	15,500
Sep 7	Paid wages	3,000
Sep 9	Brought packing materials	15,500
Sep 10	Cash sales	4,000
Sep 11	Credit sales to krishna	7,000
Sep 14	Paid wages	1,500
Sep 15	Purchased goods from Ram	15,000
Sep 16	Returned goods to Ram	250
Sep 20	Purchased stationery	1,000
Sep 21	Brought postage stamps	350
Sep 23	Paid for repairs	400
Sep 24	Paid miscellaneous expenses	250
Sep 27	Paid printing charges	300
Sep 30	Paid Salaries	7,500
Sep 30	Paid to X	8,000

3.10 SUGGESTED READINGS :

Financial Accountancy : Shukla Grewal

Financial Accountancy : Jain and Narang

Financial Accountancy : R.L. Gupta & V.K. Gupta

- Dr. Ch. Suravinda

LESSON - 4

SUBSIDIARY BOOKS

4.0. Objectives :

After going through the lesson the student can identify various types of subsidiary books, Advantages of subsidiary books, recording of transactions in these books and their posting into the ledger.

Structure :

4.1. Subsidiary Books Introduction

It has already been explained in an earlier chapter that journal is the book of prime entry. It means all business transactions are to be first recorded in the journal. In case of big business concerns, where the number of transactions are large in number, it is very inconvenient and cause delay in collecting any information required. To avoid the laborious task of recording transactions first in the journal and later posting them into ledger, an other method of recording the transactions in subsidiary books have been introduced which is also known as British system or practical system.

4.2. Advantages of subsidiary books :

The following are the advantages of subsidiary books :

1. **Convenience :** As stated above maintenance of one journal will make it quite bulky and difficult to handle. Sub-division of journal will result in reducing the size of journal and make it convenient to handle.
2. **Division of labour :** Sub division of journal helps in division of labour since different persons can write different journals.
3. **Classified information :** Each journal provides information relating to a particular aspect of the business. For example, purchases book gives information about the total credit purchases, sales book gives information about the total credit sales etc.
4. It would make easier the job of posting in the ledger, as the posting can be made in the form of totals once a month.
5. Additional information can be collected while maintaining a subsidiary book. For example, sales book can collect the information relating to the sales of different areas or of different sales man.

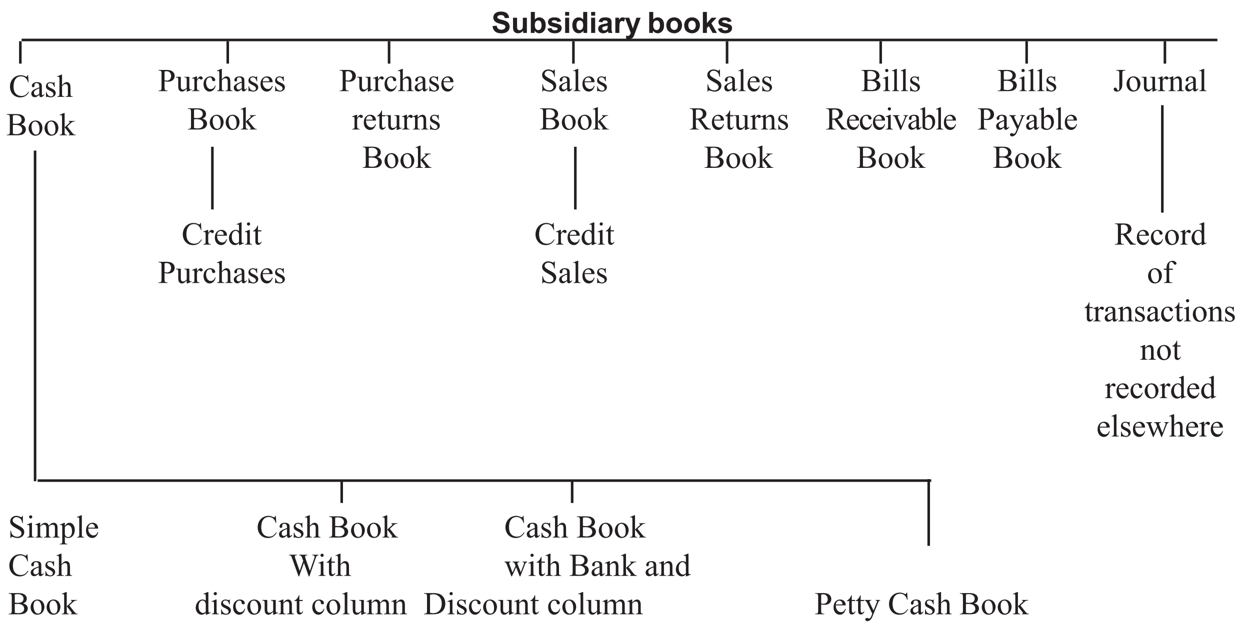
6. When the work is divided among the accounting staff and one person is required to do that work again and again, he becomes specialist of that work and his efficiency also increases.
7. The existence of separate books helps location of errors, detection of frauds in case the trial balance does not agree.

4.3. Classification of subsidiary books :

The classification of various subsidiary books and the types of transactions to be recorded in these books are as follows

1. **Cash book :** This book deals with the transactions relating to the receipts and payments of cash. It shows cash in hand and at Bank.
2. **Purchases book :** The book is meant for recording all transactions of credit purchases of goods, It shows the total credit purchases of goods and materials made during a particular period.
3. **Sales Book :** The book is maintained to record all credit sales made is and will show total credit sales during a particular period.
4. **Purchase returns book :** This book is also known as returns outwards book. This book records all returns of goods previously purchased and will show total purchase returns during a particular period and also to a particular supplier.
5. **Sales Returns book :** It is also known as returns inwards book. This book is maintained to record all sales returns made by the customers and will shows the total returns inwards during a particular period.
6. **Bill Receivable Book :** This book is maintained to record all bills received from the customers during a particular period. It will also tell the various dates on which payments are to be received by the business.
7. **Bills payable Books :** This book records all acceptances made by the firm and will indicate the various dates on which payments of various bills are to be made.
8. **Journal proper :** All these transactions which could not be recorded in any of the above subsidiary books it will be recorded in this book.

A line chart of subsidiary books is as follow :



In this lesson we will deal with all types of subsidiary books except cash book, which will be dealt in the next lesson.

4.4.Purchases book :

This book is kept to record all credit purchases of goods for resale. Cash purchases of goods are entered in the cash book so these are not entered in the purchases book. This book is also known as invoice book. The ruling of purchases book is as follows

Purchases Book

Date	Particulars	Invoice No.	L.F.	Details Rs.	Amount Rs.

In Date column, the date of the transaction is entered.

In particulars column the name of the party and particulars of the goods purchased are written.

In details column particulars regarding trade discount is written. At this stage the student must learn what is trade discount.

Trade Discount : Trade discount is the deduction allowed by the manufacturer to the whole saler or by the wholesaler to the retailer on the value of list price of the goods to enable the seller to make a profit by selling the goods at list price. There will be no entry for trade discount any where in books as it is merely a means of calculating the net selling price of the goods.

Illustration 1;

Write up purchases Book from the following transactions and post them into the ledger.

2007		Rs.
June 1	Bought goods for cash	4,000
June 4	Purchased goods from Vinayak Rs.10,000 less 10% trade discount	
June 11	Purchased goods from Siva & Co.	12,000
June 15	Purchased goods from Kesave for Rs.25,000 less 5% trade discount	
June 18	Purchased goods from Indira for cash	15,000
June 23	Purchased goods from Chandra	12,000

June 28	Bought goods from Amar subject to a trade discount of 10%	35,000
June 30	Purchased goods	10,000

Purchases Book

Date	Particulars	L.F.	Dr. Details Rs.	Cr. Amount Rs.
June 4	Vinayak, goods purchased		10,000	
	Less : Trade discount @ 10%		1,000	9,000
June 11	Siva & Co, goods purchased			12,000
June 15	Kesav goods purchased		25,000	
	Less : Trade discount @ 5%		1,250	23,750
June 23	Chandra, goods purchased			12,000
June 28	Amar, goods purchased		35,000	
	Less : Traded discount @ 10%		3,500	31,500
	Purchases account Dr			88,250

Ledger

Dr **Vinayak Account** Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
June 30	To Balance c/d		9,000	June 4	By purchases a/c.		9,000
			9,000				**9,000**
				July 1	By Balance b/d		9,000

Dr **Siva Account** Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
June 30	To Balanced c/d		12,000	June 11	By purchases a/c.		12,000
			12,000				**12,000**
July 1	By Balance b/d		12,000				

Dr **Kesav Account** **Cr**

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
June 30	To Balanced c/d		23,750	June 15	By purchases a/c.		23,750
			23,750				**23,750**
July 1	By Balance b/d		23,750				

Dr **Chandra Account** **Cr**

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
June 30	To Balanced c/d		12,000	June 23	By purchases a/c.		12,000
			12,000				**12,000**
July 1	By Balance b/d		12,000				

Dr **Amar Account** **Cr**

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
June 30	To Balanced c/d		31,500	June 28	By purchases a/c	.	31,500
			31,500				**31,500**
July 1	By Balance b/d		31,500				

Dr **Purchases Account** **Cr**

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
June 30	To Cash A/c		4,000	June 30	By Balance c/d		1,29,250
	To Cash A/c		15,000				
	To Chandra A/c		12,000				
	To Amar A/c		10,000				
	To Amount as per purchase book		88,250				
			1,29,250				**1,29,250**

Dr **Cash Account** **Cr**

Date	**Particulars**	**F**	**Amount Rs.**	**Date**	**Particulars**	**F.**	**Amount Rs.**
2007				2007			
				June 1	By purchases A/c		4,000
				June 18	By purhcases A/c		15,000
				June 30	By purchases A/c		10,000

Note : Cash Account can not be balanced because the information regarding other items is not available.

4.5. Sales books :

This book is used for recording only the credit sales of goods in which its business man deals. This is also called as sales day book. The ruling of the sales book is as follows :

Sales book

Date	Particulars	Outward invoice Number	L.F.	Details Rs.	Amount Rs.

Recording in the sales books :

The entries in the sales Journal are made in the following manner.

1. **Date column :** The date of credit sale is recorded.
2. **Particulars column :** The name and address of the customer to whom goods are sold on credit are recorded.
3. **Outword invoice number column :** The number of outward invoice is to be entered in this column.
4. **L.F.:**In L.F. column the page number of the customers account in the ledger is entered
5. **Account column :** In the amount column the amount actually receivable by the businss man i.e. catalogue price minus trade discount should be entered.

Illustration 2

Enter the following transactions in the sales book of a trader and post into ledger.

2007

April 1	Sold good to Harsha & Co for Rs.30,000. Trade discount @10%	
April 3	Sold goods to Preethi & Co for cash	Rs.50,000
April 5	Sold goods for Rs.15,000	
April 8	Sold goods to Pranya for @ 10% trade discount	Rs.50,000
April 7	sold goods to Jagan for Rs.40,000 @ 7.5% trade discount	

Sales Book

Date	Particulars	atward Invoice No.	L.F.	Details Rs.	Amount Rs.
2007					
April 1	Harsha & Co, sale of goods on credit			30,000	
	Less : Trade discount @ 10%			3,000	27,000
April 7	Pranya, sale of goods on credit			50,000	
	Less : Trade discount @ 10%			5,000	45,000
April 7	Jagan, Sale of goods on credit			40,000	
	Less : Trade discount @ 7.5%			3,000	37,000
	Sales Account Cr				1,09,000

Ledger

Dr **Harsha & Co Account** Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
April 1	To Sales A/c		27,000				

Dr **Pranya Account** Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
April 7	To Sales A/c	45,000					

Dr **Jagan Account** Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007							
April 7	To Sales A/c		37,000				

Dr **Sales Account** Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
April 7	To Balance c/d		1,74,000	Aprl 3	By cash A/.c		50,000
				Aprl 5	By cash A/c		15,000
				Aprl 7	By sundries as per sales book		109,000
			1,74,000				1,74,000
				Apr. 8	By Balance b/d		1,74,000

Dr **Cash Account** Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Aprl 3	To Sales		50,000				
Aprl 6	To Sales		15,000				

4.6. Purchase returns Book :

The purchase returns book is used for recording the returns of goods to suppliers. It is also used to record allowances for damages claimed in respect of goods purchased. In any business it may become necessary to return the goods purchased, partly or fully. The reason may be that the goods are defective, or damaged in transit. The business man may, therefore, return them to the supplier.

When goods are returned to a supplier a statement called 'Debit Note' is sent to him. It informs him that his account is debited to the extent of the value of goods returned.

The ruling of the purchase returns book is as follows.

Format of purchase Returns Book

Date	Particulars	Debit Note Numbers	L.F.	Details	Amount Rs.

Recording in the purchase return book :

1. **Date column :** The day on which the goods are returned is entered in the Date column.
2. **Particulars :** The name and address of the supplier to whom goods are returned is entered in the particulars column.
3. **Debit Note number :** The serial number of Debit Note is to be entered in this column.
4. **L.F. column :** The ledger page number of the supplier's account is entered in L.F. column.
5. **Details column :** Any information may be recorded.
6. **Amount column :** The net value of the goods returned is entered in this column.

4.7. Sales Returns Book :

The sales returns book is used for recording goods returned by the customers. This is also called returns inward book as goods are coming in.

When a customer returns goods a credit note is prepared and sent to the customer. It has the name and address of the customer, description of the goods received which are returned by the customer etc. It informs the customer that his account is credited to the extent of the value of goods returned to him. The credit note is the basis for recording in the sales returns book. Credit notes are consecutively numbered and their copies filed.

The ruling of the sales returns book is as follows.

Sales Returns Book

Date	Particulars	Debit Note Numbers	L.F.	Details	Amount Rs.

Recording in the sales returns books :

Date column : Enter the date of the credit note in the Date column.

Particulars : Name and address of the customer who has returned goods is entered in this column.

Credit Notes Numbers : Credit note number in this column.

LF column : The ledger page number of the customer's in the L.F. column.

Amount column : Net value of goods returned is entered in this column.

Illustration 3 :

Enter the following transactions of Gopi Krishna & Co in proper books.

2007	
Jan 1	Purchased on credit from Guntur digitals
Jan 12	Water heaters @ Rs.4,000 each
Jan 10	Ceiling Fans @ Rs1,000 each
Jan 15	Room coolers @ Rs.3,500 each
	Trade discount @10%
Jan 5	Sold on credit to Ajay Enterprises
Jan 6	Water heater @ Rs. 5,000 each
Jan 5	Ceiling Fans @ Rs. 1,200 each
Jan 5	Room coolers @ Rs.4,000 each
Jan 7	Retruned to Guntur digitals 2 water heaters and 1 Room cooler as defective.
Jan 10	Ajay Enterprises returned 1 ceiling Fan
Jan 11	Returned the same to Guntur digitals.
Jan 14	Purchased from Vijay Electronics on credit 20 T.V. stabilizers @ 1,500 each less 20% trade discount.
Jan 19	Sold to Mahaveer Electronics 10 stabilisers @ 600 less 10% discount
Jan 20	Sold one stabiliser @ Rs.600/-
Jan 22	Purchased on credit 20 Fans from Usha Enterprises @ Rs.1,200 each less 20% discount.
Jan 26	Sold to Murthy & Sons on credit 15 Fans @ Rs.1,400 each less 10% discount.
Jan 30	Murthy & Sons returned one fan as defective which in turn returned to Usha Enterprises.

Solution :

GOPI KRISHNA & CO BOOKS.

Dr. **Purchases Book** **Cr.**

Date	Particulars	L.F.	Details Amount Rs.	Amount Rs.
2007				
Jan1	Guntur Digitals, goods purchased			
	12 water heaters @ Rs.4,000 each			48,000
	10 ceiling Fans @ Rs.1,000 each		10,000	
	15 room coolers @ Rs.3,500 each			52,500
			1,10,500	
	Less : Trade discount @ 10%		11,050	99,450

Date	Particulars	L.F.	Details Amount Rs.	Amount Rs.
Jan 14	Vijay Electronics good purchases			
	20 T.V. stabilizers @ 1,500		30,000	
	Less : Trade discount @ 20%		6,000	24,000
Jan 22	Usha Enterprises goods		24,000	
	20 Fans @ Rs.1,200 each		24,000	
	Less : Trade discount @ 20%		4,800	19,200
Jan 31	Total purchases acccount Dr			1,42,650

Dr. **Sales Book** **Cr.**

Date	Particulars	L.F.	Details Amount Rs.	Amount Rs.
2007				
Jan 1	Ajay Enterprises, goods sold			
	6 water heaters @ Rs. 5,000 each			30,000
	5 ceiling fans @ Rs.1,200 each		6,000	
	Room coolers @ Rs.4,000 each		20,000	
				56,000
Jan 19	Mahaveer Electronics, goods sold			
	10 stabilisers @ Rs.600		6000	
	Less : Trade discount @ 10%		600	5,400
Jan 26	Murthy & sons, good sold			
	15 Fans @ Rs.1,400 each		21,000	
	Less : Trade discount @ 10%		2100	18,900
Jan 31	Total sales Account Cr			80,300

Dr. **Purchase Returns Book** **Cr.**

Date	Particulars	L.F.	Details Amount Rs.	Amount Rs.
2007				
Jan 7	Guntur Digitals			
	1 Room cooler @ Rs.3,500 each		3,500	
	Less : Trade discount @ 10%		350	3,150
Jan 11	Guntur Digitals			
	1 ceiling Fan @ Rs.1,000 each		1,000	
	Less : Trade discoung @ 10%		100	900

Jan 30	Usha Enterprises			
	1 Fan @ Rs.1200 each		1,200	
Jan 31	Less : Trade discount @ 10%		120	1,080
	Total purchse returns book cr.			5,230

Dr. **Sales Return book** **Cr.**

Date	Particulars	L.F.	Details Amount Rs.	Amount Rs.
2007				
Jan 19	Ajay Enterprises			
	1 ceiling Fan @ Rs.1,200			1,200
Jan 30	Murthy & Sons			
	1 Fan @ Rs.1,400		1,400	
	Less : Trade discount @ 10%		140	1,260
Jan 31	Total sale return account Dr			2,460

Dr. **Guntur Digital Account** **Cr.**

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 7	To purchase Return A/c		3,150	Jan 1	By Purchase A/c		99,450
Jan 11	To Purchase's Return A/c		900				
Jan 31	To Balance c/d		95,400				
			99,450				**99,450**
				Feb 1	By Balance b/d		95,400

Dr. **Vijay Electronics Account** **Cr.**

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
	To Balance c/d		24,000	Jan 14	By purchase a/c		24,000
			24,000				**24,000**
				Feb 1	By Balance b/d		24,000

Dr. Usha Enterprises Account Cr.

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 30	To purchase Returns A/c		1,080	Jan 22	By Purchases A/c		19,200
Jan 31	To Balance c/d		18,120				
			19,200				19,200
				Feb 1	By Balanceb/d		18,120

Dr. Purchases Account Cr.

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 31	To Amount as per purchase's book		1,42,650	Jun 31	By balance c/d		1,42,650
			1,42,650				1,42,650
Feb 1	To Balance b/d		1,42,650				

Dr. Ajay Enterprises Account Cr.

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 1	To Sales A/c		56,000	Jan 10	By Sales returns a/c		
1,200							
				Jan 31	By Balance c/d		54,800
			56,000				**56,000**
Feb 1	To Balance b/d		54,899				

Dr. Mahaveer Electronics Account Cr.

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 19	To Sales A/c		5,400	Jan 31	By Balancec/d		5,400
Feb 1	To Balance b/d		**5,400**				**5,400**

Dr. Murthy & Sons Account Cr

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 26	To Sales A/c		18,900	Jan 30	By Sales Returns A/c		1,260
				Jan 31	By Balance c/d		17,640
			18,900				**18,900**
Feb 1	To Balance b/d		17,640				

Dr. Sales Account Cr.

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 31	To Balance c/d		80,300	Jan 31	By amount as per sales Book		80,300
			80,300				**80,300**
				Feb 1	By Balance c/d		80,300

Dr. Purchases Returns Account Cr.

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 31	To Balance c/d		5,230	Jan 31	By Amount as per purchase returns book		5,230
			5,230				**5,230**
				Feb 1	By Balance b/d	5,230	

Dr. Sales Returns Account Cr.

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 31	To Amount as per sales returns book		2,460	Jan 31	By Balance c/d		2,460
			2,460				**2,460**
Feb1	To Balance b/d		2,460				

In addition to these four books if in any concern, the number of transactions relating to bills receivable and Bills payable are numerous in number then separate books for recording these transactions can be opened in the books. The ruling for these books also the same.

4.8 Journal proper :

In addition to these subsidiary books, as in the case of the previous four books. The original journal now called “Journal proper” is also used to record all other transactions which can not be recorded in any of the afore said books. The Journal proper is similar to the journal in ruling and form.

4.8.1 Types of transactions recorded in Journal Proper :

The following types of transactions are usually recorded through journal proper.

1. Opening entries.
2. Closing entries.
3. Adjustment entries.
4. Rectification entries.
5. Transfer entries.
6. Other entries.

4.9 Summary :

Journal is the book of prime entry in which all transactions are recorded. But when the transactions are numerousm it is impossible to record all the transactions in one journal. Hence the need for special journal for recording the transactions which are numerous in number araised. These books are known as subsidiary books. Purchases book and sales books are meant for recording only credit transactions of purchases and sales respectively.

All transactions which cannot be recorded in any of the special books are recorded in a journal known as journal proper.

4.10. Questions :

1. What is the need for special journals ?
2. What do you understand by subsidiary books ?
3. What are the advantages of subsidiary books ?
4. What is a journal proper ?
5. Name various types of subsidiary books and explain the method of recording of transactions there in along with the method of posting.
6. State the types of transactions that are recorded through the journal proper.
7. What is journal proper? Explain its uses in accountancy.

4.11. Exercises :

1. **Record the following transactions in the purchases journal of M/s Soni & co and show the ledger posting.**

2007		Rs.
Jan 2	Purchased goods from Chinku	4,000
Jan 3	Brought goods from Reni	5,400
Jan 4	Purchased from Santi	3,500

Jan 5	Brought goods from chinku with trade discount of 10%	2,000
Jan 6	Purchased from Sai goods subject to a discount of 20%	5,000
Jan 7	Venugopal sold us goods	1,800

2. **Enter the following transactions in the sales Book of Yashodara. Traders.**

2007

Apr 1	Sold 200 quintals of super fine rice @ Rs 1700 per quintal to A.P.Rice dealers with 10% discount.
Apr 3	Sold 500 quintals of Coarse rice @ Rs 1500 per quintal to super price shop at a discount of 5%
Apr 5	Sold 750 quintals of fine rice at the rate of 1600 per quintal to Gayatri Rice store at 7.5% discount

3. **Enter the following transactions of Narayana & Co in proper books.**

2007

Mar 1	Purchased on Credit from Guntur digitals Ltd. 55 water heaters @ 3,500 each 35 Electric stoves @ 500 each. 50 Electric Irons @ 600 each. Trade discount 20%
Mar 5	Sold on Credit to Joginder Singh & Sons. 45 water heaters @ 4000 each 30 Electric stoves @ 600 each. 42 Electric Irons @ 700 each. Trade discount 10%
Mar 7	Returned to Guntur Digitals, water heater and 1 Electric iron as defective
Mar 10	Joginder Singh & Sons returned two Electric Irons as defective
Mar 11	Returned the same Irons to Guntur digitals
Mar 12	Purchased from V. Guard, 50 stabilisers @ Rs 750 each less 15% discount.
Mar 18	Sold to Raj Electricals 10 stabilisers @ Rs 1000 each less 10% discount.
Mar 19	Sold two stabilisers for cash Rs 800 each
Mar 22	Purchased on credit 25 pedestal fans from Usha Co @ 1500 each less 20% discount.
Mar 26	Sold Siri & Co 5 pedestal fans @ Rs 1750/- at 10% discount

4. **Enter the following transactions in the proper books.**

2007

Apr 1	Purchased on credit from Bombay dying 1000 meters of shifting cloth @ 125 per metre. 1000 meters of pant cloth @ 250 per metre.
Apr 5	Purchased on credit from DCM Ltd. . 5000 meters of curtain cloth @ Rs 100 per metre.
Apr 10	Purchased on credit from Vimal textiles 1000 sarees @ Rs 500 per sarees 2,500 Meters of dressing material @ Rs 125/- Per metre.
Apr 15	Purchase on credit from Garden vareli 500 sarees @ Rs 350/- each 3000 Meters of dressing material @ Rs 100 per metre
Apr 20	Purchased for cash from NTC 1500 metres of linen @ Rs 10 per metre.
Apr 25	Purchased furniture for office use Rs 1000.
Apr 30	Sold old type writer for Rs 750/-

5. **From the following particulars prepare sales book.**

2007

Apr 1	Sold on credit to sundar & Co 15 Tables @ Rs 2,500 each
Apr 3	Sold to Chandra & Co dining table with six chairs @ Rs 22,000
Apr 5	Sold to Vijaya Krishna Hotel 35 cots @ Rs 15,000 each 35 Tables @ Rs 700 each, 35 dressing tables @ Rs 3,000 each. 35 stools @ Rs 200 each
Apr 15	Sold for cash one book shelf @ Rs 5,500
Apr 25	Sold to Red cross society 40 iron cots @ Rs 1500 each 40 Mattresses @ Rs 500 each. 40 pillows @ Rs 100 each.
Apr 30	Sold to Guntur club. 1 sofa set @ Rs 1,30,000/- 1 coffee Table @ Rs 2,000/-

6. **Vasudeva Rao gives the following information about his business. Record them in the concerned subsidiary books and post them to ledger accounts.**

2007

Mar 1	Purchased goods from Pragati & co at the list price of Rs 50,000 less 10% trade discount.
Mar 5	Sold goods to Raja Rao for Rs 75,000 Less 5% trade discount.
Mar 8	Returned goods to pragati & co at list price Rs 500/-
Mar 10	Raja Rao returns us goods at the list price Rs 5,000/-

Mar 13	Purchased goods from Akhil at the catalogue price of Rs. 2,00,000 less 20% trade discount.
Mar15	Sold goods to Pranav at the catalogue price of Rs.50,000 50000 less 10% trade discount
Mar 18	Returned goods to Akhil at the list price Rs 2,000
Mar 20	Pranav returns us goods at the list price Rs 5,000
Mar 22	Purchased goods from Jahnavi at Rs 80,000 less 10% trade discount.
Mar 25	Sold goods to Pavan for Rs 25,000
Mar 27	Sold goods Madan for Rs 15,000
Mar 28	Purchased goods from Sarma at the catalogue price Rs 7,500 less 10% discount.
Mar 29	Pavan returns us goods Rs 500.
Mar 30	Returned goods to sarma at the catalogue Price 750/-

7. **From the following information find out the sales for the year.**

1-7-2007	Balance of Debtors	1,00,000
	Cash received from Debtors	9,50,000
	Sales Returns	20,000
	Bad debts	30,000
31-12-2007	Balance of Debtors	2,00,000
	Cash sales	3,50,000

8. **Following information is extracted from the books of M/s Radha Krishna & Co.**

Who is hole sale cloth Merchant

2007

Jan 4	Sales to Veena & co 200 sarees @ Rs 450 each.
Jan 9	Sales to Kohinoor Bross for cash 150 sarees @ Rs 500 each 200 Blowse pieces @ Rs 35 each. Dress Material. 450 Dresses @ Rs 850/- each.
Jan 16	Sales to Bhavani textiles. 450 sarees @ Rs 350 each.
Jan 30	Sold old Furniture to Lakshman Rs 1,000 Prepare sales book.

4.12 SUGGESTED READINGS :

Financial Accountancy	:	**Shukla Grewal**
Financial Accountancy	:	**Jain and Narang**
Financial Accountancy	:	**R.L. Gupta & V.K. Gupta**

- Dr. Ch. Suravinda

LESSON - 5

CASH BOOK

5.0. OBJECTIVES : In the previous chapter you learned how purchases book, purchase Returns book, sales book and sales Returns book are prepared. In this lesson we will see How a cash book is prepared and various types of cash book.

Structure :

5.1..Introduction :

The number of transactions relating to cash are usually large because most of the business dealings ultimately resolve themselves into cash transactions, so it is necessary to keep a separate book for cash transactions. In the cash book daily record of the transactions relating to receipts and payment of cash are entered. It is a very important book of business due to following reasons.

1. Usually is any business concern the number of transactions relating to cash are more in number.
2. with the proper maintance of cash book the scope for committing fraud or misappropriation of cash can be reduced, and strict control is possible.
3. Timely collection of amounts from Debtors increase the financial position and the chances of its prompt payment to creditor, which in turn increase the reputation of business.

Cash book had a special character, that it acts dual role i, e. as a book of original entry as well as a ledger. It is a subsidiary book because all cash transactions are first recorded in the cash book and then posted to various accounts in the ledger. The recording of transactions in the cash book takes the shape of a ledger Account. Receipts of cash are entered on the debit side and payment of cash on the credit side, so there is no need of cash Account in the ledger.

The following are the types of cash Book.

1. Simple cash Book

2. Cash book with discount column.

3. Cash book with Bank and discount column.

4. Petty cash Book.

5.2 Simple Cash Book :

This types of cash book makes a record of all the receipts and payments of cash. All cash received will be recorded on the debit side and payments on the credit side. The ruling of this type of cash book is as follows.

SIMPLE CASH BOOK

Receipts					**Payments**				
Date	Particulars	R.N.	L.F	Amount Rs.	Date	Particulars	V.N.	L.F	Amount Rs.

When cash is received it is entered on the debit side of the cash Book in the amount coloum along with the name of the party paying the cash in the particulars column. Receipt number with which cash has been received by the cashier is written in the R.N. (Receipt No) column.. Similarly cash paid is entered on the credit side of the cash book. Each payment must be supported by a voucher and voucher number is entered in the V.N (voucher No.) column.

At regular periodic intervals, preferably daily, Cash Book should be balanced like other ledger accounts and the balance shown by it should be equal to cash in hand. The cash Book always shows a debit balance because, one cannot spend more than what he had.

Illustration 1 : Mr. Madan Mohan started business with Rs. 2,00,000 on 1st sep 2007. He deposited Rs 50,000 in his bank account. His transactions during the month were as follows.

2007		Rs.	
Sep. 2	Purchased table and chair for office use	25,000	
Sep. 4	Sold goods for cash	10,000	
Sep.5	Paid for Electric fittings.	2,000	
Sep.6	Paid expenses	500	
Sep.7	Paid wages		2,500

Solution :

Prepare the cash Book of Mr. Madan Mohan

Mr. Madan Mohan Books.

Receipts **Cash Book (SIMPLE)** **Payments**

Date	Particulars	R.N.	L.F	Amount Rs.	Date	Particulars	U.N.	L.F	Amount Rs.
2007									
Sep1	To Capital a/c			2,00,000	Sep 1	By Bank A/c			50,000
Sep 4	To Sales A/c			10,000	Sep 2	By Furniture A/c			25,000
					Sept 5	By Electric fittings A/c			2,000
					Sep 6	By Expenses A/c			500
					Sep 7	By Wages A/c			2,500
					Sep 7	By Balance c/d			1,30,000
				2,10,000					**2,10,000**
Sep 8	To bal b/d			1,30,000					

5.3. Two Column Cash Book :

This cash book has an additional column for discount along with cash column on each side of the cash Book. Discount column on the debit side represents cash discount allowed to customers and the credit side indicates cash discount received from creditors, cash columns are balanced but discount columns are not balanced but totalled.

At this juncture before we see how a two columnor cash book is prepared we have to know what cash discount donates ?

Discounts are of two types 1. Trade discount 2. cash discount.

As we have already discussed that trade discount is the discount allowed by the supplier on the catalogue price or listed price of a commodity. We have already learned the accounting treatment regarding trade discount in the previous lesson. Now in the current lesson we will learn about cash discount.

5.4. Cash Discount :

When a business concern sold goods on credit debitors arises similarly, when it purchased goods on credit creditors arises to the concern. To encourage payments by debtors, the concern makes an announcement that if they repay their dues within a particular date certain amount is allowed as discount. This is known as discount allowed, which is a loss to the concern and debited. Similarly our creditors also make the same announcement, to enjoy the amount of discount we pay the amounts due within that date. This is known as discount received, which is a gain and credited. Cash discount is the only discount appears in the books of accounts.

Now we will see how a two columnor cash book is prepared with an illustration.

5.5 Distinction between cash discount and trade discount :

The following are the differences between cash Discount and Trade discount.

Cash Discount	Trade Discount
1. Cash discount is allowance made by the receiver of cash to the payer for prompt payment.	1. Trade discount is an allowance made by the manufacturer or whole salers to the retailers.
2. Cash discount is recorded in the books of debtor and creditor.	2. Trade discount is not recorded in the books of either seller or buyer.
3. Cash discount is deducted from the amount of debt or net invoice price.	3. Trade discount is deducted from the catalogue price.
4. Cash discount arise at the time of receipt or payment i.e.. When cash is received or paid.	4. Trade discount appears at the time of purchase.
5. The main object of cash discount is to induce the debtors to pay promptly with in the stipulated period of credit.	5. The main object of trade discount is to enable the retailer to sell the goods at catalogue or list price and to keep some margin of profit.
6. Generally the cash discount percentage will be less.	6. Generally the Trade discount percentage will he higher.

Illustration : 2

Enter the following transactions in a Two column cash Book and post them into the ledger.

2007		Rs	
Jan 1	Cash is hand	20900	
Jan 3	Purchased goods for cash	5300	
Jan 5	Paid wages		2100
Jan 7	Withdrew from bank for expenses	9000	
Jan 7	Paid to Jishnu	2900	
	Discount Allowed by him	100	
Jan 10	Cash sales	5900	
Jan 13	Received cash from Madhava on account	9400	
	Discount allowed to him	100	
Jan 15	Purchased furniture from Achut	10,000	
Jan 16	Paid for postage stamps	100	
Jan 18	Additional capital introduced	5,000	
Jan 21	Received cash from Venugopal	8,850	
	Discount allowed	150	
Jan 24	Paid cash for travelling expenses	400	
Jan 26	Amount deposited in bank	10,000	
Jan 27	Cash paid to Bala Ram	4,550	
	Discount received	50	
Jan 28	Goods sold to Vamsi	2,700	
Jan 30	Paid salaries	4,500	

Jan 30	Cash purchases	4,800
Jan 30	Deposited into bank all cash in exceed of	4,000

Two column Cash Book

Receipts **Payments**

Date	Particulars	R.N.	L.F	Dis-count Rs.	Amount Rs.	Date	Particulars	R.N.	L.F	Dis-count Rs.	Amount Rs.
2007						2007					
Jan 1	To Bal b/d				20,900	Jan 3	By purhcases a/c				5,300
Jan 7	To Bank A/c				9,000	Jan 7	By Jishnu A/c			100	2,900
Jan 10	To Sales a/c				5,900	Jan 16	By Postage stamps				100
Jan 13	To Madhavaa/c			100	9,400	Jan 24	By Travelling exp.				400
Jan 18	To Capital a/c				5,000	Jan 26	By Bank				10,000
Jan 21	To Venugopal			150	8,850	Jan 27	By Bala Ram			50	4,550
						Jan 30	By Salaries				4,500
						Jan 30	By Purchases				4,800
						Jan 30	By Bank				22,500
						Jan 30	By Balance c/d				4,000
					59,050						**59.050**
Feb 1	To bal b/d				4,000						

Ledger Account

Dr. **Bank Account** **Cr.**

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 26	To Cash A/c		10,000	Jan 7	By cash A/c		**9,000**
	To Cash A/c		**22,500**				

Dr. **Sales Account** **Cr.**

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
				2007			
				Jan 10	By cash A/c		**5,900**

Dr. Madhava Account Cr.

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
				2007	By cash A/c		9,400
				Jan 13	By Discount A/c		100

Dr. Capital Acount Cr.

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
				2007			
				Jan 18	By cash A/c		**5000**

Dr. Venu gopal Account Cr.

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
				2007	By cash A/c		8850
				Jan 21	By Discount A/c		150

Dr. Purchases Account Cr.

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007							
Jan 3	To Cash A/c		5,300				
Jan 30	To Cash A/c		4,800				

Dr. Jishnu Account Cr.

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007				2007			
Jan 7	To Cash A/c		2,900				
	To Discount		100				

Dr. Postage stamps Accounts Cr.

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007							
Jan 16	To Cash A/c		100				

Dr. Travelling expenses Account Cr.

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007							
Jan 27	To Cash A/c		400				

Dr. Bala Ram Account Cr.

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007							
Jan 27	To Cash A/c		4,550				
	To Discount A/c		50				

Dr. Salaries Account Cr.

Date	Particulars	F	Amount Rs.	Date	Particulars	F.	Amount Rs.
2007							
Jan 27	To Cash A/c		4,500				

5.6 Three Columnar Cash Book

Now - a- days most of the trade is carried through banks i.e, payments by cheque and receipt with cheque. In such a case the cash book should have a bank column in addition to the cash and discount columns to have a record of Bank Account in the cash book. This type of cash Book is known as Three column cash Book

In case a business man has bank accounts with two or more banks. There will be two or more bank colouns on each side of the cash book, depending upon the number of banks with which he has bank accounts.

When a three coloumnor cash book is maintaied no separate account of cash or Bank Account is required in the ledger. However. Separate Discount Accounts have to be opened in the ledger, one for the discount allowed and the other for discount received.

Contra Entry :

As explained above a three columnar cash book contains columns both for cash and bank transactions. An accounting transaction involves two accounts, and there may be a transaction where cash account and bank Account are involved. Since there are no separate cash account and Bank account in the ledger no posting will done from the cash Book. For example when cash is paid into the bank, it should be debited to bank Account by entering the amount in the bank column on the debit side of the cash Book as “To Cash” and credited to cash Account by entering the amount in the cash column on the credit side of the Cash Book as “By Bank” to record the fact of cash having gone out of the business As both the accounts are in the same book and both the effects are given in the same book, letter ‘C’ is written in the L.F column against this entry on each side of the cash book to indicate that the contra effect of this transaction is recorded on the opposite side. Such type of entry appearing on both sides of the cash Book is known as contra Entry.

Similarly when cash is with drawn from the bank for office use the entry would be to debit cash Account by entering the amount in the cash column on the receipts side of the cash Book as “To Bank” and to credit the bank column as “by cash” As both accounts involved appear in the cash Book. To indicate this as a contra transaction in L.F column, letter ‘C’ is written on both sides in the L.F column.

5.5.1. Points which should be kept in view while preparing a three columnor cash Book:

The following are the points which should be kept in view while making accounting entries in the cash Book.

1. **Receipt of Cheques :** If a cheque is received and immediately sent to the bank for collection, it should be debited in the bank column, but it is sent to the bank for collection on a later date, on the date of receipt it is treated as cash and debited in the cash column. When the cheque is sent to bank for collection, contra entry will be recorded in the cash Book by giving debit to bank column and by giving credit to the cash column.

In the absence of any specific instructions in the question the student should presume that the cheque received from a party was sent to the Bank on the same day for collection.

2. **Endorsement of cheques received:** A cheque received by the business may not be sent to the Bank for collection, but may be endorsed in favour of a creditor as it is a negotiable instrument. In such a case the cheque received will be taken as a receipt of cash, similarly the cheque endorsed, will be taken as payment of cash.

3. **Dishonoured cheque :** If a cheque sent to the bank for collection is dishonoured, it should be credited in the bank column of the cash book to cancel the previous debit given to the bank column when the cheque was deposited in the bank.

When a cheque endorsed to creditor dishonouerd no entry is passed in the cash Book because for recording the dishonour. The entry is

Customer’s Account Dr
To creditors Account

It is passed through the Journal proper.

The recording of transactions in three-columnar cash book and from there posting into the ledger will be clear with the help of the following illustration.

Illustration - 3

Enter the following transactions in a three column cash Book.

2007		Rs
Jan1	Cash in hand	8,550
Jan1	Balance at Bank	24,590
Jan3	Cash sales	17,500
Jan6	Received a cheque from Ram	1,500
Jan8	Paid into bank Ram cheque	
Jan10	Paid to Dasaradh by cheque	19,800
	Discount allowed by him	200
Jan12	Cash purchases	12,100

Solution :

Receipts **Cash Book (Three columns)**
Payments

Date	Particulars	LF.	Discount	Cash Rs.	Bank Rs.	Date Rs.	Particulars Rs.	LF. Rs.	Discount Rs.	Cash	Bank
2007						2007					
Jan 1	To Bal b/d			8,550	24,590	Jan 8	By Bank a/c	C		1,500	
Jan 3	To Sales A/c			17,500		Jan 8	By Dasaradh a/c		200		19,800
Jan 6	To Ram a/c			1,500		Jan 12	By Purchses a/c			12,100	
Jan 8	To Cash /c	C		1,500		Jan 14	By cash a/c	C			5000
Jan 14	To Bank a/c	C		5,000		Jan 19	By Bank A/c	C		14,900	
Jan 15	To Anirudh a/c		100	14,900		Jan 21	By Stationery a/c			500	
Jan18	To Sales a/c			8,500		Jan 23	By commission a/c				750
Jan19	To Cash a/c	C			14,900	Jan 27	By Anirudh a/c		100		
Jan25	To Pradeep a/c				2,000	Jan 29	By Drawings a/c				14,900
Jan31	To bal c/d				10,010	Jan 31	By Salaries a/c				4000
											7,000
						Jan 31	By Bank Charges & Insurance				1550
				1,550							
						Jan 31	By Balance c/d			26,950	
			100	**55,950**	**53,000**				**300**	**55,950**	**53,000**
Feb 1	To Balance c/d			26,950		Feb 1	To Balance c/d				10,010

Jan14	With draw from bank for Office use	5,000
Jan15	Received cheque from Anirudh	14,900
	Allowed discount	100
Jan18	Cash sales	8,500
Jan19	Paid into Bank the cheque received from Anirudh.	
Jan21	Cash paid for stationery	500
Jan23	Paid commission by cheque	750
Jan25	Received cheque from pradeep and paid the same into Bank	2,000
Jan27	Anirudh's cheque dishonoured	
Jan29	Drew a cheque for personal use	4,000
Jan31	Paid salaries by cheque	7,000
Jan31	Bank charges & Insurance premium debited in the pass Book.	1,500

Illustration - 4

Enter the following transactions in a cash Book with Discount and Bank columns assuming that all payments are made by cheque and all receipts are immediately banked.

2007.		Rs
Mar 1	Paid into Bank	50,000
Mar 3	Purchased goods	22,000
Mar 7	Sold goods for cash	11,000
Mar 9	purchased goods	24,000
Mar 10	sold goods to Raju on credit	5,000
Mar 13	purchased goods from Gopi on credit	5,800
Mar 14	paid electricity charges	750
Mar 15	Received from Raju in full settlement	4,800
Mar 16	paid office rent	2,500
Mar 17	with drawn from book for petty payments	500
Mar 18	paid to Gopi in full settlement of his A/c	5,700
Mar 19	sold goods	21,000
Mar 20	sold goods to Ramanujam	8,000
Mar 21	purchased goods from Abhinav on credit	28,000
Mar 24	Received cash from Ramanujam in full settlement	7,850
Mar 25	paid to Abhinav on account in full settlement	27,800
Mar 26	paid salaries	15,000

Solutions :

Cash Book with Discount And Bank Columns

Receipts					Payments				
Date	Particulars	L.F	Discount Rs.	Bank Rs.	Date	Particulars	L.F	Discount Rs.	Bank Rs.
2007					2007				
Mar 1	To Cash A/c			50,000	Mar 3	By Purchases a/c			22,000
Mar 7	To Sales A/c			11,000	Mar 9	By Purchases A/c			24,000
Mar19	To Raju a/c		200	4,800	Mar14	By Electric chargesa/c			750
Mar24	To Sales A/c			21,000	Mar16	By Office Rent A/c			2,500
Mar28	To Ramanujam a/c		150	7,850	Mar17	By Petty Cash A/c			500
Jan 21	To Sales A/c			15,800	Mar18	By Gopi A/c		100	5,700
					Mar 25	By Abhinav A/c			27,800
					Mar 26	By Salaries A/c			15,000
					Mar 27	By Drawings			1,500
					Mar 29	By Purchases			3,000
					Mar 31	By Telephone charges			2,300
					Mar 31	By Balance c/d			10,400
			350	**1,15,450**				**350**	**1,15,450**
Feb 1	To bal b/d			10,400					

Mar 27	with drawn for personal use	1,500
Mar 28	sold goods for cash	15,800
Mar 29	purchased goods by cheque	3,000
Mar 31	paid telephone charges	2,300

5.6 Petty Cash Book :

In every business there are many payments which are of small amounts such as postage, cartage, stationery, cleaning charges etc. It is undesirable to burden the main cash Book with numerous small payments like the above so a separate book, called “petty cash Book is usually maintained. The person maintaining the petty cash book is known as petty cashier. All small payments to be made by cash are recorded in the petty cash book. The petty cashier works under the supervision of the chief cashier, who advances money in the beginning of every month/ the month/ quarter to meet petty expenses. At the end of the month / Quarter, the petty cashier submits a statement of account of the expenses incurred by him during the month / quarter and gets a fresh advance.

The best method of recording petty cash payments is to enter them in a petty cash Book maintained in a columnar from. In such a petty cash Book, a separate column for each head of expenditure is provided. The advantage of a columnar petty cash Book is that it saves unnecessary labour used in posting each item of petty cash payment separately in the ledger, only totals of various coluns are to be posted in the ledger this book is also known as Analytical petty cash Book because the various small cash payments get automatically analysed when they are entered in their respective columns.

The petty cash book is Just like the cash Book. The amount received by the petty cashier from the main cashier are entered on the debit side of the petty cash book and payments on the credit side of the petty cash book every small payment is entered twice on the credit side - one in the total payments column and second in one of the analytical amount column. The periodical total of each column is posted to the expenses accounts concerned, while the total of payments columns serves to find out the balance of cash with the petty cashier.

5.5.1 Imprest system of petty cash Book :

The petty cash Book is usually maintained on the basis of Imprest system. According to this system, a fixed amount is advanced to the petty cashier. He submits his accounts at the end of the period and the chief cashier after examining his accounts gives him a fresh advance equivalent to the amount spent by him during the period. Thus, in the beginning of each period the petty cashier has a fixed balance. The amount so advanced to him is termed as “Imprest”

The recording of transaction in a petty cash Book will be clear with the help of the following Illustration.

Illustration - 5

Prepare columnar petty cash Book on imprest system from the following particulars and post into the ledger.

2007		Rs
June 1	Received for petty Cash payments	2000
June 2	Paid for postage	160
June5	Paid for stationery	100
June 8	paid for Advertisement	200
June 12	paid for wages	80
June 16	paid for carriage	60
June 20	paid for conveyance	88
June 25	paid for travelling expenses	320
June 27	paid for postage	100
June 28	wages to office cleaner	40
June 30	paid for telegrams	80
June 30	sent register notice to land lord	15

Dr Petty Cash Book Cr

Amount Rs.	Date	Particulars	Total Rs	Postage Telgram	Printing Statonery	Advertise ment	Wages	Carriage	Travelling	Misclenious
2007	2007									
	June 1	To Cash A/c								
	June 2	By Postage Ac160	160	160						
	June 5	By Stationery A/c	100		100					
	June 8	By Advertisement a/c	200			200				
	June 12	By Wages A/c	80				80			
	June 16	By Carriage A/c	60					60		
	June 20	By Conveyance	88						88	
	June 25	By Travelling exp.	320						320	
	June 27	By Potage A/c	100	100						
	June 28	By Wages A/c	40				40			
	June 30	By Telegrams A/c	80	80						
	June 30	By Postage A/c	15	15						
			1243	**355**	**100**	**200**	**120**	**60**	**408**	
	June30	By Balance	757							
2000			2000							
757	July 1	To Balance b/d								
1243		To Bank								

5.6 Summary :

In Any business concern the number of transactions in cash are more so it is necessary to keep a separate book for cash transactions. Cash book plays dual role one as a subsidiary book other as a ledger account. There are four types of cash book. Simple cash book is prepared with cash column. In two columnor cash book a discount column is maintained along with cash column. As most of the trade now - a - days is carried through banks a bank column is also maintained in tree columnor cash book along with cash and discount columns. To record petty expenses a separate petty cash book under Imprest system is prepared.

5.7 Questions :

1. Write down the types of cash book.
2. What is a contra entry ?
3. Write about the Imprest system of petty cash.
4. Explain cash discount.
5. Write down the distinction between cash discount and trade discount.

5.8 Exercises :

1. **Prepare a cash book from the following information.**

		Rs.
Jan 1	Balance of cash	7,000
Jan 10	Bought goods on credit from Z	3,000
Jan 11	Bought goods for cash	2,500
Jan 15	sold goods for cash	4,700
Jan 17	paid salary	1,000
Jan 18	with draw for personal use	500

2. **Prepare a single column cash book with the information given below.**

2007		Rs
Jan 1	Balance of cash in hand	700
Jan 2	Received from cash sales	10,500
Jan 4	cash purchases	5,400
Jan 5	paid staff salaries	1,200
Jan 6	paid x, creditor	3,100
Jan 7	Received from debtor	1,500

3. **Prepare cash book from the following transactions.**

2007		
Apr. 1	Started business with a capital	20,000
1	Purchased furniture	8,000
5	Cash purchases	4,000
6	Sold table	6,000

8	Sold goods to Prasad	4,100	
10	Paid wages		1,000

4. Prepare a three columnor cash book from the information given below.

2007		Rs
June 1.	Introduced capital	9,000
June 1	Deposited into Bank Account	7,000
June 4	Bought furniture payment made by cheque	5,000
June10	Bought stationery through cheque	1,000
June 15	Purchased goods through cheque	1,000
June 18	With drew Rs. 100 from bank for office use.	
June 20	sold goods on credit to suresh	1,500
June 22	Deposited into bank	500
June 25	Brought goods from Mahesh	1,000
June 26	sold goods, payment received in cheque and deposited into Bank	1,500
June 27	paid to Mahesh in full suttlement	980
June 30	Received from subhash in full settlement of his account	1,480
June 31	withdrew cash from Bank for Personal use	100

Ans : cash - Rs 3,080, Bank Rs 1,020

5. Prepare a cash book from the following information.

2006		Rs
December1	Cash in hand	3,000
	Bank Balance	12,000
December 2.	cash received from Ajay and a cheque received	1,500
December 3.	A cheque issued to Neeraj	450
	in full settlement of	470
December 4	cheque received from Ajay deposited into the bank	
December 6	cash sales	6,000
December 8	purchased goods from Anil for cash	2,000
December 10	Cheque received from Ajay dishonoured	
December 10	cash deposited into Bank	1,500
December 12	A cheque received from Sunil	2,100
	in full settlement of Rs	2,200
December 13	cheque received from sunil is endorsed to Vinod in full settlement of his account of	2,150
December 15	Bank charges debited in pass book	20
December 18	An advise received from the bank	

states that :

a.	Mrs. sobha has directly deposited into bank	3,500
b.	The bank has collected interest on investments	250
c.	As per standing instructions the bank has paid insurance premium	300

December20 paid for stationery	100
December 23 Received a cheque from Imran on account	10,000
December 26 Paid salaries	2,000
December 29 cash withdrawn for office use	1,000

Ans :- cash Rs 4,900 Bank Rs. 25,480

6. Prepare three column cash book of suresh from the following information on 1st Jan 2007 suresh had Rs 900 in hand and Rs 13,000 at bank.

2007		Rs
Jan 2.	Received cheque from Arun in fulsettlement of debt Rs 1300	1,240
Jan 3	cash sales	500
Jan 3	paid for advertisement by cheque	700
Jan 4	Paid salaries and wages	870
Jan 4	Amount with drawn from bank for office use	1,200
Jan 5	Drawn cash for domestic use by suresh from bank	400
Jan 6	issued cheque in favour of Rao & sons	2,000
	Discount allowed	40
Jan 7	Received cheque from Mahata Bros	1,600
	discount allowed	40
Jan 18	sale of Machinery Payment Received by cheque	5,000
Jan 20	Bank returns cheque of Mehata Bros dishonoured	
Jan 25	New Machinery Purchased and cheque issued	20,000
Jan 26	Paid installation expenses in cash	1,000
Jan 28	Bank charges as per pass book	20

Ans :- cash Rs 730. Bank O.D Rs. 5080

7. Enter the following transaction in a cash book

2007		Rs
Jan 1	Cash in hand	5,374
	Balance at bank	15,490
Jan 3	cash sales	6,400
Jan 5	paid into bank	7,000

Jan 6	Received a cheque from Satyam	700	
Jan 8	Paid into bank satyam's cheque.		
Jan 10	Paid to Anurag by cheque on account	980	
	discount allowed by him	20	
Jan 12	cash purchases	2,500	
Jan 14	with drew from bank for office use	5,000	
Jan 15	Received cheque from lakshman	950	
	allowed discount	50	
Jan 16	cash sales	7,500	
Jan 19	paid into bank lakshman's cheque and cash	4,000	
Jan 21	cash paid for stationery	120	
Jan 23	paid commission to Rakesh	500	
Jan 25	Received cheque from Mohan	1,000	
	and paid the same into bank		
Jan 27	Lakshman's cheque dishoured		
Jan 29	Drew a cheque for personal use	800	
Jan 31	paid salaries by cheque	1,500	
	and by cash		500
Jan 31	Bank charges Rs 20 and Insurance premium		
	Rs 520 as shown in pass Book.		

Ans : Cash Rs 8654 Bank Rs. 19,370

8. Enter the following transactions in three columnor cash book.

2007		Rs
March 1.	cash in hand	600
March 1	Bank balance	3,000
March 3	cash deposited into bank	2,000
March 5	cheque received from Narayan in full settlement	
	of his bebt Rs 530/-	500
March 8	Purchased goods from Narendra	1,000
	at 5% Trade discount	
	paid half in cash and the other in cheque.	
March 15.	Narayan's cheque dishonoured	
	and returned.	
March 20	Cash with drawn from Bank	
	For office use	300
	For personal use	200
March 25	office rent paid	500
March 27	Bank charges in pass book	10
March 29	salaries paid through cheque	500

March 30	Amount received from satyam	
	in cash	500
	through cheque	1,000
	Discount allowed	50.
March 31	Amount paid to Ramachandra Rs 475	
	in full settlement of Rs 500.	

Ans: cash Rs 250 Bank o.D. Rs 1485

9. Enter the following transactions in three columnor cash book.

2007		Rs
June 1	cash in Hand	5,000
	Balance at Bank	2,000
June 2	cash sales	2,000
June 4	Amount paid to Anil by cheque	800
June 5	cash purchases	1,100
June 6	cash received from customer	2,000
June 7	Amount with drawn from Bank	
	for personal use 500.	

Ans : Bal cash Rs 6,900/- Bank Rs 1700/-

10. From the following information prepare a three columnor cash book.

2007		Rs
Mar 1	cash balance	55,000
	Bank balance	35,000
Mar 2	purchased goods paid by cheque	10,000
Mar 3	Business expenses paid	1,000
Mar 4	Cheque received from Naresh	30,000
	deposited the same into bank	
Mar 5	Amount paid to kumar in full	
	settlement of Rs 2,100	2,000
Mar 6	sold goods to vijay	5,000
Mar 10	cheque received from Naresh dishonoured.	
Mar 12	cheque received from vijay	5,000
Mar 14	cash withdrawn from Bank for	5,000
	personal expences	5,000
Mar 20	cash with drawn from bank for office use	6,000
Mar 24	cash sales	10,000
Mar 25	Deposited into bank	15,000
Mar 26	Amount received from Rekesh	
	in full settlement of his	5,900
	account of Rs 6,000	

Mar 31	Due to insolvency of a customer Who due Rs 8000 only 50% received	

Ans : cash Rs. 62,900 Bank Rs. 34,000

11. Enter the following transactions in three columnor cash book.

2007		Rs
Jan 1	cash balance	15,000
	Bank balance	50,000
Jan 2	cash sales	40,000
Jan 5	Furniture purchased and paid by cheque	8,000
Jan 6	Rent paid by cheque	5,000
Jan 7	cash deposited into bank	40,000
Jan 8	Interest on capital received	4,000
Jan 9	Salaries paid	5,000
Jan 10	cash received from vishnu	15,000
	Discount allowed	500
Jan 12	cheque received from Anjan deposited into bank	8,000
Jan 13	Anjan's cheque dishonoured.	
Jan 14	credit purchases from Gopi	6,000
Jan 18	cash with drawn for office use	12,000
Jan 20	cheque issued to Gopi	5,800
	Discount received	200
Jan 24	cash drawn from bank for personal use	4,000

Ans : cash 37000 Bank : 59,200

petty cash :

12. Enter the following transactions in petty cash book.

2007		Rs
March 1	Amount received from cashier	200-00
March 2.	Printing charges	15-00
March 4	Postage	8-00
March 6	stationery	10-00
March 10	carriage	15-00
March 15	Postage	18-00
March 20	Travelling expenses	20-00
March 25	Telegram	12-00
March 31	cool drinks	40-00

Ans :- Bal 62-00

13. Prepare the petty cash book for the following transactions and balance.

2007		
Nov 1	Advanced to petty cashier by cheque	100-00
Nov 2	Paid carriage	4-00
Nov 3	paid for stationery	15-00
Nov 4	paid for postage stamps	10-00
Nov 5	Purchased letter pads for office use	5-00
Nov 6	Paid for carriage	6-00
Nov 7	gave telegram to Mumbai	11-00

Ans : Bal Rs 49.

14. Prepare the petty cash book under the imprest system.

2007		Rs
Feb 1	cash received from cashier	100-00
Feb 2	cortage	6-00
Feb 3	Postage	2-25
Feb 4	stationery	3-00
Feb 4	Printing	11-25
Feb 4	stamps	2-00
Feb 4	Refreshments to customers	5-75
Feb 5	cleaning wages	4-00
Feb 5	Repairs to type writer	15-00
Feb 6	cortage	1-75
Feb 6	postage	4-75
Feb 6	travelling expenses	1-25
Feb 6	Entertainment	2-50

Ans:- Bal Rs. 39.25

15. M/s vimal Bros maintaining their petty cash under imprest system. Every monday cashier provides Rs 150 to petty cashier for meeting petty expenses. The expenses for one week were as follows.

2007		Rs
Jan 1	Amount received from cashier	150-00
Jan 2	Travelling expenses	8-00
Jan 2	postage stamps purchased	22-00
Jan 3	stationery	19-00
Jan 3	office expenses	6-00
Jan 4	Tea, coffee	21-00
Jan 4	carriage	10-00
Jan 5	Advance to Raj, clerk	10-00
Jan 5	Tiffins	12-00

Jan 6 Riksha

prepare petty cash under imprest system.

Ans : Bal : Rs 24.

16. Prepare a petty cash under the imprest system from the following particulars,

2007		Rs.
Dec 1	Balance with petty cashier.	800
Dec 2	Railway charges	90
Dec 2	Telegram	95
Dec 2	stationery	100
Dec 5	carriage	120
Dec 5	stationery	55
Dec 5	Postage stamps	100
Dec 7	Repairs	200
Dec 7	Travelling expences	150
Dec 8	casual wages	50
Dec 9	Electric Repairs paid	45
Dec 10	Tiffins	50
Dec 12	S.T.D charges	80
Dec 15	speed post	75

SUGGESTED READINGS :

Financial Accountancy : Shukla Grewal

Financial Accountancy : Jain and Narang

Financial Accountancy : R.L. Gupta & V.K. Gupta

- Dr. Ch. Suravinda

LESSON - 6

BANK RECONCILIATION STATEMENT

6.0. OBJECTIVES : After going though this lesson the student can know the causes of difference between the balance of cash book and pass book, the need for reconciliation and the preparation of bank reconciliation statement.

Structure :

6.1. Introduction
6.2. Need for Bank Reconciliation
6.3. Reasons for the difference
6.4. Procedure for preparation of Bank Reconciliation statement
6.5. Bank overdraft.
6.6. Summary
6.7. Questions
6.8. Exercises

6.1. Introduction :

A Business unit have to make many receipts and payment every day. The business man can relieve himself from this bothering of cash receipts and payments by opening a current account in the bank. After opening of current account with the bank, a pass book is given to the business man, which makes a record of the transactions with the bank. This pass book is written by the bank. On the other hand the business man who opens a current Account with the bank also writes his transactions with the bank either in a bank account opened in the ledger or in bank column of his cash book.

The balance of the bank account should be equal to the balance shown by the pass book, But some times these two balances do not agree. This disagrement may arise because of a mistake or time-lag between the entries made by the bank in its own account books or the entries made by a trader in his books. To reconcile these different balance shown by the cash book and pass book, a statement known as Bank reconciliation statement is prepared.

6.2. Need for Bank Reconciliation Statement

The bank column of the cash book usually shows a debit balance representing the amount held in deposit with the bank, the banker also records these transactions with his customers in his ledger considered from his point of view. The pass Book is a copy of the customer's account as it appears in the banker's ledger. It usually shows a credit balance representing the amount belonging to the customer with the banker. The cash Book usually shows a debit balance and the pass book shows a credit balance. Both these books should show the same amount as their balance. However, they usually show different amounts as their balances. This difference in the balances arises on account of the fact that the transactions are either first recorded by the business man in the cash book or by the banker later, the other party records them. The fact that transactions do not get recorded simultaneously in both the books is the main reason for the difference in these balances. The interval in the recording of the transactions, in these two books is called 'time - lag'. The business man compares his cash Book with the pass Book periodically say, once in a month. The balance shown by these two books should be one and the same. But it is usually not so because some of the entries might not have been recorded or incorrectly recorded in any of the two books.

Therefore it is necessary to prepare a statement known as bank Reconciliation statement to reconciling the two balances shown by the cash Book and the pass book on a particular date. The other important purpose of the preparation of this statement is to know the exact balance with the bank.

6.3. Reasons for the difference in Two Balances :

The reasons for the difference in the balances shown by the two books may be as follows.

1. Cheques issued but not yet presented for payment : As soon as a cheque is issued it is entered but the bank makes no entry for the cheque until it is actually presented for payment. This means that if the cheque is not presented for payment upto the date of the preparation of the Bank Reconciliations statement the balance as per Pass Book will be higher than the balance shown by the Cash Book by the amount of cheque not presented for payment.

2. Cheques paid into bank but not yet collected by the Bank : As soon as cheques are received they are entered on the debit side of the cash book, increases the balance at the bank but the bank does not give credit for the cheque deposited until it is cleared and collected.

3. Bank Charges and Interest debited in the pass Book : If there is an overdraft the bank will charge interest for the overdrawn amount. As a result the balance as per pass Book is reduced by the amount of bank charges and interest, where as balance as per Cash Book remains same due to lack of information of these charges upto the date of the preparation of the Bank Reconciliation statement. Similarly in case of Bank charges also the banker debits the pass book of the customer at first and the business man comes to know this fact only when he receives the Pass Book from the bank duly filled up.

4. Interest, Rent and dividend collected by the Bank on behalf of customer : On the instructions of the customer the bank may collect Interest, rent on property or dividend on investments. After collection of this income the bank will give the credit to the businessman so as a result the balance as per pass book increases where as there may be no entry in the cash book due to lack of this information. The cash book balance remains unchanged as there is no entry in the cash book.

5. Insurance premium, subscriptions to periodicals and other payments made by the bank on behalf of the client on the standing instructions of the customer, the bankers make certain payments like Insurance premium and other payments when they fall due and reduce his balance. But balance as per cash Book will remain same because of the omission of the entry in the cash book for payments made by the bank.

6. Cheques omitted to be banked : some times a cheque received by the businessman may be entered immediately in the cash book but may be ommitted to send the same to the bank for collection. As a resulte of this the cash book balance increases and the balance as per pass book remains same without change because no cheque is received for collection.

7. Cheques, bills of exchange dishonoured : When a cheque or bills of exange dishonoured, this fact is first recorded in the pass book, reduces the balance as per pass book. Business will make the entry only after receiving the instruction from the bank. In this time-lag the cash book shows higher balance than the pass book.

8. Direct payment into Bank : some times the customers of businessman may make payments direct into his account with the banker. The banker credit his pass book which result in an increase in the balance. As this information is not received the cash book balance remains unchanged.

9. Wrong debit or credit given in the pass Book or the cash book may also result the disagreement of the two balances.

6.4. Procedure for preparation of Bank Reconciliation statement :

Before preparation of the Bank reconciliation statement the student should first note the fact that if the balance of one book increased or Decreased the balance as per other book remains uncharged or constant.

1. Tick off all the items in the pass book with entries in the bank column of the cash book and make a list of unticked items both in cash book and pass book. These unticked items are responsible for the difference in the balances shown by the cash book and the pass book.
2. Take balance as per cash book or pass book as the starting point.
3. Decide which item unticked is added or diducted from the base.
4. Do all the adjustments accordingly if you started with cash book you will get the balance as per pass book or vice versa.
5. For deciding which items of unticked, is added to or deducted from the starting point, the following formula will help the student.

Add Add

Increase - constant - Decrease

less less

Note : if one book increased or decreased the other bock remain constant.

This can be understood by the following Illustration.

Illustration 1:

Cash Book (Bank columns only)

Date	**Particulars**	**Amount Rs.**	**Date**	**Particulars**	**Amount Rs.**
2007			2007		
Jan 1	To cash A/c	10,000 3		By Rent A/c (Ravi)	350 3
Jan 3	To Suresh A/c	600 3	Jan 2	By Krishna A/c	900 3
Jan 5	To Bhuvana A/c	700 3	Jan 13	By cash A/c	600 3
Jan 5	To cash A/c	1000 3	Jan 13	By drawing A/c	900 3
Jan 25	To Kiran A/c	750 3	Jan 25	By Mohan A/c	850 3
Jan 29	To Prasad A.c	500	Jan 29	By Rama Rao A/c	780
Jan 30	To Cash A/c	2000 3	Jan 29	By Bal cld	12670 3
	To Suresh A.c	1500			
		17,050			**17,050**

Pass Book

Date	Particulars	Dr. Rs.	Cr. Rs.	Dr. Rs	Balance Rs
2007					
Jan 1	By cash	-	1000 3	Cr	10,000
Jan 3	To Ravi	350 3	-	Cr	9650
Jan 5	By suresh	-	600 3	Cr	10250
Jan 8	To Krishna	900 3	-	Cr	9350
Jan 11	By Bhuvana	-	700 3	Cr	10050
Jan 13	To cash	600 3	1000 3	Cr	11050
Jan 17	To self	900 3	-	Cr	10450
Jan 27	To Mohan	850 3	-	Cr	9,550
Jan 30	By Kiran	-	750 3	Cr	8,700
Jan 30	By cash	-	2000 3	Cr	11,450
Jan 30	To Insurance premium	250	-	Cr	11,200
Jan 31	To Bank Charges	15	-	Cr	11185
Jan 31	To Interest	-	550	Cr	11735

In the above illustration the unticked, items are the reasons for variation between the balances of cash book and pass book. Now we will pick those, items.

1. The cheques deposited on 29th received from prasad for Rs 500 and on 30th received from Suresh for Rs 1500 are not collected by bank.
2. Cheque issued to Rama Rao for Rs 780 on 29th has not presented for payment in the bank
3. Insurance premium paid Rs 250 appearing in pass Book only.
4. Bank charges Debited in pass book Rs 15.
5. Interest credited in pass book Rs 550.

Now you decide which items should be added and which should be deducted by using the formula given. Start with either of the balance, cash book or pass book for example we started with cash book. The student, here is always advised to remember that, with one transaction, if one book increases or decreases the other book remain constant.

Item		Cashbook	Passbook	Amount Rs.	Effect Add/Less
1.	Cheque issued but not collected	Increase	Constant	2000	Less
2.	Cheque issued but not presented for payment	Decrease	Constant	780	Add
3.	Insurance premium Debited in pass book	Constant	Decrease	250	Less
4.	Bank charges Debited in passbook	Constant	Decrease	15	less
	Interest credited in pass book	Constant	Increase	550	Add

Once we decided which item is added and which one is deducted from the starting balance to find the other book balance we can proceed to prepare a bank Reconciliation statement as follows:

Bank Reconciliation statement as on 31.1.2007.

	Particulars	Amount Rs	Amount Rs
1.	Balance As per cash book		12,670
	Add		
	1. Cheque issued but not presented for payment	780	
	2. Interest collected and credited in the pass book.	550	1,330
			14,000
	less		
	1. Cheques deposited but not collected	2,000	
	2. Insurance premium Debited in pass book	250	
	3. Bank charges Debited in pass book	15	2,265
	Balance as per pass Book		11,735

The same illustration can be worked out by taking the pass book balance, as follows.

Add Add
Increase - constant - Decrease
less less

If we take the balance as per pass book

Item		Cashbook	Passbook	Amount Rs.	Effect Add/Less
1.	Cheques deposited but not collected	Constant	Increase	2000	Add
2.	Cheque issued but not pres-enteed for payment	Constant	Decrease	780	Less
3.	Insurance Premium debited in pass book	Decrease	Constant	250	Add
4.	Bank charges Debited in Pass book	Decrease	Constant	15	Add
5.	Interest Credited in pass book	Increase	Constant	550	less

Bank Reconciliation statement on 31- 1 - 2007

	Particulars	Amount Rs	Amount Rs
	Balance as per pass book.		11,735
	Add		
1.	Cheques deposited but not collected	2,000	
2.	Insurance premium paid by Bank	250	
3.	Bank charges Debited in pass book	15	2,265
	Less		14,000
4.	Cheques issued but not presented for payment	780	
5.	Interest credited in pass book	550	1,330
	Balance as per cash Book		12670

Illustration - 2

From the following particulars prepare a Bank Reconciliation statement showing the balance as per cash book on 31 Dec 2006. The following cheque were paid into Bank in December, 2006 but were credited by the bank in January, 2007;

Chinna Rs 7,000. Madhu Rs 8,000 Vasu Rs 6,000.

The following cheques were issued by the firm in December 2006 but were presented for payment in January 2007.

Pranav Rs.1,500 Pavan Rs 1,450

The following charges were made by the bank which were not recorded in the cash book;

Bank charges Rs. 120

Collection charges Rs. 115

The following payments made by the bank direct as per standing instructions were not entered in the cash book Insurance premium Rs 2,350 subscription for magazine Rs 275

A cheque for Rs 3,500 which was received from a customer was entered in the bank column of cash book in December 2006, but was to be banked in December 2006. A bill for Rs.31,000 was retired by the bank under rebate of Rs 320 but the full amount of the bill was credited in the bank column of the cash book.

The bank balance as per pass Book was Rs. 35,800 on 31-12-2006

Solution :

Bank Reconciliation statement as on 31-12-06

	Particulars	Amount Rs	Amount Rs
	Balance as per pass Book		35,800
	Add		
1.	Cheques paid into Bank not yet collected		
	Chinna	7,000	
	Madhu 8,000		
	Vasu	6,000	21,000
2.	Bank charges recorded in the pass book		
	Bank charges	120	
	Collection charges	115	235
3.	Payment made by the bank as per standing instructions.		
	Insurance premium	2,350	
	subscriptions	275	2,625
4.	Cheque entered in cash Book but omitted to be banked		3,500
			63,160
	Less		
5.	Cheques issued but not presented for payment		
	Pranav	1,500	
	Pavan	1,450	
		2,950	
6.	Rebate allowed for a bill but not entered in cash book	320	3,270
	Balance as per cash book		59,890

The student is adviced to do the problem by starting with the balance of cash book.

6.5.Bank Overdraft :

Sometimes cash book may show a credit balance or pass Book a debit balance. It indicates the amount overdrawn. This means that the trader owes this amount to the bank i.e; he has drawn more amount than his balance in the bank such a balance is technically known as bank overdraft. The overdraft balance is also referred to as the unfavourable balance.

The method of analysis or the preparation of Reconciliation statement is the same as in the case of favourable balance. However the student is expected to note the difference in the effect of a given item of discrepancy, if the balance is an unfavourable or overdraft balance. For ex: In case of favourable balance, cheques issued reduce the cash balance, But when the balance is an unfavourable balance the effect of the cheque issued will further increase the overdraft balance. here you have to note that the effect of the cause of disagreement will be exactly opposite because of the unfavourable nature of the starting balance.

Illustration 3 :

On 30th June 2007, the pass Book of Mr. Anil kumar showed an overdraft balance of Rs 80,000 prepare a Bank Reconciliation statement using the following information.

1. Out of the two cheques issued to Ajay Kumar on 25th June 2007, one for Rs 10,000 and another for Rs. 25,000. The cheque for Rs 25,000. was cashed on 5 - 7 - 2007.
2. A wrong credit for Rs 500 relating to some other account was found in the pass book.
3. Out of the three cheques deposited in the bank for collection on 22 - 6 - 2007, for Rs. 30,000 Rs 40,000 and Rs 50,000 respectectively, the cheque for Rs 40,000 alone was collected by 30 - 6 - 07.
4. There is a debit of Rs 1,600 for interest and Rs 300 for bank charges in the pass book which have not been entered in the cash book.
5. The pass Book showed that bank had collected Rs 3,000 as interest on securities but there was no entry in the cash book for interest.
6. A Bill receivable for Rs 10,000, discounted with the bank in May, was dishonoured on 28th June, 2007 and was debited in the pass Book.

Solution : Bank reconciliation statement as on 30 - 6 - 2007.

	Particulars	**Amount Rs**	**Amount Rs**
	Bank overdraft balance as per the pass book		80,000
	Add		
1.	Cheques issued but not presented for payment	25,000	
2.	Wrong credit in the pass book	500	
3.	Interest on securities collected by the bank	3,000	28,500
			1,08,500
	Less		
4.	Cheques paid in but not yet cleared	80,000	
5.	Interest on O.D, and bank charges debited in the pass book.	1,900	
6.	Dishonoured bill debited in the pass book only	10,000	9,19,000
	Overdraft Balance as per cash book		16,600

Illustration 4 :

On 31st December 2006 the cash book of Mr. Akhil showed a credit balance of Rs.50,000 with the state Bank of India. Before this date cheques worth Rs.39,600 were issued but of them cheques worth Rs.7,500 were only presented at the bank for payment. a cheque for Rs.4,500 received from a customer was entered in the Bank column of the cash book in December 2006, but it was not paid into Bank. In December cheques worth Rs.10,500, were deposited in the bank but cheques amountig to Rs.9,000 only were credited in the Pass Book. The total of a page on the receipts side of the cash book Rs.26,260s was carried to the next page as 22,620. A cheque for Rs.24,000 which was received from a customer was paid into the bank on 26th of December, but it was not entered in the Cash Book. The pass book is debited with Rs.200 for bank charges, Rs.600 for interest on overdraft and Rs.570 for insurance premium paid. Interest on investments credited in Pass Book Rs.3,000. These items not yet posted in cash book.

Prepare the Bank Reconcilation statement.

Solution :

	Particulars	**Amount Rs**	**Amount Rs**
	Bank overdraft balance as per the Cash book		50,000
	Add		
1.	Cheques debited in the Cash Book but omitted to be paid into Bank	4,500	
2.	Cheque deposited but not cleared	1,500	
3.	Bank charges debited in the Pass Book only	200	
4.	Interest on O.D. debited in the Pass book only	600	
5.	Insurance premium directly paid by the bank but not yet entered in the Cash Book	570	7,370
			57,370
	Less		
6.	Cheques issued but not yet presented	32,100	
7.	Short carry foreward of the total on the receipts side of the Cash Book	3,640	
8.	Cheques paid into the bank but not recorded in the Cash Book	24,000	
9.	Interest on investments credited in the Pass book only	3,000	62,740
	Bank balance as per Pass Book (Favourable)		5,370

Illustration 3:

The Bank Pass Book of Siva Rao showed a credit balance of Rs.24,000 on 31-12-2006. While the bank column of his Cash Book showed a different balance. You are required to prepare the Bank Reconcilation statement.

1. If the cheques amounting to Rs.12,900 deposited in the bank upto 31-12-06 a cheque of Rs.3,200 received from Papa Rao was collected by the bank on 3-1-2007.

2. Cheque of Rs.5,000 issued to Raj & Co was wrongly entered twic in the cash book.
3. Cheques issued during the month amounted to Rs.16,000 of which cheques for Rs.6000 were not presented to the bank upto 31-12-06.
4. The Pass Book showed a credit of Rs.200 as interest for which there was no entry in the Cas Book.
5. The Pass Book also showed a payment of Rs.1,675 as life insurance Premium for which no entry was made in the Cash Book.

Solution :

Bank Reconciliation statement as on 31-12-06

	Particulars	Amount Rs	Amount Rs
	Balance as per the Pass book		24,000
	Add		
1.	Cheque deposited but not credited in the Pass Book	3,200	
2.	Amount of Insurance Premium debited by the bank but not entered in the cash Book	1,675	
3.	Error in respect of carry forward in the Cash Book	540	
4.	Dishonoured cheque debited in the Pass Book but no entry made in the Cash Book	840	6255
			30,255
	Less		
5.	Cheque issued but recorded twice in the cash book	5,000	
6.	Cheques issued but not presented for payment	6,000	
7.	Interest credited in the pass book and not entered in the Cash Book	200	
8.	Direct deposit in bank by a customer but not recorded in the Cash Book	20,800	
9.	Excess amount recorded in the Cash book	29,700	
10.	Error in respect of casting in the Cash Book	2,000	63,700
	Over draft as per Pass Book		33,555

6.6 Summary :

The cash book maintained by the business man and the pass book maintained by the banker may not show identical balances on any given date. This is mainly due to time - lag i.e, gap in the recording of the transactions in the books. It can also be due to errors in any one or both the books. As these two books show two different balance, it is necessary to compare them periodically and identify the causes of disagreement. After identifying the causes of dis - agreement the effect of each cause of disagreement on the known balance must be determined and these should be added or deducted in a bank Reconciliation statement.

6.7. Questions

1. What is bank reconciliation statement.
2. What are the causes of disagreement between the cash book and the pass book balances?
3. How is a bank reconciliation statement prepared.
4. What is the procedure for finding out the points of disagreement by comparing the cash book with the pass book
5. Explain the procedure for preparing the bank reconciliation statement.

6.8 Exercises :

1. **From the following particulars prepare a Bank Reconciliation statement.**

   a. Bank Reconciliation statement.

      1. Balance as per cash book Rs 10,000 (Cr)
      2. Cheque received from a customer for Rs 500 entered the cash book but not banked.
      3. There is a wrong debit in the pass book to the extend of Rs 2,000.

      Ans : O.D Balance Rs 10,700

2 **From the following particulars prepare a Bank reconciliation statement as on 31-3-2007.**

   1. Balance as per cash book Rs 25,000
   2. Cheques issued but not presented for payment Rs 6,000
   3. Dividend Credited in the pass book only Rs 500
   4. Cheques deposited into bank but not collected Rs 8,000
   5. Bank charges debited in pass book Rs 200
   6. Cheque deposited in the bank dishonoured but this was not recorded in cash book Rs 2000
   7. Interest collected and credited in the pass book by the banker.

3. **From the following particulars prepare a Bank reconciliation statement as on 31-3-2007.**

   1. O.D Balance as per pass book Rs 12,000
   2. Out of the total cheques of Rs 7,000 issued on 28th April, only Rs 3000 cheques paid upto Apr. 30.
   3. Out of the cheques deposited Rs 3,500 only cheques of Rs 500 credited in the pass book.
   4. Information regarding the debit of interest on over draft of Rs 500 not received.
   5. One debtor directly paid into bank an amount of Rs 400 and there is an other credit of Rs 600 in the pass book for interest on investments collected by the bank.
   6. On the standing instructions bank paid insurance premium of Rs 1200, not entered in the cash book.

7. The bank column of the cash book on the credit - side under cast by Rs 1000

4. **Mr. Gopi Nadh cash book is showing a bank balance of Rs 8,500 from the following information prepare a bank reconciliation statement.**
   1. Cheques deposited into bank Rs 1000 but not collected.
   2. Interest collected and credited in the pass book only Rs. 400.
   3. Out of the cheques issued totalling Rs 5,100 in March, cheques with of Rs 1200 paid in April.
   4. On the standing instructions bank paid Rs 600 for insurance premium, not entered in the cash book.
   5. One customer deposited in the bank directly Rs 150.
   6. Bank charges debited in the pass book Rs 50.
   7. A cheque deposited in the bank dishonoured Rs 400/- information not received.

5. **On 31-1-2007 the pass book of Rama Rao showed a debit balance of Rs 4,100 prepare a bank reconciliation statement with the following information.**
   1. Out of the cheques issued for Rs 15,600 only Rs 4,600 was paid.
   2. A wrong debit of Rs 800 has been given by the Bank in pass book.
   3. There is a credit of Rs 200 in pass book only.
   4. A cheque for Rs 1000 returned dishonored and were debited in pass book only.
   5. Interest and bank charges Rs 100 were not recorded in cash book.
   6. Interest and bank charges Rs 100 were not recorded in cash book.
   7. A cheque of Rs 500 debited in the cash book ommitted to be banked.
   8. A wrong credit has been given by the banker for Rs 500 in the pass book.

6. **From the following particulars prepare a bank reconciliation statement.**

1.	Over draft as per pass book	13,800
2.	Interest on overdraft not entered in cash book	240
3.	Bank charges debited in the pass book	60
4.	Cheques drawn but not cashed by the customers	2,,300
5.	Cheques paid into bank but not cleared	4,340
6.	A bill receivable discounted with bank, dishonoured, debited in the pass book	1,000

7. **On 30th June 2007 the pass book of Mr. Kotesh showed an overdraft balance of Rs 30,000 prepare a bank reconciliation statement using the following information.**
   1. Out of the cheques issued to Siva on 26 June 2007, one for Rs 1000 and another for Rs 2500 the cheque for Rs 2,500 was cashed on 5th July 2007
   2. A wrong credit for Rs 250 relating to some other account was found in the pass book
   3. Out of three cheques deposited into bank for collection on 22nd June 2007 for Rs 3,500 Rs 4000 and Rs 5000 respectively, the cheque for Rs 4000 alone was collected by June 30th 2007.
   4. There is a debite of Rs 800 for interest and Rs 150 for bank charges in the pass book which have not been entered in the cash book.

5. The pass book showed that bank had collected Rs 6000 as interest on govt securities. But there was no entry in the cash book for interest.
6. A bills receivable for Rs 5000 discounted with the bank in the month of May was dishonored on 26 June 1997 and was debited in pass book.

8. **From the following information given below, find out the bank balance as per pass book of Suresh as on 31st Dec 2007.**
   1. Bank balance as per cash book on 31-12-2002 was Rs 5000
   2. Out of cheques issued for Rs 22,000 before 31st Dec for Rs.750 seens to have been not presented for payment.
   3. Cheque for Rs 2,500 received from a customer though recorded in cash book but not sent to bank
   4. Cheque for Rs 500 though issued to suppliers was not recorded in cash book.
   5. Total of a folio of cash book Rs 8,760 was carried as Rs 7,860
   6. Insurance premium Rs 2,500 paid by the bank was not recorded in cash book.

9. **From the following information prepare a Bank Reconciliation statement as on 31-3-2007 of Sirish & co.**
   1. Bank overdraft as per cash book Rs 2,40,900
   2. A customer of the firm who received a cash discount of 2% on this account of Rs 200 paid the company a cheque on 19th March. The bank coloun of the cash book.
   3. Interest debited by the bank on 29th March 2007 but no advice received Rs 27,870.
   4. Cheque issued before 31st March 2007 but not yet presented to bank for Rs 66,000.
   5. Transport subsidy received from government directly by the bank but no advice to the company Rs 42,500
   6. Draft deposited in the bank but not collected till 31st March 2007, Rs 13,500.
   7. Bills for collection credited by the bank Rs 83,600 were not communicated to the company till April 1, 2007
   8. Amount wrongly debited to the company's account by the bank for which no details are available Rs 7,400.
   9. Bankers have made a mistake in balancing by showing over drawn balance in excess by Rs 1000 on 31-3-2007 This was rectified on 4-4-2007.

10. **From the following particulars, ascertain the bank balance as per cash book of Saraswathi as on 31st March 2007.**
    1. Credit balance as per pass book as on 31 - 3 - 2007 Rs 2,500
    2. Bank charges of Rs 60 had not been entered in the cash book.
    3. Out of the cheque of Rs 3,500 paid into the bank a cheque of Rs 3,500 was not yet credited by the banker.
    4. Out of the cheques issued for Rs 4,500 cheques of Rs 3,800 only were presented for payment.
    5. A dividend of Rs 400 was collected by the banker directly but not entered in the cash book
    6. A cheque of Rs 600 had been dishonoured but no entry was made in the cash book.

11. **From the following particulars ascertain the bank balance as per bank pass book of Rama Seshaiah as on 31 - 12- 2007.**

    1. Bank over draft as per cash book on 31-12-07 Rs 6,000
    2. Interest on overdraft for six months endings 31-12-2007 Rs 200 is debited in the pass book
    3. Cheques issued but not cashed before 31-12-07 amounted to Rs 1,500.
    4. Cheques deposited into bank but not cleared and credited before 31-12-07 amounted to Rs 2,500
    5. Interest on investments collected by bank pass book amounted to Rs 1,800,
    6. Bills receivable discounted with bank was dishonoured, and bank had debited Rs 1050 including Rs 50 for bank charges.
    7. The bank coloun cash book receipts side was over cast by Rs 1,000
    8. Bank had wrongly debited his account with Rs 500

12. **From the following particulars of M/s Mamata & co show the bank balance as per cash book as on 31-9-2007.**

    1. On 30-9-07 bank balance as per pass book was Rs 7,850.
    2. Out of cheques paid into bank for Rs 7,500 cheques for Rs 5,000 yet to be collected
    3. Cheques issued in favour of Mr. Sadasiva a supplier for Rs 2,000 are yet to be presented.
    4. A cheque from Kishore for Rs 3,750 deposited in bank on 15th sep, was omitted to be recorded in cash book.
    5. A cheque issued to Mr. Kedar for Rs 4,500 was wrongly recorded as Rs 4,050 in cash book.
    6. An amount of Rs 1,500 pertaining to M/s Madan & co was wrongly credited our account by the banker.

13. **Prepare the Bank reconciliation statement as on 30-6-2007 from the following particulars.**

    1. Debit balance as per pass book on 31 - 6- 07 Rs 15,000
    2. A cheque of Rs 200 was deposited on 25-6-2007 but was not recorded in cash book.
    3. Cheque of Rs 17,000 were issued but of these Rs 10,000 worth were presented before 30-6-07.
    4. Cheques received on 20-6-07 Rs 2,000 were not sent to bank but noted in cash book.
    5. Cheques worth Rs 10000 were sent to bank for collection. Of these Rs 2,000 were credited on 8-7-07 Remaining cheques were credited before 30-6-07.
    6. Bank paid Rs 300 on behalf of Customer to Trade Association. This was to recorded in cash book.
    7. Interest on overdraft Rs 800 was not entered in cash book.
    8. Bank expenses Rs.100 were recorded twice in cash book and another bank charges for Rs. 35 was not recorded in the cash book.
    9. Cash book credit side Bank column was under cast by Rs 1,000

14. **The pass book of a trader is showing a debit balance of Rs 12300 on 31-1-2007 From the following information prepare a bank reconciliation statement.**
    1. Cheques amounting to Rs 4,680 was drawn on 25th January out of which cheques for Rs 3,300 were cashed up to 31st January.
    2. A wrong debit of Rs 240 has been given by Bank in pass book
    3. A cheque for Rs 60 was credited in pass book but was not recorded in cash book.
    4. Cheques amounting to Rs. 6,300 were deposited for collection, But cheques for Rs. 2,200 have been credited in pass book at 5th Feb 2007.
    5. A cheque for Rs 300 returned dishonoured and were debited in pass book.
    6. Interest and bank charges amounted to Rs 30 were not accounted in cash book.
    7. A cheque received entered in cash book but not sent to Bank for collection Rs 150.
15. **On 31-8-2007 pass book of Anupama Showed a credit balance of Rs 37,400 in Account No. 1 which did not agree with his cash book, On scrutiny the following discrepancies were located.**
    1. Three cheques totalling Rs 15200 were deposited into her account of which only those for Rs 9,800 were credited before 31st August.
    2. Anupama has issued two cheques of Rs 1,200 and RS 1,400 only the first cheque was presented for payment before 31st August.
    3. The banker paid electricity bill of Rs 750, Telephone bill of Rs 900 as per the standing instructions of Anupama.
    4. Pass book shows entries of Rs 50 towards charges and Rs 75 towards interest.
    5. A cheque issued for Rs 300 against A/c No. 1 has wrongly entered in A/c No. II by the banker.
    6. The pass book has no entry for the cheque of Ram Prasad for Rs. 270 as it has been dishonoured.
    7. Payments side bank column has been under cast by Rs 20.

    Prepare bank Reconciliation statement as on 31-8-2007.

SUGGESTED READINGS :

Financial Accountancy : Shukla Grewal

Financial Accountancy : Jain and Narang

Financial Accountancy : R.L. Gupta & V.K. Gupta

Dr. Ch. Suravinda

Lesson 7

Trial Balance

7.0 Objective:

After going through this lesson you will be able to understand the following:

1. Method of preparing Trial Balance
2. Advantages of Trial Balance
3. Errors of Trial Balance

Structure:

7.1: Trial Balance – Meaning:

You have learnt preparation of subsidiary books and preparation of ledger accounts in the previous lessons. While writing the transactions in double entry system, you have observed that there is one debit item and its equal credit item. Without debit there is no credit and with out credit there is no debit. For example, when the totals of sales book are credited to sales account, we debit debtors account. These entire debits amount will be equal to the credit of sales account. Similarly, when a transaction is written for total receipts, it will be debited to cashbook with the equal amount. When entries are recorded in ledger, the debit balances of ledger will be equal to credit balances. However, due to some errors knowingly or unknowingly lead to difference in the balances.

Businessman, by the end of the year prepares final accounts and ascertains gross profit, net profit and firm financial position based on the balances of the ledger. If the balances in the ledger are not accurate, the final accounts become erroneous. The decisions taken based on these accounts are not dependable. That is why businessman tries for accuracy of accounts. Trial Balance is a device useful for such preparation. This is not an account. It is a statement consisting of balances of ledger. The accuracy of the ledger can also be proved from this.

7.2: Methods of preparing Trial Balance:

Trial Balance can be prepared in two ways. They are totals method and balances method. Let us discuss about them.

7.2.1: Totals Method:

Under this method all accounts of the ledger are shown under different heads. Under the head “Trial Balance”, there are three columns Viz., particulars, debit totals and credit totals. If the debit and credit totals are equal, the trial balance is said to be correct.

7.2.2: Balances Method:

Under this method only balances of ledger are taken. In any account when debit balances are more than credit balances only the difference is taken as debit balance. In this way the balances of various accounts are shown as debit and credit under the head Trial Balance. If the credit and debit balances are same, the trial balance is said to be correct.

The following example can be observed to understand the above two methods.

Illustration:

Trial Balance

Name of the Account	**Totals**		**Balances**	
	Debit	Credit	Debit	Credit
	Rs.	Rs.	Rs.	Rs.
Cash in hand	3,305	2,680	625	
Cash at bank	8,100	5,650	2,450	
Capital account	44,770		44,770	
Drawings account	350		350	
Stock	35,100		35,100	
Furniture	4,530	400	4,130	
Purchases	1,350		1,350	
Sales	2,000		2,000	

Sundaram	4,000	1,000	3,000	
Prakash	2,000	3,500	1,500	
Ganesh	1,100	450	650	
Wages and salaries 600		600		
Interest account	75		75	
Discount account	100	160	60	
	60,610	**60,610**	**48,330**	**48,330**

7.3: Factors to be considered while preparing Trial Balance:

The following are the factors to be considered while preparing Trial Balance.

1. If all personal accounts are to be shown in the trial balance, the list of accounts becomes big. Therefore, it is better to show only two accounts, one debtors account and the other creditors account.

2. Though the debit and credit amounts are entered properly, sometimes there arises some difference. This may be due to non-entry of capital or stock.

3. Even after the entry of capital and stock, there may be difference in totals. In such case that difference shall be transferred to 'Suspense Account'. If the debit side of the trial balance is higher, then the suspense account shows credit balance. Contrary, if the credit side of the trial balance is higher, then the suspense account shows debit balance. The debit balance of the suspense account shall be shown on the assets side and the credit balance of the suspense account shall be shown on the liabilities side. Then only the balances in the balance sheet tally. After the errors in ledger are rectified, the suspense account will be closed.

4. Normally, closing stock appears in adjustments than in trial balance. If it is given in the trial balance means, it is to be assumed that the trading account was already prepared. In such case gross profit or loss appears in the trial balance.

5. It is to be remembered that different accounts show the balances in the following way while preparing trial balance.

   a) All expenses (salaries, wages, interest paid, rent, commission, discount paid, transport, insurance premium etc) —— Debit balances.

   b) All assets (plant, machinery, cash, debtors, furniture, goodwill, patents, fixtures, campuses etc.) —— Debit balances.

   c) Bad debts, drawings, opening stock —— Debit balances.

   d) All incomes (discount received, commission, rent etc) —— Credit balances.

e) All liabilities (creditors, bills payable, overdraft, loan taken etc) — - Credit balances.

f) Capital, reserve for bad and doubtful debts —— Credit balances.

7.4: Advantages of Trial Balance:

The following are the advantages of preparing Trial Balance.

1. By preparing trial balance after preparation of ledger accounts helps in testing the accuracy of the accounting.
2. As there are many transactions in business firms, there are chances for mistakes. Trial balance acts as an index in identifying such mistakes. When the totals of debits and credits are not equal we can say that there is a mistake in the trial balance.
3. For preparation of final accounts at the end of the year and to ascertain gross profit, net profit and financial position, trial balance helps as a first step.

However, it is to be remembered that even though there are equal in balances in the trial balance, we cannot come to the conclusion that there are no mistakes. Trial balance cannot identify all errors. They will be discussed later.

7.5: Errors in Trial Balance:

After writing entries from transactions, recording in ledger, and showing debit and credit balances in the trial balances, there occur some errors due to mistake or recklessness. We can say that the trial balance is erroneous if the balances are not tallied. But sometimes, trial balance may be wrong in spite of equal debit and credit balances. These errors can be divided into two categories viz., disclosed errors and undisclosed errors.

7.5.1: Disclosed Errors:

When the following errors take place, the trial balance balances disagree. They are explained as follows:

a) **Wrong totaling or casting of the subsidiary books:** If there are wrong totals in subsidiary books, trial balance will disclose. For example, if the total of the sales book is under cast by Rs.500, the sales account is credited with Rs.500 less. The personal accounts of customers are debited properly relating to their purchases. In such situation, credits will be more than debits by Rs.500. Similarly, any error of wrong totaling in any subsidiary book will be disclosed by the trial balance.

b) **Posting a wrong amount to ledger account:** When ledger is recorded with a wrong amount, the trial balance will disclose the error. For example, if a supplier sends Rs. 750 worth of goods, this amount needs to be recorded in purchases book. However, it may be recorded as Rs. 570. In such situations, credits are less than debits by Rs. 180 (750-570). This leads to difference in the trial balance.

c) **Posting an amount on the wrong side of a ledger account:** If the totals of accounts are recorded one side instead of the other, it also leads to imbalance in the trial balance. For example, if goods of Rs.300 are returned to the supplier, it is to be recorded in sales returns book. Similarly, the same amount should be debited to the seller account. But, if his account is credited with Rs.300, the credit side of the account will increase by Rs.600 (300+300).

d) Omission of an amount from ledger accounts: When the amounts to be posted in ledger accounts are not posted, there occurs difference in balance. For example, if we pay cash to the supplier, the supplier's account should be debited and the cash account should be credited. But my mistake, only one of the two is recorded there comes difference.

e) Omission of an amount from the trial balance: When the balances of accounts are posted in trial balance and any one-account balance is misses, the trial balance will not agree.

7.5.2: Undisclosed Errors:

If the above-mentioned errors are not there, the totals of the trial balance equal. However, when the totals of the trial balance are equal, it cannot be said that it is error free. Trial balance cannot disclose some errors. These are serious errors than the above. The following are the errors not disclosed by trial balance.

a) Omission of an entry altogether from subsidiary books: these errors occur when the transactions are ignored completely in the subsidiary books. For example, if we receive back Rs. 200 worth of goods from the customer, and not recorded in the sales returns book, then the customer account is also not credited. The sales returns account is also not debited. In result, this amount will be excluded from totals. Thus, trial balance will not show any difference though there is an error.

b) Writing the wrong amount in the subsidiary books: when the wrong totals are recorded in the subsidiary book, and based on this error entries are posted, trial balance cannot identify the error. For example, an invoice of Rs.860 is recorded as Rs.680 in sales book; the totals of trial balance will not differ, though there is an error of Rs.180 of both credit and debit sides.

c) Posting to a wrong head: When transactions are not recorded in correct accounts, these errors occur. For example, a sale of Rs.650 sold to Indra & co., and written in the name of Chandra& co., the totals of trial balance do not differ.

d) Errors of principles: If transactions are written against the principles of accounting, these errors occur. The following are such errors:

1. **Treating expenditure as asset:** In certain situations, expenditure is treated as asset. For example, repairs of machinery if debited to machinery account instead of repairs account, the trial balance do not show any difference as amount is debited in one or the other account.

2. **Treating asset as expenditure:** Some times, the purchase of assets also will be shown as expenditure. For example, furniture worth Rs. 3,500 purchased for office work, may be debited to office expenditure account instead of furniture (asset) account.

3. **Treating of income as liability and liability as income:** These errors may also happen often. For example, a commission of Rs. 2000 earned may wrongly be credited to the person or the organization that has given the commission instead of crediting to commission account. Similarly, a loan taken may wrongly be credited to sales account instead of personal account.

4. **Compensating errors:** Sometimes the errors on debit side may compensate errors on credit side. Because of this, trial balance looks correct. For example, an excess debit of Rs.150 to purchases account, excess debit of Rs.100 to sales account and an excess debit of Rs. 50 to sales returns account do not affect the trial balance.

7.6: Ascertaining of Errors:

It is the duty of an accountant to rectify the errors when the totals of the trial balance are not tallied. To ascertain the errors quickly, the following measures are required.

a) The debit and credit side totals of trial balance are to be ascertained first. When one account is shown instead of different accounts like sundry debtors and sundry creditors, they are to be totaled again.

b) Care is to be taken to see that the balances of all accounts including cash and bank balances should be included in the trial balance.

c) The correct difference in trial balance is to be ascertained. Any account carries such amount balance may be verified. Similarly, half the amount accounts, double the amount accounts need to be verified.

d) Sufficient care should be taken while ascertaining the balances of various accounts.

e) It is necessary to verify the subsidiary accounts once again. Particularly, when 1,10,100,1000 like mistakes are happened.

f) When there is abnormal difference in trial balance, it is to be compared with previous year trial balance. For example, if sales account is far higher than that of the previous year, that account needs to be verified.

g) It is to be checked that all amounts are posted in trial balance.

h) Even at this stage, the difference is not identified; all accounts are to be verified. For this purpose, it is better to look into the totals of subsidiary books first. Then, they are to be observed whether all the aspects are recorded. Further, they are to be looked into whether they are opened with correct balances.

7.7: Illustrations:

1. Prepare trial balance from the following account balances.

Narayanamurthy Capital Account	21,500

Narayanamurthy Drawings Account	2,500
Opening stock	25,500
Debtors	23,500
Loan to Sundar	5,000
Bills receivable	3,000
Bills payable	4,450
Creditors	12,000
Cash at office	400
Tools and fixtures	6,250
Bank overdraft	3,000
Cash at bank	2,250
Import duty	1,750
Purchases	20,000
Salaries	1,250
Sales	56,500
Wages	5,500
Purchases returns	300
Sales returns	250
Commission	350
Stationery	500
Business expenses	850
Rent account	500
Discount received	2,000
Bad debts	400

Solution:

Trial Balance

Debit Balances	Rs.	Credit Balances	Rs.
Narayanamurthy Drawings a/c	2,500	Narayanamurthy Capital a/c	21,500
Opening stock	25,500	Bills payable	4,450
Debtors	23,500	Creditors	12,000
Loan to Sundar	5,000	Bank overdraft	3,000
Bills receivable	3,000	Sales	12,000

Cash at office	400	Purchases returns	300
Tools and fixtures	6,250	Discount received	2,000
Cash at bank	2,250		
Import duty	1,750		
Purchases	20,000		
Salaries	1,250		
Wages	5,500		
Sales returns	250		
Commission	350		
Stationery	500		
Business expenses	850		
Rent account	500		
Bad debts	400		
	99,750		**99,750**

2. Some inexperienced people prepare the following trial balance. Prepare it proper way.

	Debit balances		Credit balances
	Rs.		Rs.
Cash in hand	375	Opening stock	8,500
Cash at bank	9,100	Bills payable	8,00
Discount given	600	Debtors	19,000
Sales	27,500	Bills receivable	850
Furniture	750	Creditors	22,500
Machinery	10,000	Purchases returns	475
Carriage inwards	650	Purchases	15,000
Insurance	400	Office salaries	4,150
Stationery & Printing	350	Sales returns	500
Taxes	550		
Mukundam Capital	20,500		
Mukundam Drawings	1,000		
	71,775		**71,775**

Solution:

Trial Balance

Debit balances	Rs.	Credit balances	Rs.
Cash in hand	375	Sales	27,500
Cash at bank	9,100	Mukundam Capital	20,500
Discount given	600	Bills payable	800
Furniture	750	Creditors	22,500
Machinery	10,000	Purchases returns	475
Carriage inwards	650		
Insurance	400		
Stationery & Printing	350		
Taxes	550		
Mukundam Drawing	1,000		
Opening stock	8,500		
Debtors	19,000		
Bills receivable	850		
Purchases	15,000		
Office salaries	4,150		
Sales returns	500		
	71,775		**71,775**

3. Prepare trial balance for the year ending 31st December 2007 from the following ledgers of Chatterji.

	Rs.		Rs.
Plant and machinery	80,000	Salaries	6,800
Purchases	68,000	Wages	10,000
Purchases returns	1,275	Discount received	800
Sales returns	1,000	Sundry Creditors	25,000
Opening stock	30,000	Freight – Purchases	750

Capital account	1,00,000	Freight – Sales	1,200
Discount given	350	Rent, rates and taxes	2,000
Bank charges	75	Advertisements	2,000
Sundry debtors	45,000	Cash at bank	6,900
Sales	1,27,000		

Solution:

Trial balance of Chatterji as on 31st December 2007

	Debit balances Rs.		Credit balances Rs.
Plant and machinery	80,000	Capital account	1,00,000
Purchases	68,000	Sales	1,27,000
Sales returns	1,000	Purchases returns	1,275
Opening stock	30,000	Discount received	800
Discount given	350	Sundry creditors	25,000
Bank charges	75		
Sundry debtors	45,000		
Salaries	6,800		
Wages	10,000		
Freight – Purchases	750		
Freight – Sales	1,200		
Rents, rates and taxes	2,000		
Advertisements	2,000		
Cash at bank	6,900		
	2,54,075		**2,54,075**

4. Prepare trial balance from the books of Gupta as on 31st December 2007.

	Rs.		Rs.
Capital	8,794	Furniture	250
Opening stock as on 1-1-2007	8,560	Cash in hand	5

Discount (Cr)	35	Sundry creditors	845
Wages	3,000	Rates and taxes	30
Advertising	470	Printing and stationery	50
Plant and machinery	2,000	Sundry debtors	1,800
Sales	36,000	Drawings	1,250
Water and energy	70	General expenses	123
Purchases returns	190	Insurance	42
Office rent	150		
Purchases	26,270		
Bills receivable	200		
Cash at bank	666		

Solution:

Trial balance of Gupta as on 31st December 2007

	Debit balances Rs.		Credit balances Rs.
Opening stock	8,560	Capital	8,794
Wages	3,000	Discount (Cr)	35
Advertising	470	Sales	36,000
Plant and machinery	2,000	Purchases returns	190
Water and energy	70	Sundry creditors	845
Office rent	150	Suspense account	1,072
Purchases	26,270	(Dif. In trial balance)	
Bills receivable	200		
Cash at bank	666		
Furniture	250		
Cash in hand	5		
Sundry debtors	1,800		
Rates and taxes	30		

Printing and stationery	50		
Drawings	1,250		
General expenses	123		
Insurance	42		
	46,936		**46,936**

5. From the following particulars prepare Trial balance of Pradeep as on 31st December 2007.

	Rs.		Rs.
Pradeep capital	1,19,400	Sales	3,56,530
Pradeep drawings	10,550	Sales returns	2,780
Sundry creditors	59,630	Salaries	11,000
6% loan (credit)	20,000	Rent and taxes	5,620
Cash in hand	3,030	Interest and discount	5,870
Cash at bank	18,970	Traveling expenses	1,880
Sundry debtors	62,000	Repairs	3,370
Bills receivable	9,500	Insurance	400
Provision for doubtful debts	2,500	Bad debts	3,620
Furniture	8,970	Commission received	5,640
Plant and machinery	28,800		
Stock as on 1-1-2007	89,780		
Purchases	2,56,590		
Productive wages	40,970		

Solution:

Pradeep Trial balance as on 31st December 2007

	Debit balances Rs.		Credit balances Rs.
Pradeep drawings	10,550	Pradeep capital	1,19,400

Cash in hand	3,030	Sundry creditors	59,630
Cash at bank	18,970	6% loan (credit)	20,000
Sundry creditors	62,000	Provision for doubtful debts	2,500
Bills receivable	9,500	Sales	3,56,530
Furniture	8,970	Commission received	5,640
Stock on 1-1-2007	89,780		
Purchases	2,56,590		
Productive wages	40,970		
Sales returns	2,780		
Salaries	11,000		
Rent and taxes	5,620		
Interest and discount	5,870		
Traveling expenses	1,880		
Repairs	3,370		
Insurance	400		
Bad debts	3,620		
	5,63,700		**5,63,700**

7.8: Try yourself:

1. The following balances are taken from Nagabhushanam books. Prepare trial balance as on 31st December 2007.

	Rs.		Rs.
Nagabhushanam Capital	15,000	Sales returns	1,000
Nagabhushanam Drawings	2,500	Discounts given	800
Furniture	1,300	Discounts received	1,000
Bank overdraft	2,100	Taxes and insurance	1,000
Creditors	6,650	General expenses	2,000
Business premises	10,000	Salaries	4,500
Opening stock	11,000	Commission paid	1,100

Debtors	9,000	Carriage inwards	900
Rent received	500	Reserve for bad&doubtful debts	250
Purchases	55,000	Bad debts	400

(Total of trial balance: Rs. 1,00,500)

2. The following are the balances taken from Raghupathi as on 30th September 2007. Prepare trial balance from these particulars.

	Rs.		Rs.
Raghupathi capital	59,700	Cash at bank	11,665
Drawings	5,275	Cash in hand	295
Bills receivable	4,750	Insurance	200
Machinery	14,400	Traveling expenses	910
Debtors	31,000	Salaries and wages	5,500
8% Loan (Cr)	10,000	Stock as on 1-10-2006	44,840
Fixtures and Fittings	4,485	Rent and taxes	2,810
Creditors	28,815	Commission received	2,820
Bad debts	1,810	Sales	1,78,215
Discount	2,935	Purchases	1,28,295
Repairs	1,285	Productive wages	20,485
Purchases returns	1,390		

(Total of trial balance: Rs. 2,80,940)

3. Prepare trial balance from the following balances.

	Rs.		Rs.
Opening stock	18,600	Discount given	1,500
Coal and coke	2,000	Loans	5,000
Productive wages	11,000	Debtors	16,000
Purchases	80,000	Creditors	4,000
Sales	1,20,000	Profit & loss A/A(Cr)	4,000
Carriage outwards	1,500	Lease asset	6,500
Repairs	1,000	Machinery	8,000
Loose tools	1,300	Patents	1,000

Capital	40,000	Discount received	600
Lighting charges	1,800	Goodwill	15,000
Office salaries	2,600	Cash at bank	5,100
Office furniture	500	Cash in hand	200

(Total of trial balance: Rs. 1,73,600)

4. The following are the balances of Niranjan as on 31st December 2007. Based on these prepare trial balance.

	Rs.		Rs.
Sundry debtors	60,000	Capital	2,00,000
Sales	2,50,000	Drawings	35,000
Sundry creditors	10,000	Opening stock	50,000
General trading expenses	12,000	Sales returns	3,000
Factory rent	2,000	Plant and machinery	60,000
Interest received	1,200	Motor vehicles	20,000
Purchases returns	2,000	Bank balance	23,000
Productive wages	20,000	Loan on Pledge (Dr)	20,000
Purchases	1,00,000	Cash balance	100
Discount received	1,800	Traveling expenses	6,000
Provision for bad debts	2,000	Discount given	2,000
Furniture	5,000	Office salaries	22,000
Carriage inwards	5,500	Rates, taxes and insurance	1,200

(Total of trial balance:Rs. 4,67,000)

5. The following are the balances of Sudhakar as on 31st December 2007. Prepare trial balance as on that date.

	Rs.		Rs.
Land and buildings	26,000	Carriage inwards	1,700
Sundry debtors	40,500	Discount given	1,400
Sundry creditors	45,000	Discount received	1,100
Plant and machinery	20,000	Reserve for doubtful debts	1,000
Purchases	35,000	Factory expenses	3,400

Sales	1,23,400	Patent rights	2,000
Opening stock	23,500	Capital	45,000
Wages	27,000	Drawings	6,100
Factory rent and taxes	2,500	Cash at bank	4,000
Salaries	6,800	Cash in hand	250
Advertising	3,000		
Office rent and insurance	4,000		
General expenses	6,800		

(Total of trial balance: Rs. 2,15,500)

7.9: Summary:

According to double entry system for every debit there will be equal credit. When accounts are written according to this principle, debit balances equal to credit balances.

For preparation of final accounts and to know the accuracy of account balances trial balance is prepared. It is not an account. It is a statement consisting of balances of ledger.

The credit and debit of trial balance should be equal. Nominal expenses, assets, debtors are shown on debit side and incomes, creditors; liabilities are shown on credit side.

7.10: Glossary:

Trial balance: It is a statement consisting of accounting balances prepared by the business man by the end of the year to know the accuracy of accounts.

Suspense account: It is a temporary account opened to transfer the difference in the trial balance if any.

Totals method of trial balance: A statement prepared based on the debit and credit balances of each account. Debit balances are shown on debit side and credit balances on credit side.

Balances method of trial balance: A statement prepared based on the balance of each account. Only the net balance will be shown in the trial balance.

7.11: Self Assessment Questions:

1. Why a trial balance? And how is it prepared?
2. What are the errors disclosed by trial balance?
3. What are the errors not disclosed by trial balance?

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Lesson: 9

Bills of Exchange: Trade Bills

9.0 Objective:

After going through the lesson you will be able to understand

1. The definition of Bills of Exchange
2. The definition of Promissory Note
3. The differences between Bills of Exchange and Promissory Note
4. Various terms used in Bills of Exchange
5. Account method of Trade bills in the books of drawer, drawee and endorsee.

Structure:

9.1: Introduction

9.2: Bills of Exchange – Definition

9.3: Important terms in Bills of Exchange

9.4: Promissory Note Vs. Bills of Exchange

9.5: Model Journal entries

9.6: Illustrations

9.7: Try Yourself

9.8: Summary

9.9: Glossary

9.10: Questions

9.1: Introduction:

We all know that in the present modern business world all transactions are not limited to cash alone. When goods are sold, the purchaser may not immediately pay the amount. These credit transactions are inevitable in almost all businesses. In such cases, the purchaser sometimes gives a letter of agreement to the seller agreeing to pay the amount due after a stipulated period. Such letter or instrument is called as bills of exchange. These instruments can be transferred from one person to the other freely.

9.2 Bills of Exchange – Definition:

Section 5 of the Negotiable Instruments Act defines a Bill of Exchange as," an instrument in writing containing an unconditional order, signed by the maker, directing a certain person, to pay a certain sum of money only to, or to the bearer of a certain person or to the bearer of the instrument".

9.3: Important terms in Bills of Exchange:

1. **Drawer:** The person who draws the bill of exchange is called the *drawer*. He is the creditor who sells goods.
2. **Drawee or Acceptor:** The person on whom the bill of exchange is drawn is called *drawee*. He is the debtor who buys goods. The drawee becomes the acceptor when he accepts the bill of exchange.
3. **Payee:** The person named in the bill of exchange, to whom or to whose order the money in the instrument is to be paid, is called the *payee*.
4. **Holder:** The person who is entitled to the possession of the bill of exchange in his own name and who has a right to receive or recover the amount due on the instrument, is called the *holder.*
5. **Holder in due course:** A *holder in due course* is a holder who obtains a negotiable instrument for valuable consideration, in good faith and before maturity. He will have a valid title over the instrument though the title of the transferor may be defective.
6. **Endorsement:** The payee of a negotiable instrument may not himself keep the instrument with him. He may transfer the ownership of the instrument in favour of another person. Such a person can get the payment of the instrument from the drawee. The process of transferring of a ownership of the instrument is termed as *"endorsement*" of the instrument. According to Negotiable Instruments Act, " when the maker or holder of a negotiable instrument signs his name otherwise than as such maker, for the purpose of negotiation, on the back or face thereof, or on a slip of a paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to endorse the instrument. The person endorsing the instrument is called the 'endorser'. The person, to whom the instrument is endorsed, is called the 'endorsee'.
7. **Maturity of bill:** A bill of exchange matures on the date on which it falls due. If the instrument is payable on demand, it becomes due immediately on presentation for payment. If it is payable after the expiry of a particular period of time, the date of maturity will be calculated after adding *three days of grace*.
8. **Dishonour:** Non-payment of the amount of a bill of exchange on the date of maturity is called *dishonour* of the instrument.
9. **Noting:** Noting is authentic and official proof of presentment and dishonour of a bill of exchange. It is a memorandum of a minute recorded by a notary public upon the dishonoured instrument or upon a paper attached thereto or partly upon each. However, noting is not compulsory.

10. **Retiring of a bill:** If all parties agree, a bill may be withdrawn before maturity either because the acceptor desires its withdrawal to avoid its dishonour or because he is desirous of paying the amount without waiting till its due date.

11. **Renewal of bill:** When the original bill has been dishonoured or retired (where the drawee is not in a position to pay), if the parties agree, a new bill in place of the original bill may be accepted by the drawee. This is termed as renewal of bill. The new bill may be for the full amount, i.e. of the old bill and noting charges, if any, plus interest.

12. **Discounting the bill:** The holder of the bill or the drawer need not keep the bill with him till the due date. In case he needs money, he can sell the bill to the bank. This is called as discounting the bill. In such case bank reduces some amount in the bill amount in the form of discount. Generally, discount is mentioned as a percentage.

13. **Promissory note:** Section 4 of the Negotiable Instruments Act defines a promissory note as, "an instrument in writing (not being a bank note and a currency note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument".

9.4: Promissory note Vs. Bills of Exchange

Promissory note	**Bills of Exchange**
1. It is an unconditional instrument	1. It is only an order to pay the sum.
2. The person who has taken money promises to pay the same.	2. The creditor writes the bill to pay sum due.
3. Debtor need not accept the note.	3. Drawer writes the bill and drawee accepts.
4. There are two parties, creditor and debtor	4. There are three parties, drawer, drawee and payee.
5. Dishonour notice not required.	5. Notice of dishonour not required.
6. The responsibility to pay the sum lies on the debtor or the writer of the note.	6. Responsibility to pay the sum lies On the drawee.

9.5: Model Journal Entries:

Books of Drawer		**Books of Drawee**	
1. When bill is written:			
Bills receivable A/C	Dr	Drawer A/C	Dr
To Drawee		To Bills payable	

2. When bill honoured:

Cash/Bank A/C Dr	Bills Payable A/C Dr
To Bills receivable	To Cash/Bank

3. When bill dishonoured:

Drawee A/C Dr	Bills Payable A/C Dr
To Bills receivable	To Drawer

4. When bill sent for collection:

Bank for collection of bills A/C Dr	No Entry
To Bills receivable	

5. When the sent bill honoured:

Cash/Bank A/C Dr	Bills payable A/C Dr
To Bank for collection of Bills	To Cash/Bank

6. When bill sent for collection dishonoured:

Drawee A/C Dr	Bills payable A/C Dr
To Bank for collection of Bills	To Drawer

7. When bill endorsed:

Endorsee A/C Dr	No Entry
To Bills receivable	

8. When endorsed bill honoured:

No Entry	Bills payable A/C Dr
	To Cash/Bank

9. When endorsed bill dishonoured:

Drawee A/C Dr	Bills payable A/C Dr
To Endorsee	To Drawer

10. When bill discounted at bank:

Cash/Bank A/C Dr	No Entry
Discount A/C Dr	
To Bills receivable	

11. When discounted bill honoured:

No Entry		Bills payable A/C	Dr
		To Cash/Bank	

12. When discounted bill dishonoured:

Drawee A/C	Dr	Bills payable A/C	Dr
Cash/Bank		To Drawer	

9.6: Illustrations:

Illustration: 1:

On 1st July 2007 Srinivas sold goods worth Rs.1,000 to Ramesh and wrote a bill of three months on him. Ramesh accepted the bill and honoured on the due date. Write journal entries in the books of Srinivas and Ramesh.

Solution:

Journal entries in the books of Srinivas:

1-7-2007	Ramesh A/C	Dr	1,000	
	To sales			1,000
	(Being goods to Ramesh)			
	Bills receivable A/C	Dr	1,000	
	To Ramesh			1,000
	(Being accepted bill received from Ramesh)			
4-10-2007	Cash/Bank A/C	Dr	1,000	
	To Bills receivable			1,000
	(Being the sum received on due date)			

Journal entries in the books of Ramesh:

1-7-2007	Purchases A/C	Dr	1,000	
	To Srinivas			1,000
	(Being goods purchased from Srinivas)			
	Srinivas A/C	Dr	1,000	
	To Bills payable			1,000
	(Being acceptance given for the bill)			
4-10-2007	Bills payable A/C	Dr	1,000	
	To cash/Bank			1,000

Illustration 2:

On 1st July 2007 Kumar wrote a bill for Rs.7, 500 on Rajan for 4 months duration. Rajan after acceptance returned the bill. Kumar discounted the bill at the bank at 6 per cent. Write journal entries in the books of both the parties assuming that the bill is honoured on the due date.

Solution:

Journal entries in the books of Kumar:

1-7-2007	Bills receivable A/C	Dr	7,500	
	To Rajan			7,500
	(Being bill received from Rajan)			
	Bank A/C	Dr	7,350	
	Discount A/C	Dr	150	
	To Bills receivable			7,500
	(Being bill discounted (7,500x4/12x6/100))			

Journal entries in the books of Rajan:

1-7-2007	Kumar A/C	Dr	7,500	
	To Bills payable			7,500
	(Being bill accepted)			
4-11-2007	Bills payable	Dr	7,500	
	To Bank			7,500
	(Being bill honoured)			

Illustration 3:

On 1st January 2007 Ramu wrote a bill on Nageswararao for Rs.300 of 3 months duration. On 1st March 2007 Ramu endorsed this bill to Kantharao from whom he purchased goods for the same amount. On the same date Kantharao discounted the bill at the bank at 6 per cent. On the due date bill is honoured. Pass journal entries in the books of all parties.

Solution:

Journal entries in the books of Ramu:

1-1-2007:	Bills receivable A/C	Dr	300	
	To Nageswararao			300
	(Being bill received from Nageswararao)			

1-3-2007	Purchases A/C	Dr	300	
	To Kantharao			300
	(Being goods purchased from Kantharao)			
	Kantharao A/C	Dr	300	
	To Bills receivable			300
	(Being bill received from Nageswararao endorsed to Kantharao)			

Journal entries in the books of Nageswararao:

1-1-2007	Ramu A/C	Dr	300	
	To Bills payable			300
	(Being bill accepted)			
4-4-2007	Bills payable A/C	Dr	300	
	To Bank			300
	(Being the bill honoured)			

Journal entries in the books of Kantharao:

1-3-2007	Ramu A/C	Dr	300	
	To Sales			300
	(Being goods sold on credit)			
	Bills receivable A/C	Dr	300	
	To Ramu			300
	(Being bill received from Ramu)			
	Bank A/C	Dr	298-50	
	Discount A/C	Dr	1-50	
	To Bills receivable			300
	(Being bill discounted (300x1/12x6/100)			

Illustration: 4:

On 1st July 2007 Sridhar sold goods worth Rs.500 to Suresh and got acceptance of the bill. He sent the bill to the bank for collection and the amount is collected. Write the necessary entries in the books of both the parties.

Solution:

Journal entries in the books of Sridhar:

1-7-2007	Suresh A/C	Dr	500		
	To Sales			500	
	(Being goods sold on credit)				
	Bills receivable A/C	Dr	500		
	To Suresh			500	
	(Being accepted bill received)				
4-10-2007	Bank for collection of bills A/C		Dr	500	
	To bills receivable				500
	(Being bill sent for collection)				
	Bank A/C		Dr	500	
	To bank for collection of bills				
	(Being bill collected)				

Journal entries in the books of Suresh:

1-7-2007	Purchases A/C	Dr	500	
	To Sridhar			500
	(Being goods purchased)			
	Sridhar A/C	Dr	500	
	To Bills payable			500
	(Being bill accepted)			
4-10-2007	Bills payable A/C	Dr	500	
	To bank			500
	(Being bill honoured)			

Illustration 5:

On 1st July 2007 Lohith wrote a 3 months bill on Rohit for Rs.3000 and got his acceptance. Write entries to renew the bill before the due date assuming the following circumstances.

a) Got acceptance for the new bill of 3 months in the place of old one with 6% interest.

b) Got cash 1/3rd of the bill, and new bill of 3 months for the remaining amount with 6% interest.

c) Got Rs.1, 500 along with Rs. 15 towards interest and a new bill for the remaining amount.

Solution:

Entries in the books of Lohit:

1-7-2007	Bills receivable A/C	Dr	3,000	
	To Rohit			3,000
	(Being acceptance received)			
	Rohit A/C	Dr	3,000	
	To Bills receivable			3,000
	(Being old bill cancelled)			

a) When the new bill got accepted with 6 % interest:

4-10-2007	Bills receivable A/C	Dr	3,045	
	To interest			45
	To Rohit			3,000
	(Being the bill the renewed at 6% interest)			

b) When 1/3rd cash received and the new bill for the remaining at 6% interest:

4-10-2007	Bank A/C	Dr	1,000	
	Bills receivable A/C	Dr	2,030	
	To Interest			30
	To Rohit			3,000
	(Being new bill received with part payment)			

c) When Rs.1, 500 cash and Rs.15 interest received with a new bill received:

	Bank A/C	Dr	1,515	
	Bills receivable A/C	Dr	1,500	
	To interest			15
	To Rohit			3,000
	(Being new bill received along with interest and part payment)			

Journal entries in the books of Rohit:

1-7-2007	Rohit A/C	Dr	3,000	
	To Bills payable			3,000

(Being bill accepted)

4-10-2007	Bills payable A/C	Dr	3,000	
	To Lohit			3,000
	(Being the bill cancelled)			
a)	Lohit A/C	Dr	3,000	
	Interest A/C	Dr	30	
	To Bills payable			3,030
	(Being new bill accepted with 6% interest)			
b)	Lohit A/C	Dr	3,000	
	Interest A/C	Dr	30	
	To Bank			1,000
	To Bills payable			2,030
	(Being 1/3rd cash paid and new bill accepted with interest)			
c)	Lohit A/C	Dr	3,000	
	Interest A/C	Dr	15	
	To Bank			1,515
	To Bank			1,500
	(Being the new bill accepted along with part payment)			

Illustration 6:

On 1st July 2007 Kamalnath sold goods to Vimalnath for Rs.5, 000 and wrote four bills on him. First bill for a month to Rs.700, second bill for 2 months for Rs.1, 500, third bill for 3 months for Rs.2, 000 and the fourth bill for 4 months for the remaining amount. Vimalnath accepted all these bills.

Kamalnath kept the fist bill with him. On July 1st itself, the second bill transferred to Amarnath, the third bill discounted on 1st August at 6% and the fourth bill sent to bank for collection.

All these four bills dishonoured on the due date. Write necessary journal entries in the books of Kamalnath, Vimalnath and Amarnath.

Solution:

Journal entries in the books of Kamalnath:

1-7-2007	Vimalnath A/C	Dr	5,000	
	To sales			5,000

	(Being goods sold on credit)			
	Bills receivable A/C	Dr	700	
	To Vimalnath			700
	(Being a bill of one month due received)			
	Bills receivable A/C	Dr	1,500	
	To Vimalnath			1,500
	(Being a bill of two months due received)			
	Bills receivable A/C	Dr	2,000	
	To Vimalnath			2,000
	(Being a bill of 3 months due received)			
	Bills receivable A/C	Dr	800	
	To Vimalnath			800
	(Being a bill of 4 months due received)			
	Amarnath A/C	Dr	1,500	
	To bills receivable			1,500
	(Being Vimalnath bill endorsed to Amarnath)			
1-8-2007	Bank A/C	Dr	1,980	
	Discount A/C	Dr	20	
	To bills receivable			2,000
	(Being bill discounted)			
4-7-2007	Vimalnath A/C	Dr	700	
	To bills receivable			700
	(Being the first bill dishonoured)			
4-9-2007	Vimalnath A/C	Dr	2,000	
	To Amarnath			2,000
	(Being endorsed second bill dishonoured)			
4-10-2007	Vimalnath A/C	Dr	2,000	
	To bank			2,000
	(Being the discounted third bill dishonoured)			
4-11-2007	Bank for collection of bills A/C	Dr	800	
	To Bills receivable			800
	(Being the fourth bill sent for collection)			
	Vimalnath A/C	Dr	800	
	To Bank for collection of bills			800
	(Being bill sent for collection dishonoured)			

Journal entries in the books of Vimalnath:

1-7-2007	Purchases A/C	Dr	5,000	
	To Kamalnath			5,000
	(Being goods purchased on credit)			
	Kamalnath A/C	Dr	700	
	To Bills payable			700
	(Being first bill accepted)			
	Kamalnath A/C	Dr	1,500	
	To bills payable			1,500
	(Being second bill accepted)			
	Kamalnath A/C	Dr	2,000	
	To bills payable			2,000
	(Being third bill accepted)			
	Kamalnatha A/C	Dr	800	
	To bills payable			800
	(Being fourth bill accepted)			
1-8-2007	Bills payable A/C	Dr	700	
	To Kamalnath			700
	(Being the bill dishonoured)			
4-9-2007	Bills payable A/C	Dr	1,500	
	To Kamalnath			1,500
	(Being the second bill dishonoured)			
4-10-2007	Bills payable A/C	Dr	2,000	
	To Kamalnath			2,000
	(Being the third bill dishonoured)			
4-11-2007	Bills payable A/C	Dr	800	
	To Kamalnath			800
	(Being the fourth bill dishonoured)			

Journal entries in the books of Amarnath:

1-7-2007	Bills receivable A/C	Dr	1,500	
	To kamalnath			1,500
	(Being endorsed bill received)			
4-9-2007	Kamalnath A/C	Dr	1,500	
	To Bills receivable			1,500
	(Being endorsed bill dishonoured)			

Illustration 7:

On 1st July 2007 Sivaprasad sold goods to Ramprasad for Rs.6, 000 and wrote a bill for 3 months and got his acceptance. Later, he discounted the bill at the bank at 8%. On the due date the bill dishonoured due to insolvency of Ramprasad. Bank charged Rs.36 towards noting charges. 25 paise per rupee collected from Ramprasad in full settlement. Write journal entries in the books of both the parties.

Solution:

Journal entries in the books of Sivaprasad:

1-7-2007	Ramprasad A/C	Dr	6,000	
	To Sales			6,000
	(Being goods sold on credit)			
	Bills receivable A/C	Dr	6,000	
	To Ramprasad			6,000
	(Being accepted bill received)			
	Bank A/C	Dr	5,880	
	Discount A/C	Dr	120	
	To bills receivable			6,000
	(Being bill discounted at 8%)			
4-10-2007	Ramprasad A/C	Dr	6,036	
	To bank			6,036
	(Being cash paid to bank with realization expenses due to dishonour)			
	Bank A/C	Dr	1,509	
	Bad debts A/C	Dr	4,527	
	To Ramprasad			6,036
	(Being 25 paise per rupee realized from Ramprasad)			

Journal entries in the books of Ramprasad:

1-7-2007	Purchases A/C	Dr	6,000	
	To Sivaprasad			6,000
	(Being goods purchased for credit)			
	Sivaprasad A/C	Dr	6,000	
	To Bills payable			6,000
	(Being bill accepted)			
	Bills payable A/C	Dr	6,000	
	Realisation expenses A/C	Dr	36	
	To Sivaprasad			6,036
	(Being bill dishonoured)			

4-10-2007	Sivaprasad A/C	Dr	6,036	
	To bank			1,509
	To Deficit account			4,527
	(Being 25 paise in a rupee paid and settled Sivaprasad account)			

9.7: Try yourself:

1. On 1st March 2007 Balumahendra wrote a 3 months bill on Krishnakanth for Rs.2, 400 and got his acceptance. On the same day he discounted the bill with the bank at 5 %. On the due date Krishnakant honoured the bill. Pass the journal entries in the books of both the parties.

2. On 1st July 2007, Srikanth wrote a bill on Srinath for Rs.6, 000 with a due date of 3 months and got his acceptance. Srikanth endorsed this bill to Pramod. On the due date the bill is honoured. Record entries in the books of Srikanth, Srinath and Pramod.

3. On 1st January 2007, Nagarjuna sold goods worth Rs.10, 000 to Prabhakar and wrote a bill on the same date and got his acceptance. You are required to pass journal entries in the books of both the parties assuming the following situations:

   a) When the bill is with Nagarjuna till the date of its maturity.

   b) When Nagarjuna endorses the bill to Chiranjeevi.

   c) When Nagarjuna send the bill to bank for collection.

   d) When Nagarjuna discounts the bill with the bank at 8%.

4. On 1st June 2007, Ramana sold goods worth 8,000 to Prakash and wrote a 2 months bill on him and in return prakash sent his acceptance. But on the due date the bill dishonoured. Write journal entries in the books of both the parties.

5. On March 1st 2007 A wrote a 3 months bill on B for Rs.15, 000 and got his acceptance. On the same day the bill is endorsed to C. On 1st April C discounted the bill with bank at 8%. On the due date the bill is dishonoured and A paid to the bank Rs.15, 100 including realization expenses. You are required to pass journal entries in the books of A, B, and C.

6. On 1st January 2007 Vimal draw on Chaitanya three bills of exchange in full settlement of claim. The first for Rs. 14,000 at one month, the second for Rs.16, 000 at two months and the third for Ts.18, 000 at three months. Chaitanya duly accepted the bills.

   Vimal endorsed the first bill to his creditor Tarun on 3rd January 2007, the second bill discounted on 15th January2007 for Rs.15, 900 and the third bill sent for collection to the bank on 4th February 2007. All the bills are honoured on the due date except the second one, which is charged with Rs.240 towards noting charges. Vimal charged Chaitanya Rs.300 for interest and draw on him a new bill for two months for the amount due. This bill is duly met on maturity. Pass journal entries in the books of Vimal.

9.8: Summary:

In the present modern business world, the importance of bills of exchange is more prominent. Besides currency notes, trade bills are also in use as medium of exchange. To meet the short-term necessities these instruments are highly in use.

These as negotiable instruments can be transferred to any one, can be discounted at bank and can be kept as money value for future i.e. up to due date.

9.9: Glossary:

Bills of Exchange: An instrument in writing containing an unconditional order, signed by the maker, directing a certain person, to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument.

Promissory Note: An instrument in writing containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument.

Noting Charges: The amount charged by the bank on the drawer of the bill when the bill is dishonoured.

Renewal of bill: A new bill in the place of a old bill accepted by the drawee for continuation of the transaction.

9.10: Self Assessment Questions:

1. Define Bills of Exchange. Explain its characteristics.
2. Define Promissory Note. Distinguish between Bills of Exchange and a Promissory Note.
3. Bring out various terms related to Bills of Exchange.

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Lesson 10

Bills of Exchange – Accommodation Bills

10.0 Objective:

After going through the lesson you will be able to understand the following:

1. Meaning and purpose of Accommodation bills
2. Differences between trade bills and accommodation bills
3. Method of writing entries and accounts

Structure:

10.1: Meaning and purpose of Accommodation Bills:

When two persons for the purpose of meeting temporary money problem act as drawer and drawee and prepare bill and discount at bank for accommodation is called 'accommodation bill'.

Accommodation bill may be created for accommodation of one of the parties or for mutual accommodation.

In case the bill is created for the purpose of one party, usually he is the drawer of the bill. After getting the acceptance of the drawee, the drawer discounts the bill with the bank. On the due date he sends the amount due under the bill to the drawee to enable the drawee to meet the bill on maturity.

In case the bill is created for mutual purpose, the drawer has to send his part of the amount to the drawee before the due date. After receiving the amount, the drawee, adding his part of the money pays back the amount or honours the bill on due date.

Any bill can be called as accommodation bill, if it does not have the base of business transaction. Bank discounts trade bills easily. But while going for discounting accommodation bills, it considers the credit worthy ness and the financial position of the parties.

10.2: Trade bill vs. Accommodation bill:

The following are the major differences between a trade bill and an accommodation bill.

Trade bill	**Accommodation bill**
1.It comes into existence because of trade transaction i.e. buying or selling.	1. It comes into existence just to accommodate the party or parties.
2. It can either be discounted at the bank or kept with the drawer or endorse to third part.	2. It is created for the purpose of discounting.
3. The main purpose of trade bill is settlement of transaction.	3. The main purpose of this bill is Accommodation.
4. The drawer bears the discount charges.	4. Both parties share the discount proportionately.
5. These are desirable in view of business Transactions.	5. These bills may harm business activities.
6. Discounting of the bill is easy.	6. Discounting depends on the image and financial positions of the parties.

10.3: Writing accommodation bill for one party purpose:

When one party or person in need of money can request the other to accept a bill for accommodation. The needy person as drawer writes the bill on the other and gets his acceptance. Later, he gets the bills discounted and uses money for his own purpose. On the due date he sends money to the drawee to honour the bill. Then, the drawee pays money at the bank and thus honours the bill. In this case, the loss of discount, naturally borne by the drawer of the bill.

Illustration 1:

On 1st July 2007 Prakash for his own purpose wrote a three months bill on kiran fro Rs.6, 000 and got his acceptance. He discounted the bill with the bank at 5 %. Before the due date he sent the bill money to kiran and he honours it on the due date. Write journal entries in the books of Prakash and Kiran.

Solution:

Journal entries in the books of Prakash:

1-7-2007	Bills receivable A/C	Dr	6,000	
	To Kiran			6,000
	(Being accepted bill received from kiran)			
	Bank A/C	Dr	5,925	
	Discount A/C	Dr	75	
	To bills receivable			
	(Being bill discounted at 5%)			
4-10-2007	Kiran A/C	Dr	6,000	
	To Bank			6,000
	(Being cash sent to kiran to honour the bill)			

Journal entries in the books of Kiran:

1-7-2007	Prakash A/C	Dr	6,000	
	To bills payable			6,000
	(Being acceptance given)			
4-10-2007	Bank A/C	Dr	6,000	
	To Prakash			6,000
	(Being cash received from Prakash to honour the bill)			
4-10-2007	Bills payable A/C	Dr	6,000	
	To Bank			6,000
	(Being bill honoured)			

10.4: Writing accommodation bill for mutual purpose:

For mutual accommodation one person draws bill on the other and gets his acceptance. The drawer discounts the bill and both the persons in the agreed ratio will share the money. They also bear the discount in the same ratio. Before or on the due date the drawer sends his part of amount to the drawee to enable him to honour the bill. On the due date the drawee honours the bill with the amount sent by the drawer and with his contribution.

Illustration 2:

On 1st July 2007 Hariharan draws a 2 months bill on Girish for Rs.8, 000 for mutual accommodation. Girish sent his acceptance. Hariharan discounts the bill with the bank at 6% and sends 1/4th of the received amount to Girish. On the due date Hariharan sent his part amount to Girish and he in return honours the bill. Write necessary journal entries in the books of both the parties.

Solution:

Journal entries in the books of Hariharan:

1-7-2007	Bills receivable A/C	Dr	8,000	
	To Girish			8,000
	(Being accommodation bill drawn)			
	Bank A/C	Dr	7,920	
	Discount A/C	Dr	80	
	To Bills receivable			8,000
	(Being bill discounted at 6%)			
	Girish A/C	Dr	2,000	
	To bank			1,980
	To discount			20
	(Being 1/4th of the amount sent to Girish)			
4-9-2007	Girish A/C	Dr	6,000	
	To bank			6,000
	(Being amount sent to Girish to honour the bill)			

Journal entries in the books of Girish:

1-7-2007	Hariharan A/C	Dr	8,000	
	To bills payable			8,000
	(Being bill accepted for mutual accommodation)			
	Bank A/C	Dr	1,980	
	Discount A/C	Dr	20	
	To Hariharan			2,000
	(Being 1/4th of the bill amount received)			
4-9-2007	Bank A/C	Dr	6,000	
	To Hariharan			6,000
	(Being amount received from Hariharan)			
	Bills payable A/C	Dr	8,000	
	To Bank			8,000
	(Being the bill honoured on the due date)			

10.5: Writing of bills mutually and discount and share among themselves in agreed ratio:

In this method two persons for mutual accommodation purpose draw bills and get the acceptance reciprocally. The first person discounts the bill and sends the agreed amount to the second person. Similarly, the second person also does like this. Before the due date they send back the money taken earlier and the two bills honoured.

Illustration 3:

A and B agreed to draw bills for mutual accommodation. On 1st July 2007, A draws a 2 months bill for Rs.4, 000 on B and got his acceptance. He discounted the same in the bank at 6% and returned half the amount to B. Similarly, B draws a 2 months bill for Rs.7, 000 on A and got his acceptance. B discounted the bill with the bank at 6% and returned half the amount to A. Before the due date both the parties sent their part of the used amount and two bills are honoured on the due date. Write journal entries in the books of A and B.

Solution:

Journal entries in the books of A:

1-7-2007	Bills receivable A/C	Dr	4,000	
	To B			4,000
	(Being accepted bill received)			
	B's A/C	Dr	7,000	
	To bills payable			7,000
	(Being acceptance given to A's bill)			
	Bank A/C	Dr	3,960	
	Discount A/C	Dr	40	
	To bills receivable			4,000
	(Being bill discounted with bank at 6%)			
	B's A/C	Dr	2,000	
	To bank			1980
	To discount			20
	(Being half the bill amount sent to B)			
	Bank A/C	Dr	3,465	
	Discount A/C	Dr	35	
	To B's account			3,500
	(Being half the bill amount received from B)			
4-9-2007	Bank A/C	Dr	3,500	
	To B's account			3,500
	(Being B's share received for accepting the bill)			
	Bills payable A/C	Dr	7,000	
	To Bank			7,000
	(Being the bill honoured)			
	B's A/C	Dr	2,000	
	To Bank			2,000
	(Being A's share or used amount sent to B to honour his bill)			

Journal entries in the books of B:

1-72007	Bills receivable A/C	Dr	7,000	
	To A's account			7,000
	(Being acceptance received from A)			
	A's A/C	Dr	4,000	
	To bills payable			4,000
	(Being acceptance given for the bill drawn by A)			
	Bank A/C	Dr	6,930	
	Discount A/C	Dr	70	
	To bills receivable			7,000
	(Being bill discounted at 6%)			
	A's A/C	Dr	3,500	
	To bank			3,465
	To discount			35
	(Being half the amount sent to A)			
	Bank A/C	Dr	1980	
	Discount A/C	Dr	20	
	To A's account			2,000
	(Being half the bill amount received from A)			
	A's A/C	Dr	3,500	
	To bank			3,500
	(Being used amount sent to A)			
	Bills payable A/C	Dr	4,000	
	To Bank			4,000
	(Being accepted bill honoured)			

10.6: When bill is drawn for drawer (one party) purpose and drawer fails to send his part to drawee and makes new proposal:

In this circumstance, the drawee honours the bill and the earlier drawer including interest for the extended period accepts a new bill.

Illustration: 4:

On 1st July 2007 Usha draws a 4 months bill on Sita for Rs.4, 000 and got her acceptance. She discounted the bill immediately with the bank at 9 % interest. On the due date Usha failed to send the amount to Sita. However, Sita honours the bill. Usha agreed to pay Rs. 2,500 and accept a new bill for 3 months along with 12% interest. Sita accepted the proposal and the bill honoured on the due date. Write journal entries in the books of Usha and Sita.

Solution:

Journal entries in the books of Usha:

1-7-2007	Bills receivable A/C	Dr	4,000	
	To Sita			4,000
	(Being accepted bill received from Sita)			
	Bank A/C	Dr	3,880	
	Discount A/C	Dr	120	
	To bills receivable			4,000
	(Being bill discounted)			
4-11-2007	Interest A/C	Dr	45	
	To Sita			45
	(Being interest due to Usha for 3 months at 12%)			
	Sita A/C	Dr	4,045	
	To bank			2,500
	Bills payable			1,545
	(Being part amount paid and accepted for new bill with interest)			
7-2-2008	Bills payable A/C	Dr	1,545	
	To bank			1,545
	(Being the bill honoured on the due date)			

Journal entries in the books of Sita:

1-7-2007	Usha A/C	Dr	4,000	
	To bills payable			4,000
	(Being bill accepted)			
4-11-2007	Bills payable A/C	Dr	4,000	
	To bank			4,000
	(Being accepted bill honoured)			
	Usha A/C	Dr	45	
	To Interest			45
	(Being interest due on 1500 at 12% for 3 months)			
	Bank A/C	Dr	2,500	
	Bills receivable	Dr	1,545	
	To Usha			4,045
	(Being part amount and a new bill received from Usha with interest)			
7-2-2008	Bank A/C	Dr	1,545	
	To bills receivable			1,545
	(Being amount received on due date)			

10.7: When two bill is drawn for mutual purpose and the drawee fails to honours the bill on due date, even though drawer sends his part:

In this case the drawee that dishonours the bill has to pay noting charges to the bank.

Illustration: 5:

On 1st January 2007 for mutual accommodation, Sharma draws a bill on Shastri for Rs.12, 000 a 4 months bill and got his acceptance. On the same day Sharma discounted the bill with the bank at 9% and given 1/3rd of the bill amount to Shastri. On the due date Sharma sent his part of the amount to Shastri to enable him to honour the bill. But Shastri failed to honour the bill and bank chaged Rs. 30 towards noting charges. Pass journal entries in the books of Sharma and Shastri.

Solution:

Journal entries in the books of Sharma:

1-1-2007	Bills receivable A/C	Dr	12,000	
	To Shastri			12,000
	(Being accepted bill received)			
	Bank A/C	Dr	11,640	
	Discount A/C	Dr	360	
	To Bills receivable			12,000
	(Being bill discounted at 9%)			
	Shastri A/C	Dr	4,000	
	To Bank			3,880
	To Discount			120
	(Being 1/3rd of the amount sent to Shastri)			
4-5-2007	Shastri A/C	Dr	8,000	
	To bank			8,000
	(Being 2/3rd of bill amount sent to Shastri to honour the bill)			
	Shastri A/C	Dr	12,030	
	To bank			12,030
	(Being amount paid to bank with noting charges as Shastri dishonours the bill)			

Journal entries in the books of Shastri:

1-1-2007	Sharma A/C	Dr	12,000	
	To bills payable			12,000
	(Being bill accepted)			
	Bank A/C	Dr	3,880	
	Discount A/C	Dr	120	

	To Sharma			4,000
	(Being 1/3rd of bill amount received)			
4-5-2007	Bank A/C	Dr	8,000	
	To Sharma			8,000
	(Being 2/3rd of the bill amount received for honouring the bill)			
	Bills payable A/C	Dr	12, 000	
	To Sharma			12,000
	(Being bill dishonoured)			
	Noting Charges A/C	Dr	30	
	To Sharma			30
	(Being noting charges payable to Sharma)			

Illustration 6:

On 1st July 2007 Arjunarao and Apparao have decided to share the proceeds of an accommodation bill in 4:7 ratio respectively after discounting it. Arjunarao draws a 3 months bill for Rs.3, 410 on Apparao. After getting his acceptance Arjunarao discounted the bill with the bank for Rs.3,300 and send to Apparao the agreed amount. On the due date, Arjunarao failed to send the used amount to Apparao. Even then Apparao honoured the bill. Later, Arjunarao accepted a bill drawn by Apparao for the due amount for three months including an interest of Rs.90. On the due date the bill is honoured. Write journal entries in the books of both the parties.

Solution:

Journal entries in the books of Arjunarao:

1-7-2007	Bills receivable A/C	Dr	3,410	
	To Apparao		3,410	
	(Being the accepted bill received from Apparao)			
	Bank A/C	Dr	3,300	
	Discount A/C	Dr	110	
	To bills payable			3,410
	(Being bill discounted with the bank)			
	Apparao A/C	Dr	2,170	
	To bank			2,100
	To discount			70
	(Being 7/11th part sent to Apparao)			
4-10-2007	Apparao A/C	Dr	1,240	
	Interest A/C	Dr	90	
	To bills payable			1,330
	(Being new bill accepted with interest)			
7-1-2008	Bills payable A/C	Dr	1,330	

	To bank			1,330
	(Being the bill honoured)			

Journal entries in the books of Apparao:

1-7-2007	Arjunarao A/C	Dr	3,410	
	To bills payable			3,410
	(Being bill accepted drawn by Arjunarao)			
	Bank A/C	Dr	2,100	
	Discount A/C	Dr	70	
	To Arjunarao			2,170
	(Being 7/11th of the share received)			
4-10-2007	Bills payable A/C	Dr	3,410	
	To bank			3,410
	(Being bill honoured on due date)			
	Bills receivable A/C	Dr	1,330	
	To Arjunarao			1,240
	To interest			90
	(Being new bill received with interest)			
7-1-2008	Bank A/C	Dr	1,330	
	To bills receivable			1,330
	(Being bill amount received on due date)			

Illustration 7:

On March 1st 2007 Jayapal draws a 4 months bill for mutual accommodation on Mahipal for Rs.15, 200 and got his acceptance. Jayapal discounted the bill with the bank for Rs.15, 000 and sent 3/5th of the amount to Mahipal. On the due date Mahipal honoured the bill despite Jayapal's failure to return his part of the amount. Jayapal accepted a new bill drawn by Mahipal for 3 months adding to the due an interest of Rs.100. Mahipal, after receiving the bill discounted with the bank for Rs.70 less. Before the due date of the bill, Jayapal declared insolvent. Mahipal received 20 % per cent dividend from Jayapal in full settlement. Write journal entries in the books of both the parties and record in ledger books.

Solution:

Journal entries in the books of Jayapal:

1-3-2007	Bills receivable A/C	Dr	15,200	
	To Jayapal			15,200
	(Being accepted bill received)			
	Bank A/C	Dr	15,000	
	Discount A/C	Dr	200	

	To bills receivable			15,200
	(Being bill discounted)			
	Mahipal A/C	Dr	9,120	
	To bank			9,000
	To discount			120
	(Being 3/5th of the bill amount sent to Mahipal)			
4-7-2007	Mahipal A/C	Dr	6,080	
	Interest A/C	Dr	100	
	To Bills payable			6,180
	(Being new bill accepted with interest)			
7-10-2007	Bills payable A/C	Dr	6,180	
	To Mahipal			6,180
	(Being bill dishonoured)			
	Mahipal A/C	Dr	6,180	
	To Bank			1,236
	To discount			4,944
	(Being 20 paise in a rupee paid and settle the account)			

Mahipal Account

1-3-2007	To Bank	9,000	1-3-2007	By Bills receivable	15,200
	To Discount	120	7-10-2007	By Bills payable	6,180
4-7-2007	To Bills payable	6,080			
7-10-2007	To Balance C/D	6,180			
		21,380			**21,380**
	To Bank	1,236		By Balance B/D	6,180
	To Deficit	4,944			
		6,180			**6,180**

Journal entries in the books of Mahipal:

1-3-2007	Jayapal A/C	Dr	15,200	
	To bills payable			15,200
	(Being bill accepted)			
	Bank A/C	Dr	9,000	
	Discount A/C	Dr	120	
	Jayapal			9,120
	(Being 3/5th of the bill amount received)			
4-7-2007	Bills payable A/C	Dr	15,200	
	To bank			15,200

	(Being bill honoured)			
	Bills receivable A/C	Dr	6,180	
	To Jayapal			6,080
	To interest			100
	(Being new bill received with interest)			
	Bank A/C	Dr	6,110	
	Discount A/C	Dr	70	
	To Bills receivable			6,180
	(Being bill discounted with the bank)			
7-10-2007	Jayapal A/C	Dr	6,180	
	To bank			6,180
	(Being amount paid to bank as bill dishonoured by Jayapal)			
	Bank A/C	Dr	1,236	
	Bad debts A/C	Dr	4,944	
	To Jayapal			6,180
	(Being 20 paise in a rupee received in full settlement)			

Mahipal Account

1-3-2007	To Bills payable	15,200	1-3-2007	By Bank	9,000
7-10-2007	To Bank	6,180		By Discount	120
				By Bills receivable	6, 080
				By Balance C/D	6,180
		21,380			**21,380**
	To Balance B/D	6,180		By Bank	1,236
				By Bad debts	4,944
		6,180			**6,180**

10.8: Try yourself:

1. On 1st April 2007 Mahesh and Dinesh draw 3 months bills of Rs.3000 each for mutual accommodation and sent their acceptances reciprocally. They have discounted the bills at 8% and used the proceeds themselves. On the due date both of them honoured the bills. Write journal entries in the books of both the parties.
2. On 1st July 2007 Salim for accommodation purpose wrote a 3 months bill on Syed for Rs. 2500 and got his acceptance. They have agreed to share the amount in 3.2 ratio respectively. Salim discounted the bill at 12 % and send the agreed amount to Syed. Before the due date, to honour the bill, Syed draws a 3 months bill on Salim for Rs. 5000 and Salim accepted the bill. Syed discounted the bill for Rs.4, 925 and after honouring the bill sent the remaining amount as per the agreement sent to Salim. On the due date of the second bill Syed became insolvent, and Salim honours the bill. 30 paise in a rupee is the dividend received by Salim from Syed. Write the required journal entries in the books of both the parties and enter in ledger books.

3. On 1st May 2007 A drew and B accepted a bill at three months for Rs.2000. On 4th May 2007 A discounted the bill at his bank for 6 per cent per annum and remitted half the proceeds by cheque to B. On 1st June 2007 B drew and A accepted a bill at three months for Rs.500. On 4th June 2007 B discounted the bill with his bank at 6% per annum and remitted half the proceeds to A. A and B agreed to share the discounts equally. At maturity A met his acceptance but B failed to meet his and A, therefore, had to pay it. A then drew and B accepted a new bill at three months for the amount of the original bill plus Rs.30 for interest. On 1st November 2007, B became insolvent and paid to his creditors 50 paise in a rupee in full settlement. Write journal entries in the books of A and B.

4. X, for mutual and temporary accommodation of himself and Y; draws upon the latter a bill of exchange at three months for Rs.1, 800 dated 1st January 1980. Y accepts the bill and sends it to X. X discounts the bill immediately at his bank, the rate of discount being 6% per annum and hands over half the proceeds to Y. Y for a similar purpose and at the same time draws a bill at three months on X for Rs.900. X accepts the bill. Y discounts the bill at 6% per annum and hands over half the proceeds to X. Y becomes insolvent on 31st March2007 and as such fails to meet his acceptance on maturity. On 30th June 2007, a first and final dividend of 25 paise in the rupee was paid out of his estate in settlement of his dues.

   Write up the Journal entries in the books of X and Y.

10.9: Summary:

For temporary adjustment and without any business dealings, when two persons draw and accept bills are called accommodation bills. These are to be discounted with the banks compulsorily. When bills are discounted with banks, discounts will also be shared in the ratio of the share of the proceeds. The person that draws the bill has to send the used amount to the drawee on the due date enabling him to honour the bill.

Accommodation bills are not natural bills or created based on business transactions. Generally, banks do not accept for discounting these bills. These are not acceptable for commerce environment.

10.10: Glossary:

Accommodation bills: Bills for the purpose of mere accommodation are called accommodation bills. These are not related to any business transaction. They are just a creation for mutual purpose.

10.11: Self Assessment Questions:

1. What is an accommodation bill? Explain its purpose?
2. Distinguish between a trade bill and an accommodation bill.

Dr.R.Jayaprakash Reddy.

Lesson - 11

FINAL ACCOUNTS

TRADING ACCOUNT & PROFIT & LOSS ACCOUNT

OBJECTIVES:

Through the study of this Lesson, you are able to understand

- What are the objectives of preparing Final Accounts?
- What are the various stages in the preparation of Final Accounts?
- What is the treatment of Capital and Revenue items?
- How the Trading Account is prepared?
- How the Manufacturing Account is prepared?
- How the Profit & Loss Account is prepared?

STRUCTURE :

11.1. Introduction

11.2. Objectives

11.3. Various stages in the preparation of Final Accounts

11.4. Capital & Revenue items

11.5. Trading Account

11.6. Manufacuting Account

11.7. Profit & Loss Account

11.8. Summary

11.9. Questions

11.10.Exercises

11.1. INTRODUCTION :

The main objectives of any business is earning Profit. If the businessman is able to know the Profit / Loss of the business in one financial year; then he will be able to take the appropriate decisions about the operation of business in future, expansion of business etc. Generally the businessman will prepare various statements at the end of the every half year or every year to findout Profit or Loss, Assets and Liabilites of the business firm. These statements are called Final Accounts. Preparation of Final Accounts is the last stage in the process of Accounting. Final Accounts are prepared with the help of Journal Entries and Ledger Balances.

11.2. OBJECTIVES OF FINAL ACCOUNTS:

There are two objectives in the preparation of Final Accounts

a) to findout the Profit or Loss of the business for a particular period

b) to findout the true financial position of the business firm on a particular date i.e., to find out the total value of assets, total value of liabilities and the amount of Capital invested in the firm etc.

11.3. STAGES IN THE PREPARATION OF FINAL ACCOUNTS :

There are 3 stages in the preparation of Final Accounts. They are

a) Preparation of Trading Account for the year ended -----

b) Preparation of Profit & Loss Account for the year ended -----

c) Preparation of Balance Sheet as on -----

The Trading Account and Profit & Loss Accounts are prepared to achieve the first objective i.e., to find out the Profit & Loss of the business for a particular period. Balance Sheet is prepared to achieve the second Objective i.e., to find out the true financial position of the business on a particular date.

11.4. CAPITAL AND REVENUE ITEMS:

Business transactions can be devided into two broad categories.

1) Capital items 2) Revenue items.

The Capital items can be subdivided into two categories viz. Revenue Expenditure and Revenue Income. All the Revenue items must be entered in the Trading Account and Profit & Loss Account and all the Capital itmes must be entered in the Balance Sheet.

11.4.1. Capital Expenditure :

The amount paid for the purchase of Fixed Assets is called Capital Expenditure. The expenditure incured for the development and constructive changes for the increase of earning capacity is called as Capital Expenditure. For Example:- Purchase of Plant & machinery, their carriage, installation expenses etc.

11.4.2. Revenue Expenditure:

The day today expenses incured in the regular course of business are called Revenue Expenses. The expenditure paid for smooth conduct of the business and to maintain the Assets with the same capacity is called Revenue Expenditure. For Ex:- Office Expenses, Selling & Distribution Expenses etc.

11.4.3. Capital Incomes:

The Profits or the incomes earned on the non-trading transactions are called capital incomes or capital profits. For Ex:- Amount received on the sale of fixed asset, premium received when the shares are issued at premium, Profit received when the assets are insured at excess value.

11.4.4. Revenue Incomes:

The amounts received in the day today business transactions are called Revenue Incomes. These incomes will be received every year which means these are recurring incomes.

For Ex:- Sale of goods, Commission received, Interest received, Discount received etc.,

11.4.5. Differences between Capital Expenditure and Revenue Expenditure:

S.No	Revenue Expenditure	S.No	Capital Expenditure
1.	Recurring expenses are called Revenue expenses	1.	Non recurring expenses are called Capital expenses
2.	When the purchase is meant for sales it is treated as revenue expenditure	2.	When the purchase is meant for using it in the Business, it is treated as capital expenditure.
3.	Expenses incured to maintain the existing capacity of the asset is called Revenue expenditure	3.	Expenses incured to increase the earing capacity of the asset is called capital expenditure.
4.	The Benefit of the Revenue expenditure will be limited to one year	4.	The benefit of the capital expenditure will extend for long time i.e. for more than one year.

11.4.6. Difference between Capital Receipts and Revenue Receipts:-

11.4.7. Treatment of Capital and Revenue items in Final Accounts:

Revenue Expenses must be debited to the Trading Account and Profit & Loss Account and Revenue Incomes must be credited to the Trading Account and Profit & Loss Account. Capital Receipts must be shown on the Liabilities side of the Balance Sheet and Capital Payments or Capital Expenditure must be shown on the Assets side of the Balance Sheet.

11.4.8. Classification of Firms:

The business firm can be devided into two categories for the purpose of preparation of Final Accounts.

i) Trading firms,

ii) Manufacturing firms

i **Trading firms:-** The business firm purchasing the finished goods and selling them with profit are called trading firms. These firms does not involve in manufacturing the goods. The Final Accounts of these firms will be consisting of

a) Trading Account,

b) Profit & Loss Account,

c) Balance Sheet.

ii Manufacturing firms:- The firm purchasing the raw-material converting them into finished goods with manufacturing process and selling them with Profit are called Manufacturing firms. The Final Accounts of these firm consisting of -

a) Manufacturing Account,

b) Trading Account,

c) Profit & Loss Account &

d) Balance Sheet.

11.5. TRADING ACCOUNT:

The Account prepared to findout the Profit or loss on the purchase and sale of the goods is called Trading Account. The Profit ascertained in the Trading Account is called Gross Profit. If there is loss in this Account, it is called Gross Loss. The Proforma of the Trading Account will be as under:

Dr Trading Account of Mr. X for the year ended 31-03-2007. Cr

Particulars		Amount Rs.	Particulars		Amount Rs.
To Opening stock		xxx	By sales	xxx	
To Purchases	xxx		Less sales returun	xxx	xxx
Less purchase Returns	xxx	xxx	By Closing stock		xxx
To Carriage inwards		xxx			
To Wages		xxx			
To Fuel		xxx			
To Freight & duty		xxx			
To Import duties		xxx			
To dock expenses		xxx			
To Marine insurance		xxx			
To Duty & Clearing charges		xxx			
To consumable stores		xxx			
To octroi		xxx			
To Royalty		xxx			
To gross profit balance c/d		xxx			
(Transfer to P&L Account)					
		xxx			xxx

11.5.1 Items to be debited to Trading Account:-

The details of the items to be debited to Trading Account were:-

1) **Opening Stock:-** It is the balance of Stock in the beginning of the year. In the case of manufacturing firms, the opening stock includes three items viz., Raw-material, work-in-progress and Finished goods.

2) **Purchases:-** The net amount of goods purchased during the year must be debited to Trading Account. Purchase Returns must be deducted from Purchases to find out Net Purchases.

3) **Direct Expenses:-** The expenses incurred for the purchase of goods and making them ready for sale are called Direct Expenses. They can be devided as follows.

   a) **Expenses for the purchase of goods:-** For Ex:- Carriage inwards, Cartage, Freight, Duty, Octroi, Local Taxes, Import Duties, Clearing Charges, Unloading Charges, Dock Charges, Railway Charges etc.

   b) **Expenses for manufacture of goods:-** For Ex:- Gas, Water, Fuel, Power, Factory Lighting, Stores, Royalty, Factory Insurance, Factory Expenses, Factory Rent, Manufactureing Expenses etc.

   c) **Wages:-** The remuneration paid to the workers for participating in the Production is called wages. The term 'Wages & Salaries' shall be debited to Trading Account and the term 'Salaries & Wages' shall be debited to Profit & Loss Account.

11.5.2. Items to be Credited to Trading Account:-

1) **Sales:-** The net amount of goods sold during the year must be credited to Trading Account. Sales Returns must be deducted from Sales to findout the net amount of Sales.

2) **Closing Stock:-** This item is generally given in Adjustments but not in Trial Balance. It is the balance of stock at the end of the year. Closing Stock must be valued at Cost or Market Value which ever is less.

3) **Loss of Stock:-** The loss or goods by fire or any other reason must be credited to Trading Account.

11.5.3. Closing Entries to be passed in the preparation of Trading Account:-

The following entries shall be passed for the preparation of Trading Account. The various accounts transfered to Trading Account will be closed with these entries.

1)	Trading Account	Dr.	xxx	
	To Opening Stock			xxx
	To Purchases			xxx
	To Direct Expenses			xxx
	(Being the Opening Stock, Purchases & all Direct Expenses transfered to Trading Account)			
2)	Sales A/c	Dr.	xxx	
	Closing Stock Account	Dr.	xxx	
	To Trading Account			xxx
	(Being the Sales and Closing Stock transfered)			
3)	Purchase Returns Account	Dr.	xxx	
	To Purchases Account			xxx
	(Being the returns transfered to Purchases Account)			
4)	Sales Account	Dr.	xxx	
	To Sales Returns Account			xxx
	(Being the returns transfered to Sales Account)			
5)	Trading Account	Dr.	xxx	
	To Profit & Loss Account			xxx
	(Being the Gross profit transfered to Profit & Loss Acc.)			
6)	Profit & Loss Account	Dr.	xxx	
	To Trading Account			xxx
	(Being the loss transfered to Profit & Loss Account			

11.5.4. Advantages of Trading Account:-

1) Gross Profit or Gross Loss can be ascertained.
2) Changes in the Direct Expenses can be observed
3) Cost of groods sold can be calculated through the Trading Account.
4) By comparing the Opening and Closing Balances, it can be observed that whether the purchases are made properly or not.
5) The improvement or development of the firm can be observed by comparing the Sales of current year with the Standard Sales or with the Sales of last year.

Example-1:-

From the following data prepare Trading Account of Mr X for the year ended 31-03-2007.

Stock on 01-04-06 Rs.18000/-, Purchases Rs.90000/-, Purchase Returns Rs.6000/- Sales Rs.153000/-, Sales Returns Rs.9000/-, Carriage inwards Rs.3000/-, Freight Rs.1500, Cartage Rs.1500/-, Duty and Clearing Charges Rs.1200/-, Stock on 31-03-2007 Rs.21000/-

Solution:-

Dr Trading Account of Mr. X for the year ended 31-03-2007 Cr

Particulars		Amount Rs.	Particulars		Amount Rs.
To opening stock		18,000	By sales	1,53,000	
To purchases	90,000		Less sales returun	9,000	1,44,000
Less purchase Returns	6,000	84,000	By Closing stock		21,000
To carriage inwards		3,000			
To Freight		1,500			
To Cartage		1,500			
To Duty & crearing charges		1,200			
To gross profit balance c/d		55,800			
		1,65,000			1,65,000

Example-2:-

From the following particulars of Mr. Y prepare Trading Account for the year ended 31-03-2007

Opening stock on (01-04-06)		Fuel	750
Raw material	12,000	Factory Rent	3,000
Work in progress	30,000	Factory lighting	1,500
finished goods	21,000	Sales	1,20,000
Purchases	6,000	Sales Returns	3,000
carriage inwards	3,000	Closing stock on 31.03.07	
wages	3,000	Raw material	12,300
clearing charges			
marine insurance	3,000	Work in - progress	14,700
coal & coke	1,500	Finished goods	27,000
Power	750		

Solution:

Dr. Trading Account of Mr. Y for he year ended 31-03-2007 Cr.

Particulars	Amount Rs.	Particulars		Amount Rs.
To Opening stock on (01-04-06)		By sales	1,20,000	
Raw material	12,000	Less returns	3,000	1,17,000
Work in progress	30,000	By closing stock		
Finished goods	21,000	Raw material		12,300
To Purchases	54,000	Work - in - progress		14,700
To carriage inwards	6,000	Finished goods		27,000
To wages	3,000			
To clearing charges	3,000			
To marine insurance	3,000			
To coal & coke	1,500			
To Power	750			
To Fuel	750			
To Factory Rent	3,000			
To Factory lighting	1,500			
To Gross profit. Balance C/d	31,500			
	1,71,000			1,71,000

11.6. MANUFACTURING ACCOUNT :

The manufacturing firms will compute the Cost of Production by preparing Manufacturing Account. These firms will prepare the Manufacturing Account along with the Trading Account and Profit & Loss Account. The Cost of Production will be calculated through Manufacturing Account and it will be transferred to Trading Account to findout the Gross Profit or Gross Loss. The Proforma of the Manufaturin Account is given here under.

Dr Manufacturing Account of X for the year ended 31-03-2007 Cr

		Rs.		Rs.
To Opening stock on (01-04-06)			By closing stock	
Raw material		xxx	Raw material	xxx
Work in progress		xxx	Work - in - progress	xxx
To Purchases of Material	xxx		By cost of production -	xxx
Less Returns	xxx	xxx	(Transfer to trading account)	
To productive wages		xxx		
To Power		xxx		
To Heating & lighting		xxx		
To Factory Rent & Insurance		xxx		
To coal & coke		xxx		
To repairs to plant		xxx		
To Depreciation on Machinery		xxx		
		xxx		xxx

Dr Trading Account of Mr X for the year ended 31-03-2007 Cr

	Rs.			Rs.
To Opening Balance of finished goods	xxx	By sales (finished goods)	xxx	
To purchase of finished goods	xxx	Less Returns	xxx	xxx
To Cost of production (Transfer from manufacturing account)	xxx	By finsihed goods (closing balance)		xxx
To Gross profit	xxx			
	xxx			xxx

Example- 3:-

From the following particulars prepare Manufacturing Account and Trading account of Mr Balu for the Year ended 31. 03,07.

	Rs.		Rs.
Raw material on 01.04.06	6,000	Material returned	100
on 31.03.07	5,800	Repairs to plant	800
Consumable stores	1,700	Repairs to factory buildings	500
Motive power	3,000	finished goods on 01.04.06	6,000
Work in progress on 01.04.06	8,000	on 31.03.07	7,000
on 31.03.07	10,000	Depreciatoin on Factory builidings	2,000
		on plant & machinery	3,000
Factory Rent & Rates	1,600	Factory lighting	400
Factory Insurance	500	Productive wages	21,000
Other Direct expenses	1,300	Carriage in words	600
Sales	82,000	Purchases	23,000
Sales Returnes	2,200		

Solution:

Dr Manufacturing Account of Balu for the year ended 31-03-2007 Cr

Particulars		Amount Rs.	Particulars	Amount Rs.
To Opening stock			By closing stock	
Raw material		6,000	Raw material	5,800
Work in progress		8,000	Work in progress	10,000
To Purchase of Material	23,000		By cost of production - C/D	
Less Returnes	100	22,900	(Transfer to trading A/c)	57,500
To carriage in words		600		
To wages		21,000		
To Consumable stores		1,700		
To Motive power		3,000		
To Factory Rent & Rates		1,600		

To Factory Insurance	500		
To Direct expenses	1,300		
To Repairs to plant	800		
To Repairs to factory buildings	500		
To Depreciatoin on Factory builidings	2,000		
on plant	3,000		
To Factory lighting	400		
	73,300		73,300

Dr Trading Account of Balu for the year ended 31-03-2007 Cr

		Rs.			Rs.
To Opening stock (finished goods)		6,000	By sales	82,000	
To Cost of production	B/D	57,500	Less Returns	2,200	79,800
(Transfer to Trading A/c)			By closing stock of finsished goods		7,000
To Gross profit Balance C/d		23,300			
		86,800			86,800

11.7. PROFIT & LOSS ACCOUNT :

Profit & Loss Account is prepared to find out the Net Profit or Net Loss during a particular business period. This account will be started with the Gross Profit and all the expenses and losses given in the Trial Balance will be debited (except those debited to Trading Account) and all the Incomes and Profits given in the Trial Balance will be credited. The proforma of Profit & Loss Account will be as under.

Dr Profit & Loss Account of Mr. X for the year ended 31-03-2007 Cr

	Rs.		Rs.
To salaries & wages	xxx	By Gross Profit	xxx
To Rent & Taxes	xxx	By Rent received	xxx
To Lighting	xxx	By commission received	xxx
To Insurance	xxx	By Discount received	xxx
To printing & stationary	xxx	By interest received	xxx
To Postage & Telegrams	xxx	By interest on investments	xxx
To Telephone	xxx	By interest on Drawings	xxx

To legal expenses	xxx	By interest on Bank deposits	xxx
To Audit fees	xxx	By dividends received	xxx
To Selling & Distribution expenses	xxx	By profits on sale of assets	xxx
To Gowdown expenses	xxx	By Bad debts recovred	xxx
To Packing expenses	xxx	By Apprentice premium	xxx
To Advertising	xxx	By reserve for discount on creditors	xxx
To Commission on sales	xxx		
To Baddebts	xxx		
To Discounts allowed	xxx		
To Delivery van expenses	xxx		
To Travelling expenses	xxx		
To Carriage outwards	xxx		
To Samples	xxx		
To Interest on capital	xxx		
To Interest on loans	xxx		
To Depreciation on Assets	xxx		
To Repairs on Assets	xxx		
To Net profits (transfer to capital account)	xxx		
	xxx		xxx

11.7.1. Closing entries to be passed for the transfer of expenses and incomes to Profit & Loss Account:-

a) For the transfer of all indirect expenses and losses to Profit & Loss Account:-

Profit & Loss Account	Dr.	xxx	
To Administrative expenses			xxx
To Selling and Distribution Expenses			xxx
To Financial Expenses			xxx
To Operating Expenses			xxx
To Provisions & Reserves			xxx

b) For the transfer of various incomes and profits to P&L Account

Discount received Account	Dr.	xxx	
Interest received Account	Dr.	xxx	
Commission received Account	Dr.	xxx	
Dividends received Account	Dr.	xxx	
Apprentice Premium Account	Dr.	xxx	
To P&L Account			xxx

c) For the transfer of Net Profit to Capital Account

Profit & Loss Account	Dr.	xxx	
To Capital Account			xxx

d) For the transfer of Net Loss to Capital Account

Capital Account	Dr.	xxx	
To Profit & Loss Account			xxx

Example-4:

From the following particulars, prepare Profit & Loss Account for the year ended 31-03-2007.

	Rs.		Rs.
Salaries	3,000	Audit fees	600
Carriage outwards	1,000	Baddebts	400
Printing & Stationery	1,500	Commssion received	500
Discount allowed	750	Rent, rates, insurance	500
Postage	250	General expenses	400
Repairs	400	Gross Profit	11,000

Solution:

Dr. Profit & Loss Account of --- for the year ended 31-03-2007 Cr

	Rs.		Rs.
To Salaries	3,000	By Gross profit	11,000
To Carriage outwards	1,000	By Commssion received	500
To Printing & Stationery	1,500	By Rent received	500
To Discount allowed	750		
To Postage	250		
To Repairs	400		
To Audit fees	600		
To Baddebts	400		
To Rent, rates, insurance	500		
To General expenses	400		
To Net Profit			
(Transfer to captial A/c)	3,200		
	12,000		12,000

Example 5 :

From the following particulars, prepare Trading and Profit & Loss Accunt for the year ended 31-03-2007

	Rs.		Rs.
Stock on 1-4-06	50000	Purchases	500000
Purchase Returns	50000	Sales	1000000
Sales Retunrs	50000	Direct Wages	20000
Indirect Wages	10000	Carriage in wards	5000
Carriage out wards	10000	Distribution expenses	5000
Office Rent	20000	Repairs	10000
Duty	5000	Coal & Gas	15000
Office Lighting	10000	Closing Stock	150000

Solution:

Dr Trading & Profit & Loss Account of --- for the year ending 31-03-07 Cr

		Rs.			Rs.
To Opening stock		50,000	By sales	10,00,000	
To Purchases	5,00,000		less Returns	50,000	9,50,000
Less Returns	50,000	4,50,000	By closing stock		1,50,000
To Direct wages		20,000			
To Carriage in wards		5,000			
To Duty		5,000			
To Coal and Gas		15,000			
To Gross profit					
(Transfer to P&L Ac)		5,55,000			
		11,00,000			11,00,000
To Indirect Wages		10,000	By Gross profit		5,55,000
To Carriage out wards		10,000			
To Distribution expenses		5,000			
To Office Rent		20,000			
To Repairs		10,000			
To Office Lighting		10,000			
To Net Profit					
(Transfer to captial A/c)		4,90,000			
		5,55,000			5,55,000

11.8. ADVANTAGES OF PROFIT & LOSS ACCOUNT :

1) Net result of the business firm can be ascertained by the preparation of Profit & Loss Account.

2) The percentages of various expenses on Sales can be ascertained by the preparation of this account. These percentages can be compared with the last year's percentages and the firm's control on expenses can be analysed.

3) The efficiency of the firm can be ascertained by comparing the actual expenses with the Standard expenses.

4) The development of the firm in future can be estimated by finding out the net profit.

5) Preparation of Profit & Loss account facilitates the creation of Reserves and provisions to meet the Contingent Liabilities.

11.9. SUMMARY:

Every businessman prepares Final Accounts at the end of the year to findout the Profit or Loss of the business. Trading and P&L Accounts are prepared to find out the profitability of the firm. When the profitability is good, It can be said that there is chance for improvement of the business.

11.10. QUESTIONS:

a) Short Answer questions:-

1) What are the main objectives of Final Accounts?
2) What are the various stages in the preparation of Final Accounts?
3) What is necessity of recognising the difference between the Capital and Revenue items?
4) Explain the Capital & revenue items?
5) State the differences between Capital Expenditure & Revenue Expenditure?
6) State the differences between Capital Receipts & Revenue Receipts?
7) What is meant by Trading Account? Why it is prepared?
8) State the Advantages of Trading Account.
9) State the various items in Trading Account.
10) Prepare the ‘Format’ of the Trading Account.
11) Write the closing entries for the various items in Trading Account.
12) What is meant by Production Account/ Manufacturing Account? Show the Formats of the Manufacturing Account and Trading Account which are prepared by manufacturing firms.
13) What is meant by Profit & Loss Account? Why it is prepared?
14) What is the necessity of Profit & Loss Account?
15) Explain the various items in the Profit & Loss Account?
16) Prepare the Format of Profit & Loss Account.
17) Write the closing entries for the various items in Profit & Loss Account.

b) Essay Questions:-

1) What is meant by Capital Expenditure? Explain the differences between the Capital Expenditure & Revenue Expenditure.

2) What is meant by Trading Account? Prepare the Trading Account of a business firm with assumed figures.

3) Why the Profit & Loss account is prepared? What is its importance?

4) Why the Manufacturing Account is prepared in Manufacturing firms? Prepare the Format of Manufacturing Account.

11.11. EXERCISES :

1) From the following particulars prepare Trading Account for the year ended 31-03-2007

	Rs.		Rs.
Opening Stock 1-4-06	10000	Net Purchases	52400
Manufacturing Wages	8000	Clearing Charges	648
Import Duties	3000	Freight	210
Net Sales	74900	Factory Rent & Taxes	1640
Factory Insurance	640	Carriage inwards	167
Octroi and Dock Expenses	164	Closing Stock 31-3-07	13000

(GP Rs.11031)

2) From the following information prepare Trading Account and find out Gross Profit

	Rs.		Rs.
Opening Stock	5570	Sales Returns	524
Purchases	13816	Carriage inwards	1400
Sales	15284	Import duties	252
Purchase Returns	390	Closing Stock	8880

(GP Rs.2992)

3) From the following particulars, prepare Trading Account for the year ending 31-03-2007

	Rs.		Rs.
Purchases	85000	Wages	10000
Manufacturing Expenses	3900	Opening Stock	20000
Carriage inwards	200	Sales Returns	100

Sales	135000	Purchase Returns	400
Freight & Duty	10000	Consumable Stores	400
Power	600	Closing Stock	24000

(GP Rs.29200)

4) From the following data prepare Trading Account and give necessary journal entry.

	Rs.		Rs.
Purchases	6500	Lighting	50
Sale	11850	Stores Expenditure	150
Purchase Returns	100	Stock on 1-4-06	500
Clearing charges	50	Stock 31-3-07	1250
Cartage	50	Wages	800
Fuel & Power	250	Sales Returns	100
Discount allowed	100		

(GP Rs.4750)

5) From the following particulars prepare production Account for the year ended 31-03-2007

	Rs.		Rs.
Opening Stock; Material	6000	Wages of Workers	40000
Work-in-progress	8000	Lighting & Gas(Factory)	4000
Finished Goods	16000	Carriage in wards	2000
Closing Stock: Material	2000	Special plant rent	4000
Work-in-progress	10000	Rent of the factory	8000
Finished goods	8000	Repairs to Plant	4000
Supervisor Salary	16000	Repairs to Factory	2000
Wages	2000	Salaries of staff working	6000
Worke managers salary	12000	Royalty on Production	4000
Purchase of Material	80000		

(Ans: Cost of Production = 180000)

6) From the following particulars, prepare Profit & Loss Account for the year ended 31-03-2007

	Rs.		Rs.
Salaries	3000	Printing & Stationery	1500
Carriage outwards	1000	Commission received	1000
Discount allowed	500	Rent received	500
Commission Paid	1500	Insurance Premium	1000
Bad debts	1000	Office Electricity charges	500
Repairs	1000	Gross Profit	24000
Advertisements	1000	Audit Fees	500
General Expenses	1000	Postage	1000

(Ans: N.P. Rs.11500)

7) From the following ledger balances of Gopal, prepare Profit & Loss Account for the year ended 31-03-2007

	Rs.		Rs.
Rent Paid	6000	Bad debts	1000
Salaries	8000	Printing & Stationery	1500
Commission Paid	2000	Office Insruance	1000
Discount allowed	2000	Postage	500
Advertisements	2000	Repairs	500
Telephone charges	1000	Interest received	3500
Interest on loans	3000	Gross Profit 40% on Sales	200000

(Ans: NP: 55000)

8) From the following ledger balances, of Mr. Suresh, prepare Trading and Profit & Loss Account for the year ended 31-03-2007.

	Rs.		Rs.
Opening Stock	41730	Wages	12270
Sales	207830	Discounts	8240
Purchases	127330	Discounts received	7630

Carriage	4780	General Expenses	13380
Baddebts	2250	Taxes	1880
Closing Stock	44200		

(Ans: GP Rs.65920; NP Rs.47800)

9) From the following ledger balances of Devanand, prepare Trading and Profit & Loss Account for the year ending 31-03-2007

	Rs.		Rs.
Wages	33000	Sales Returns	1500
Carriage	2250	Carriage outwards	750
Purchases	120000	Opening Stock	27000
Commission	3750	Duty etc.	1800
Salaries	27000	Discount allowed	6000
Printing & Stationery	750	Rent, Taxes, Insurance	9000
Trade Expenses	2700	Coal, Oil etc.	1200
Factory expenses	6750	Sales	225000
Interest received	4500	Discount received	9000
Purchase returns	3000	Closing Stock	500

(Ans: GP: Rs.35000, Net Loss: Rs.1450)

10) From the following ledger balances, prepare Trading and Profit & Loss Account

	Rs.		Rs.
Sales	16000	Sales returns	800
Purchases	12500	Purchase returns	700
Carriage inwards	425	Opening Stock	6400
Wages	375	Closing Stock	3225
Salaries	2800	Rent	1800
Advertisements	300	Insurance	240
Commission received	800	Discount allowed	115

(Ans: GP:545; Net Loss:5000)

11) Prepare Trading and Profit & Loss Account

	Rs.		Rs.
Stock on 1st Jan.	5000	Purchases	195000
Wages	14000	Insurance	5500
Carriage in	4000	Commission (Dr)	4000
Interest on Capital	3500	Stationery	2250
Returns inwards	6500	Commission (Cr)	2000
Returns outwards	2500	Trade Expenses	1000
Rent & Taxes	5500	Carriage out	7250
Sales	250000	Stock in 31st Dec.	125000

(Ans: GP:153000, NP:126000)

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Lesson - 12

FINAL ACCOUNTS

BALANCE SHEET, ADJUSTMENTS

OBJECTIVES:

By the Study of this chapter, you will be able to understand the:

- Importance of Balance Sheet
- Objectives of Balance Sheet
- Method of Preparation of Balance Sheet

STRUCTURE:

12.1. Introduction

12.2. Definition

12.3. Objectives of Balance Sheet

12.4. Proforma of Balance Sheet

12.5. Differences between Trial Balance & Balance Sheet

12.6. Differences between P&L Account & Balance Sheet

12.7. Adjustments

12.8. Summary

12.9. Examples

12.10. Questions

12.11. Exercises

12.1. INTRODUCTION:

Balance Sheet is the third and last step in the Final Accounts. Balance Sheet is prepared to find out the true financial position of a business on a particular date. It is not an account but only a statement.

12.2. DEFINITION OF BALANCE SHEET :

"Balance Sheet is a Statement prepared with the help of Assets and Liabilites to find out the true financial position of the business on a particular date".

12.3. OBJECTIVES OF BALANCE SHEET:

a) to know about all the Assets and the nature of these assets of the business firm.

b) to know about all the Liabilities payable and their nature.

c) to know about he Capital of the firm.

12.4. PROFORMA OF BALANCE SHEET :

Balance Sheet must be prepared in a systematic and Standard method. All the Liabilities will be shown on one side and the Assets on the other side of the Balance Sheet in a systamatic method. Balance Sheet can be prepared in two methods.

1) Order of Liquidity

2) Order of Permanance.

1. Order of Liquidity : The format of the Balance Sheet in this method will be as under.

Balance sheet of Sri Ram as on 31 - 03-07

Liabilities			**Amount Rs.**	**Assets**	**Amount Rs.**
Current Liabilities :				Current Assets :	
Out standing expenses			xxx	Cash in hand	xxx
Incomes received in Advance			xxx	Cash at bank	xxx
Bills payable			xxx	Short term investments	xxx
Bank over draft			xxx	Debtors	xxx
Creditors			xxx	Incomes receivable	xxx
Loans :				Prepaid expenses	xxx
Long term loan			xxx	Closing stock	xxx
Short term loan			xxx	Fixed Assets	
Reserves & Surplus :				Furniture & Fixtures	xxx
General Reserves			xxx	Vehicles	xxx
Special Reserves			xxx	Plant & Machinery	xxx
Capital				Land & Building	xxx
Capital		xxx		Free hold property	xxx
Add Net profit		xxx		Lease hold property	xxx
Add Further capital		xxx		Intangible Assets	
Add Interest on capital		xxx		Patents	xxx
		xxx			
Less Drawings	xxx			Trade Marks	xxx
Interest	xxx	xxx	xxx	Copy Rights	xxx
				Good will	xxx
			xxx		xxx

2. Order of Permanance : It is an opposite method to the above model. The format of the Balance sheet in this method will be as under.

Balance sheet of Sri Ram as on 31 - 03-07

Liabilities			**Amount Rs.**	**Assets**	**Amount Rs.**
Capital			xxx	Intangible Assets :	
Add Net profit		xxx		Good will	xxx
Add Further capital		xxx		Copy Rights	xxx
Add Interest on capital		xxx xxx		Trade Marks	xxx
Less Drawings	xxx			Patents	xxx
Interest	xxx	xxx	xxx	Fixed Assets	
Reserves & Surplus				Lease hold property	xxx
General Reserves			xxx	Free hold	xxx
Special Reserves			xxx	Land & Buildings	xxx
Loans				Plant & Machinery	xxx
Long term loan			xxx	Furniture & Fittings	xxx
Short term loan			xxx	Vehicles	xxx
Current Liabilities :				Current Assets :	
Creditors			xxx	Closing stock	xxx
Bank O D			xxx	Incomes receivable	xxx
Bills payable			xxx	Prepaid expenses	xxx
Incomes received in Advance			xxx	Debtors	xxx
Out standing expenses			xxx	Bills Receivable	xxx
				Cash in hand	xxx
				Cash at Bank	xxx
			xxx		xxx

12.5 DIFFERENCES BETWEEN TRIAL BALANCE & BALANCE SHEET:

S.No	Trial Balance	S.No	Balance Sheet
1.	Trial Balance is prepared to find out the arithmatic accurancy of the ledger accounts	1.	Balance sheet is prepared to findout the financial porision of a business.
2.	The ledger balances of all types of accounts personal real and nominal accounts will be entered in the trial balance	2.	Personal accounts and real accounts only will be entered in the balance sheet.
3.	Trial Balance does not reveal the profit or less.	3.	Profit or loss will be adjusted to the capital in the Balance sheet.
4.	Opeining stock will be posted in Trial Balance	4.	Closing stock will be posted in the Balance sheet
5.	It is prepared before the preparation of Trading & Profit & loss account	5.	Balance sheet is prepared after the preparation of Trading & Profit & loss account
6.	Adjustments Viz : Out standing expenses prepaid expenses etc. are not entered in the trial balance	6.	All the adjustments are made in the Balance sheet

12.6 DIFFERENCES BETWEEN PROIFT & LOSS ACCOUNT AND BALANCE SHEET:

S.No	Balance Sheet	S.No	P& L Account
1.	It is only a statment	1.	It is an account
2.	It is prepared to find out the financial position of the business.	2.	It is prepared to find out the profit or loss of the business.
3.	The balances of personal and Real accounts will be shown in this account	3.	The balances of Nominal accounts only will be entered in this account
4.	Balance sheet will reveal the ability of the firm to discharge the liabilities and will reveal the liquidity of the firm	4.	P&L Account will reveal the profitability and return on capital of the firm.
5.	Liabilities will be posted on the left hand side and Assets will be posted on the Right hand side of the Balance sheet	5.	It is also devided into two parts. The left hand side is called. " Debit side" and the right side is called "credit side ".
6.	It is prepared on a particular date	6.	It is prepared for the year ending.

12.7 ADJUSTMENTS :

The transactions given outside the Trial Balance are called adjustments. The items given in the Trial Balance must be entered only once in Final Accounts. Bu the items given outside the Trial Balance (Adjustments) must be entered twice in Final Accounts after the writing the adjustment entry: Adjustments are generally made for the following items.

1) Closing Stock:-

Adjustment Entry:-

Closing Stock Account	Dr.	xxx	
To Trading Account			xxx

Accounting Treatment:-

1) It must be credited to Trading Account

2) It must be shown as an Asset in the Balance sheet

When the Closing Stock is given in Trial Balance- it must be shown as an Asset in the Balance Sheet only.

2) Outstanding Expenses:-

For Ex:- Outstanding Salaries, Rent, Wages etc.,

Adjustment Entry:-

Expenses Account	Dr.	xxx	
To Outstanding Expenses Account			xxx

Accounting treatment:-

1) It must be added to the respective item on the debit side of the Profit & Loss Account.

2) It must be shown as Liability in the Balance Sheet

When it is given in Trial Balance - it must be shown as a liability in the Balance Sheet only

3) Prepaid Expenses:- For example : Prepaid Insurance, Taxes, Rents etc.,

Adjustment Entry:-

Prepaid Rent A/c.	Dr.	xxx	
To Rent A/c.			xxx

Accounting Treatment:-

1) It must be deducted from the respective item on the debit side of the Profit & Loss Account.

2) It must be shown as an Asset in the Balance Sheet.

When it is given in Trial Balance - It must be shown as an Asset in the Balance Sheet only.

4) Incomes Receivable:- For Ex :- Rent receivable, Interest receivable etc.

Adjustment entry:-

Incomes receivable Acc.	Dr.	xxx	
To Incomes Account			xxx

Accounting Treatment:-

1) It must be added to the respective item on the credit side of the Profit & Loss Account

2) It must be shown as Asset in the Balance Sheet

When it is given in Trial Balance - It must be shown as an Asset in the Balance Sheet.

5) Incomes Received in Advance:- For Ex : Rent received in Advance, Interest received in Advance etc.

Adjustment entry:-

Incomes Account	Dr.	xxx	
To Incomes received in advance			xxx

Accounting Treatment:-

1) It must be deducted from the respective item on the Credit side of the Profit & Loss Account.

2) It must be shown as Liability in the Balance Sheet.

When it is given in Trial Balance - it must be shown as Liability in the Balance Sheet.

6) Depreciation on Fixed Assets:- For Ex:- on Machinery, Furniture etc.

Adjustment entry:-

Depreciaton Account	Dr.	xxx	
To Fixed Asset Account			xxx

Accounting treatment:-

1) It must de debited to P&L account

2) It must be deducted from the value of respective asset on the assets side of the Balance sheet

When it is given in Trial Balance - it must be debited to P & L Account.

7) Interest on Capital:-

Adjustment Entry:-

Interest on Capital Acc.	Dr.	xxx	
To Capital Acc.			xxx

Accounting Treatment:-

1) It must be debited to the Profit & Loss Account
2) It must be added to the Capital on the Liabilites side by the Balance Sheet.

When it is given in Trial Balance - It must be debited to the P & L Account.

8) Interest on Drawings :

Adjustment Entry:-

Drawings Acc	Dr.	xxx	
To Interest on Drawings Ac.			xxx

Accounting Treatment:-

1) It must be credited to Profit & Loss Account
2) It must be deducted from the Capital on the Liabilities side of the Balance Sheet.

When it is given in Trial Balance - it must be credited to the P & L Account.

9) Interest on Loans :

Adjustment Entry:-

Interest on Loans Acc.	Dr.	xxx	
To Loans Acc.			xxx

Accounting Treatment:-

1) It must be debited to P & L Account
2) It must be shown as Liability in the Balance Sheet.

When it is given in Trial Balance - it must be debited to P & L Account.

10) Baddebts :

Adjustment Entry:-

Bad debts Acc.	Dr.	xxx	
To Debtors Acc.			xxx

Accounting Treatment:-

1) It must be debited to P & L Account

2) It must be deducted from Debtors in the Balance sheet.

When it is given in Trial Balance - it must be debited to P & L Account.

When it is given both in Trial Balance & in Adjustments:-

1) Both amounts must be debited to P & L Account

2) Amount given in Adjustments only must be deducted from Debtors in the Balance Sheet.

11) Reserve for Baddebts or Reserve for Bad & doubtful debts:-

Adjustment Entry:-

Profit & Loss Acc.	Dr.	xxx	
To Reserve for Baddebts Acc.			xxx

Accountng Treatment:-

When it is given as an Adjustment:-

1) It must be debited to P & L Account

2) It must be deducted from Debtors in the Balance Sheet

When it is given only in Trial Balance - it must be deducted from Debtors in the Balance Sheet.

When it is given both in Trial Balance and as an Adjustment

1) Both the amounts must be compared - when Adjustment amount is more than Trial Balance amount - the difference amount must be debited to P & L Account.

When the Adjustment amount is less than the Trial Balance amount - the difference amount must be credited to P & L Account.

2) The amount given in Adjustments only must be deducted from Debtors in the Balance Sheet.

12) Reserve for Discount on Debtors:-

Adjustment Entry:-

P&L Acc.	Dr.	xxx	
To Reserve for Discount on Debtors Acc.			xxx

Accounting Treatment:- The same procedure must be followed which was followed in the case Reserve for Baddebts as above.

13) Reserve for Discont on Creditors:-

Adjustment Entry:-

Reserve for Discount on Credition Acc. Dr. xxx

To P & L Account xxx

Accounting Treatment:-

1) It must be credited to P&L Account

2) It must be deducted from Credition in the Balance Sheet.

When it is given in Trial Balance - it must be deducted from Creditors in Balance Sheet.

When it is given both in Trial Balance and as an Adjustment:-

1) Both the amounts must be compared - when the Adjustment amount is more than the Trial Balance amount - the difference amount must be credited to P & L Account.

When the Adjustment amount is less than the Trial Balance amount - the difference amount must be debited to P & L Account.

2) The amount given in Adjustments only must be deducted from Creditors in the Balance Sheet.

14) Loss of Goods in Fire:-

a) When such goods were not insured:-

Adjustment Entry:- P & L Account Dr. xxx

To Trading Acc. xxx

Accountng Treatment:-

1) It must be credited to Trading Account

2) It must be debited to P & L Account.

b) When such goods were Insured and when the Insurance Company agreed to pay the total amount of loss as compensation:-

Adjustment Entry:-

Insurance Company Account Dr. xxx

To Trading Account xxx

Accounting Treatment:-

1) It must be credited to Trading Account.

2) It must be shown as an Asset in the Balance sheet.

c) When the Insurance Company agreed to pay a part of the loss as compensation:-

Adjustment Entry:-

Insurance Company Account	Dr.	xxx	
P&L Account	Dr.	xxx	
To Trading Account			xxx

Accounting Treatment:-

1) Total amount of goods destroyed must be credited to Trading Account.

2) Net loss (Total loss-Insurance claim) must be debited to P&L Acc.

3) Insurance claim agreed by the Insurance Company must be shown as asset in the Balance Sheet.

15) Goods used for Office Purpose:-

Adjustment Entry:-

P&L Account	Dr.	xxx	
To Purchases Account			xxx

Accounting treatment:-

1) It must be deducted from Purchases in the Trading Account.

2) It must be debited to P&L Account.

16) Goods used for Personal Purpose:-

Adjustment Entry:-

Drawing Account	Dr.	xxx	
To Purchases Account			xxx

Accounting Treatment:-

1) it must be deducted from Purchases in the Trading Account.

2) It must be deducted from Capital in the Balance Sheet.

17) Providing Reserve Fund:-

Adjustment Entry

P & L Account Dr. xxx

To Reserve Fund Account xxx

Accounting Treatment:-

1) It must be debited to P&L Account.

2) It must be shown on the Liabilities side of the Balance Sheet.

18) Manager's Commission on the basis of Profits:-

Adjustment Entry:-

P & L Account Dr. xxx

To Outstanding Commission to Manager Acc. xxx

Accounting Treatment:-

1) It must be debited to P&L Account

2) It must be shown as Liability

The Calculation of Manager's Commission is 2 types.

1) Commission as a percentage on NP 'BEFORE' charing such

Commission = NP x % of Commission/100

2) Commission as a percentage on NP 'AFTER' charging such

Commission = NP x % Commission/ 100 + % of Commission

19) Goods Purchased, included inthe Closing Stock, but not entered in the Books of Account:-

Adjustment Entry:-

Purchases Account Dr. xxx

To Creditors Account xxx

Accounting Treatment:-

1) It must be added to Purchases in the Trading Acc.

2) It must be added to Creditors in the Balance Sheet.

20) Sale of Assets but recorded as goods sold:-

Adjustment Entry:-

Sales Account	Dr.	xxx	
To Asset Account			xxx

Accounting Treatment:-

1) It must be deducted from Sales in the Trading Account

2) It must be deducted from Asset in the Balance Sheet

21) Wages paid for erection of Machinery but recorded as Wages:-

Adjustment Entry:-

Machinery Account	Dr.	xxx	
To Wages Accounts			xxx

Accounting Treatment:-

1) It must be deducted from Wages in the Trading Account

2) It must be added to Machinery in the Balance Sheet.

22) Goods sold but not recorded as Sales:-

Adjustment Entry:-

Debtors Account	Dr.	xxx	
To Sales Account			xxx

Accounting Treatment:-

1) It must be added to Sales in the Trading Account

2) It must be added to Debtors inthe Balance Sheet.

12.8. SUMMARY:

Balance Sheet will reveal the true financial position of the business on a particular date and Final Accounts must be prepared after making the adjustments.

12.9. EXAMPLES:

Example 1 :

The Net profit of Suma Industries for the year ended 31-03-07 was Rs. 26938 From the following Ledger Balances, prepare Balance sheet as on that date.

	Rs.		Rs.
Cash in Hand	7200	Creditors	9472
Cash at Bank	18,654	Drawings	4,800
Plant & machinery	17,000	Capital	30,000
Debtors	11,356	Bills Payable	5,600
		Stock on 31-03-07	13,000

Solution :

Balance Sheet of Suma Industries as on 31.03.07

Liabilities		Amount Rs.	Assets	Amount Rs.
Capital	30,000		Plant & machinery	17,000
Add N.P	26,938		Closing Stock	13,000
	56,938		Debtors	11,356
Less Drawings	4,800	52,138	Bank	18,654
Creditors		9,472	Cash	7200
Bills Payable		5,600		
		67,210		67,210

Example 2 :

From the following particulars, prepare Balance sheet under order of Liquidity mehtod and order of permanance method as on 31-03-07.

	Rs.		Rs.
Capital	10,000	Drawings	3,000
Net Profit of current year	15,000	Closing stock	6,000
Mortgage loan	7,500	Bills payable	2,500
Bills Receivable	4,000	Good will	6,000
Debtors	9,000	Creditors	3,000
Plant & machinery	20,000	Investments	9,000
Cash in hand	1,000	Cash at bank	3,000
Land & Buildings	17,000		

Solution :

Order of Liquidty

Balance Sheet of .... as on 31.03.07

Liabilities		Amount Rs.	Assets	Amount Rs.
Bills payable		2,500	Cash in hand	1,000
Creditors		3,000	Cash at Bank	3,000
Mortgage loan		7,500	Bills Receivable	4,000
Capital	50,000		Debtors	9,000
Add N.P	15,000		Closing stock	6,000
	65,000		Investments	9,000
Less Drawings	3,000	62,000	Plant & Machinery	20,000
			Land & Buildings	17,000
			Good will	6,000
		75,000		75,000

Order of Permanace

		Rs.		Rs.
Capital	50,000		Good will	6,000
Add N.P	15,000		Land & Buildings	17,000
	65,000		Plant & Machinery	20,000
Less Drawings	3,000	62,000	Closing stock	6,000
Mortgage loan		7,500	Investments	9,000
Creditors		3,000	Debtors	9,000
Bills payable		2,500	Bills Receivable	4,000
			Cash at Bank	3,000
			Cash in hand	1,000
		75,000		75,000

Example 3:

The Trial Balance of Chandra Sekhar on 31-03-07 was as under.

	Rs.	Rs.
Land & buildings	27,500	
Plant & Machinery	13,320	
Opening stock	41,730	
Purchases & sales	1,27,330	2,07,830
Carriage	4,780	
Bad Debts	2,250	
Wages	12,270	
Debtors, Creditors	54,450	24,290
Discounts	8,240	7,630
Furniture	1,920	
Capital & Drawings	18,550	1,06,590
General Expenses	13,380	
Bank	18,740	
Taxes	1,880	
	3,46,340	3,46,340

Stock on 31-03-07 Rs. 44200. Prepare final Accounts.

Solution :

Trading & Profit and Loss Account of Chandra Sekhar for the Year ended 31-03-07

Dr	Rs.		Cr Rs.
To Opening stock	41,730	By Sales	2,07,830
To Purchases	1,27,330	By closing stock	44,200
To Carriage	4,780		
To Wages	12,270		
To Gross (profit transfer	65,920		
to P&L Account)	2,52,030		2,52,030
To General Expenses	13,380	By G.P	65,920
To Taxes	1,880	By Discount received	7,630
To Discounts (allowed)	8,240		
To Bad debts	2,250		
To Net profit(Transfer to capital A/c.)	47,800		
	73,550		73,550

Balance Sheet of Chandra Sekhar as on 31.03.07

		Rs.		Rs.
Capital	1.06,590		Land & Buildings	27,500
Add N.P	47,800		Plant & Machinery	13,320
	1,54,390		Furniturs	1,920
Less Drawings	18,550	1,35,840	Closing stock	44,200
Creditors		24,290	Debtors	54,450
			Cash at Bank	18,740
		1,60,130		1,60,130

Example 4 :

From the following Trial Balance, Prepare final accounts.

	Rs.	Rs.
Capital & Drawings of Srinivas	50,000	4,00,000
Land & Buildings	27,500	
Lease hold land	2,50,000	
Free hold premises	2,00,000	
Good will	70,000	
Trade marks	1,30,000	
Plant & Machinery	1,50,000	
Fixtures & Fittings	20,000	
Opening stock	1,80,000	
Bills Receivable & Bills Payable	40,000	60,000
Debtors & Creditors	1,60,000	2,40,000
Purchases & Sales	8,00,000	15,00,000
Returns	10,000	20,000
Carriage in	15,000	
Carriage out	5,000	
Freight & Duty	12,000	
Productive wages	2,20,000	
Coal, gas & Water	8,000	
Factory Expenses	45,000	
Salaries	1,80,000	
Rent, Taxes and Insurance	60,000	
Commission	25,000	
Discounts	40,000	60,000
Interest		30,000
Stationery	5,000	
Trade expenses	18,000	
Cash in hand	7,000	
Bank O.D.		3,90,000
	27,00,000	27,00,000

Solution :

Trading & Profit and Loss Account of Srinivas for the Year ended 3103-07

Dr.					Cr
		Rs.			**Rs.**
To Opening stock		1,80,000	By Sales	15,00,000	
To Purchases	8,00,000		Less Returns	10,000	14,90,000
Less Returns	20,000	7,80,000			
To Carriage in		15,000			
Freight & Duty		12,000			
To Productive wages		2,20,000			
To Coal, gas & Water		8,000			
To Factory Expenses		45,000			
To Gross (profit transfer		2,30,000			
to P& L Account)		14,90,000			14,90,000
To Carriage out		5,000	By G.P		2,30,000
To Salaries		1,80,000	By interest		30,000
To Rent, Taxes and Insurance		60,000	By Discount		60,000
To Commission		25,000	By Net loss(Transfer to Capital Ac)		13,000
To Discounts		40,000			
To Stationery		5,000			
To Trade expenses		18,000			
		3,33,000			3,33,000

Balance Sheet of Srinivas as on 31.03.07

		Rs.		Rs.
Capital	4,00,000		Good will	70,000
Less Net loss 13000			Free hold premises	2,00,000
Less Drawings50000	63,000	3,37,000	Lease hold premises	2,50,000
Bank O.D		3,90,000	Trade Marks	1,30,000
Creditors		2,40,000	Plant & Machinery	1,50,000
Bills payable		60,000	Fixtures & Fittings	20,000
			Bills Receivable	40,000
			Debtors	1,60,000
			Cash	7,000
		10,27,000		10,27,000

Example 5 :

The following Balance sheet is prepared by an inexperienced accountant. Prepare the correct Balance sheet.

Liabilities		Rs.			Rs.
Plant Machinery 1-4-06		24,000	Capital	30,000	
Debtors	49,200		Add interest	1,500	31,500
Less Reserve	2,460	46,740	Creditors		58,800
Drawings		3,600	Depreciation on plant		1,200
Repair to Machinery		280	Reserve for bad debts		2,100
Stock on 1.4.06	6,800		Profit		21,600
Stock on 31.03.07	24,000	30,800	Bills payable		600
Cash		2,520	Balance		4,980
Buildings		12,840			
		1,20,780			1,20,780

Solution :

Balance sheet of .... as on 31.03.07

Liabilities		Rs.	Assets		Rs.
Capital	30,000		Buildings		12,840
Add interest	1,500		Plant Machinery (24000-1200)		22,800
Add N.P	21,600		Closing Stock		24,000
	53,100		Debtors	49,200	
Less Drawings	3,600	49,500	Less RBD	2,460	46,740
Creditors		58,800	Cash		2,520
Bills payable		600			
		1,08,900			1,08,900

12.10. QUESTIONS:

a) Short Answer & Essay questions:-

1. What is meant by Balance Sheet ? What are the Objectives in the preparation of Balance sheet ?
2. Prepare a Model Balance sheet under order of Liquidity and order of permanance with assumed figures.
3. What are the differences between Trial Balance and Balance sheet ?
4. What are the differences between P& L Account and Balance sheet ?

12.11. EXERCISES:

1. From the following ledger balances taken from the Trial Balance of Venkatesh, prepare Final accounts for the year 2007.

   Credit Balances : Capital Rs. 360000, Creditors Rs. 87,200 ; Bills Payable Rs. 25270 ; Sales Rs.789,820 ; Loans Rs. 1,20,000.

   Debit Balances : Debtors Rs. 38850 ; Salaries Rs. 40,000 ; Discount Rs. 10,000; Postage Rs.2,730 ; Bad Debts Rs. 2,870 ; Interest Rs. 12,950 ; Insurance Rs. 4,170 ; Machinery Rs.1,00,000 ; Opening stock Rs. 99,450 ; Purchases Rs. 6,20,920 ; Wages Rs. 43,000 ; Bulidings Rs. 2,37,800 ; Fixtures Fittings Rs. 1,69,550.

   (Ans ; G.P. 26,450 ; Net Loss Rs. 46,270 ; B. S : Rs. 5,46,200)

2. From the following Trial Balance on 31.12.07 Prepare Balance sheet

	Rs.	Rs.
Cash in hand	36,000	
Bank O.D		30,000
Capital		3,25,000
Land & buildings	1,00,000	
Closing stock	60,000	
Furniture	12,500	
Good will	47,500	
Bills Receivable, Bills Payable	35,000	40,000
Car	40,000	
Prepaid Advertisments	5,000	
Debtors, Creditors	1,50,000	70,000
P&L Ac.		5,000
Loan from Ram		30,000
Drawings	25,000	
	5,00,000	5,00,000

(Ans ; Total of B. S : Rs. 4,75,000)

3. The trial balance of Mr. Ram Babu on 31.03.07 was as under. Prepare final accounts.

	Rs.	Rs.
Capital		2,25,000
Cash in hand	25,000	
Stock on 1.04.06		
Finished Goods	35,000	
Work in progress	70,000	
Raw Material	30,000	
Purchase of Raw material	7,05,000	
Machinery	2,25,000	
Sales		12,62,250
Carriage in	7,500	
Carriage out	4,500	
Rent	13,500	
Discount	1,050	
Office fire insurance	2,100	
Sundry Debtors & Creditors	1,59,000	51,000
Reserve for Bad debts		600
Printing & stationery	7,800	
Other Expenses	8,400	
Advertisments	45,000	
Drawings	18,000	
Office salaries	54,000	
Furniture & Fittings	60,000	
Factory power & Fuel	22,500	
Productive wages	2,000	
Cash in hand	6,000	
Cash at bank	37,500	
	15,38,850	15,38,850

Stock on 31. 03.07	Rs.
Finished Goods	50,000
Raw Material	10,000
Work in progress	55,000

(Ans ; G.P. 5,05,250 ; Net Profit Rs. 3,74,500 ; B. S: Rs. 6,32,500)

4. From the following Trial Balance of Raghava prepare Trading and P&L Account and Balance Sheet on 31.03.07.

	Rs.		Rs.
Cash in hand	25,000	Capital	8,00,000
Plant & Machinery	1,97,200	Creditors	5,41,600
Direct wages	3,49.650	Loan	1,00,000
Salaries	1,59,650	Purchase Returns	31,400
Furniture	94,800	Sales	24,68,500
Carriage	19,800		
Carriage out	21,500		
Free hold property	2,50,000		
Manufacturing expenses	94,550		
Insurance & Taxes	41,750		
Good will	3,00,000		
General expenses	81,420		
Fuel & Power	12,760		
Factory lighting	9,860		
Distribution Expenses	24,730		
Stock on 01.04.06	3,41,700		
Horses & carts	51,650		
Purchases	9,71,650		
Sales Returns	37,700		
Discount	9,280		
Bad debts	14,850		
Interest & Bank charges	4,950		

Cash in hand	69,300		
Cash at Bank	1,450		
	39,41,500		39,41,500

(Ans ; G.P. 6,62,230 ; Net Profit Rs. 3,04,100 ; B. S : Rs. 17,45,700)

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Lesson - 13

FINAL ACCOUNTS - PROBLEMS

OBJECTIVES:

By the study of this chapter, you will be able to solve the Final Accounts with adjustments.

STRUCTURE :

13.1. Examples.

13.2. Exercises

13.1. EXAMPLES :

1. From the following Trial Balance of Mr Balu prepare Trading & P&L A/C for the year ending 31.3.07 and Balance sheat as on that data.

	Rs.		Rs.
Plant & Machinery	40,000	Capital	1,00,000
Debtors	24,000	Creditors	12,000
Drawings	10,000	Returns out wards	5,000
Purchases	1,05,000	Sales	2,00,000
Wages	50,000	Bills payable	5,000
Bank	10,000		
Repairs	500		
Stock on 01.04.06	20,000		
Rent	4,000		
Manufacturing Expenses	8,000		
Trade expenses	7,000		
Baddebts	2,000		
Carriage out	1,500		
Returns inwards	4,000		
Cash in hand	36,000		
	3,20,000		3,20,000

Adjustments :

1) Closing stock Rs. 14,500

2) Depreciate plant & Machinery by Rs. 4,000

3) Interest on capital 5%

4) Outstanding Repairs Rs. 400/-

Solution:-

Dr Trading & P&L A/C of Mr. Balu for the year ended 31-03-2007 Cr

Particulars		Amount Rs.	Particulars		Amount Rs.
To opening stock		20,000	By sales	2,00,000	
To purchases	1,05,000		Less sales returns	4,000	1,96,000
Less Returns	5,000	1,00,000	By Closing stock		14,500
To wages		50,000			
To Manufacturing Exp.		8,000			
To Gross Profit		32,500			
		2,10,500			2,10,500
To Repairs	500		By G.P		32,500
Add outstanding	400	900			
To Rent		4,000			
To Trade expenses		7,000			
To Baddebts		2,000			
To Carriage out		1,500			
To Depreciation on plant		4,000			
To Interest on capital 100000x5/100		5,000			
To Net Profit - Transfer to cap. A/C		8,100			
		32,500			32,500

Balance Sheet of Mr. Balu as on 31-03-2007

		Rs.		**Rs.**
Capital	1,00,000		Plant & Machinery (40,000-4,000)	36,000
Add interest on Cap.	5,000		Closing stock	14,500
Add N.P	8,100		Debtors	24,000
	1,13,100		Bank	10,000
Less Drawings	10,000	1,03,100	Cash	36,000
Creditors		12,000		
Bills payable		5,000		
Outstanding Repairs		400		
		1,20,500		1,20,500

Example 2. The Trial Balance of Siva on 31.12.07 was as under. Prepare Final Accounts

	Rs.		**Rs.**
Drawings	7,000	Capital	85,000
Buildings	23,000	Purchase Returns	3,800
Stock on 1.1.2007	29,000	Sales	2,38,000
Purchases	2,07,000	Apprentice premimum	1,000
Sales Returnes	5,000	Commission	600
General Expenses	8,000	Bank O.D	2,800
Rent & Taxes	6,400	Creditors	20,000
Baddebts	3,400	Bills payable	2,000
Debtors	64,000		
Interset on O.D	400		
	3,53,200		3,53,200

Adjustments :

1) Stock on 31.12.07 Rs. 29,000/-

2) Out standing Rent Rs. 500/- ; Prepaid Taxes Rs. 350/-

3) Apprentice premium to be adjusted over 5 years

4) Depreciate Buildings by 10%

5) Interest on capital 5% and interest on Drawings 3%

6) Commission received in advance Rs. 500/-

Solution:-

Dr Trading & P&L AC of Siva for the year ended 31-12-2007 Cr

		Rs.			Rs.
To opening stock		29,000	By sales	2,32,000	
To purchases	2.07,000		Less Sales returns	5,000	2,33,000
Less Returns	3,800	2,03,200	By Closing stock		29,000
To Gross Profit Transfer to AC		29,800			
		2,62,000			2,62,000
To General Exp.		8,000	By G.P		29,800
To Rent & Taxes	6,400		By Apprentice premium	1,000	
Less Prepaid taxes	350		Less Received in advance	800	200
	6,050		By Commission	600	
Add outstanding Rent	500	6,550	Less Recieved in Advance	500	100
To Baddebts		3,400	By interest on Drawings 7000x3/100		210
To interest on O.D		400			
To Deperciation Buildings		2,300			
To interestion Cap		4,250			
To Net profit (Transfer to Cap. Ac)		5,410			
		30,310			30,310

Balance Sheet of Siva as on 31-03-2007

			Rs.		Rs.
Capital		85,000		Buildings (23,000-2,300)	20,200
Add interest on Cap.		4,250		Closing stock	29,000
Add N.P		5,410		Debtors	64,000
Less Drawings	7,000	94,660		Prepaid Taxes	350
Interest	210	7,210	87,450		
Creditors			20,000		
Bank O.D			2,800		

Bills payable	2,000		
Apprentice premium recived in Advance	800		
Commission	500		
Outstanding Rent	500		
	1,14,050		1,14,050

3. From the following Trial Balance of ' Kranthi ' on 31.03.07 prepare final accounts

	Rs.		Rs.
Purchases	1,65,625	Sales	2,56,650
Sales returns	4,250	Purchase Returns	3,120
Sundry Debtors	40,200	Reserve for Baddebts	5,200
Stock on 01.04.06	26,725	Sundry crdeitors	25,526
wages	20,137	Bills payable	8,950
Salaries	8,575	Interest on investments	825
Furniture	6,575	Capital	28,000
Patents	4,500	Out standing wages	2,019
Postage, stationary , Insurance	3,226	Out standing Rent	750
Lighting	350		
Trade expenses	2,314		
Rent & Taxes	3,517		
Baddebts	525		
5% prakash loan (on 1.12.06)	3,000		
Investments	11,500		
Prepaid insurance	524		
Cash in hand	5,752		
Bills Receivable	17,070		
Drawings	6,000		
Depreciation on Furniture	675		
	3,31,040		3,31,040

Adjustments :

1) Stock on 31.12.07 Rs. 10,520/-

2) A fire occured in March 2007 and goods of Rs. 1000 were destroyed and the insurance company agreed to pay Rs. 700/- as compensation.

3) Bills Receivable dishonoured Rs. 650/- but no entry is passed for dishonour.

4) Depreciate patents by 25%

5) Write off Rs. 850 from debtors as baddebts and provide Reserve for Baddebts @ 5%

6) Goods purschased on credit Rs. 5000/- is included in closing stock but no entry is passed.

Solution:-

Dr. Trading & P&L A/C of Kranthi for the year ended 31-03-07 Cr.

		Rs.			**Rs.**
To opening stock		26,725	By sales	2,56,650	
To purchases	1,65,625		Less returun	4,250	2,52,400
Add additional purchases	5,000		By Closing stock		10,520
	1,70,625		By Loss due to fire		1,000
Less Returnes	3,120	1,67,505			
To wages		20,137			
To Gross profit		49,553			
		2,63,920			2,63,920
To Salaries		8,575	By G.P		49,553
To Postage, stationary, insurance		3,226	By interest on loan of prakash		
To Lighting		350	3000 x 5/100 x 4/12		50
To Trade exp.		2,314	By R.B.D. (5200 -2000)		3,200
To Rent & Taxes		3,517	By intereston investments		825
To Baddebts (525+850)		1,375			
To Depreciation on Furniture		675			
To Loss due to fire (1000-700)		300			
To Depreciation on Patents					
4500 x 25/100		1,125			
To net profit (Transfer to capital ac)		32,171			
		53,628			53,628

Balance Sheet of Kranthi as on 31-03-2007

		Rs.			Rs.
Capital	28,000		Furniture		6,575
Add N.P	32,171		Patents (4500 - 1125)		3,375
	60,171		Investments		11,500
Less Drawings	6,000	54,171	5% prakash loan Ac		3,000
Creditors (25,526 +5000)		30,526	Interest receivable on loan		50
Bills payable		8,950	Insurance claim due		700
Outstanding wages		2,019	Closing stock		10,520
Rent		750	Debtors	40,200	
			Add Bills Dishonoured	650	
				40,850	
			Less Baddebts	850	
				40,000	
			Less R.B.D. 5%	2,000	38,000
			Bills Receivable	17,070	
			Less Bills dishonoured	650	16,420
			Cash		5,752
			Prepaid Insurance		524
		96,416			96,416

4. From the following Ledger Balance of ' Prakash ' prepare final accounts

	Rs.		Rs.
Stock on 01.04.06	96,000	Wages	28,000
Salaries	4,000	Drawings	6,500
Capital	50,000	Bills payable	5,000
Carriage	5,000	Interest on over draft	200
Purchases	1,20,000	Bills Receivable	6,000
Rent	2,000	Plant & Machinery	20,000
Travelling Expenses	5,000	Repairs to Machinery	1,600
Cash in hand	5,600	Office expenses	5,000
IncomeTax	500	Bank loan	14,000
Baddebts	5,000	Sales	2,50,000
Discount on purchases	4,000	Creditors	23,300
Purchase Returns	1,500	Cash at Bank	1,800
Buildings	5,000	Sales Returns	1,000
Debtors	35,000		

Adjustments :

1) Stock on 31.03.07 Rs. 35,000/-

2) Bad debts Rs. 3,000/-

3) Provision for Bad debts 5%

4) Goods drawn for house hold purpose Rs. 3,000/-

5) Goods of Rs. 1000/- were given away as free samples

6) Erection charges of Machinery Rs. 1,000 were included in wages account

7) Depreciation on plant & Machinery 10%

8) Interest on capital 5%

9) Outstanding wages Rs. 1500/-, salaries Rs. 450, Rent Rs. 400/-

Solution:-

Dr. Trading & P&L AC of Prakash for the year ended 31-03-07 Cr.

Particulars			Rs.	Particulars		Rs.
To opening stock			96,000	By sales	2,50,000	
To purchases		1,20,000		Less returuns	1,000	2,49,000
Less Returns	1500			By Closing stock		35,000
Less Drawings	3000					
Less Free samples	1000	5,500	1,14,500			
To wages		28,000				
Add out standing		1,500				
		29,500				
Less Erection charges						
of Machine		1,000	28,500			
To carriage			5,000			
To Gross profit						
(Transfer to P&L AC)			40,000			
			2,84,000			2,84,000
To Salaries		2,000		By G.P		40,000
Add outstanding		450	4,450	By Discount on purchases		4,000
To intereston O.D			200			
To Rent		2,000				
Add out standing		400	2,400			
To Depreciation on P&M						
21,000x10/100			2,100			
To Travelling expenses			5,000			
To Repairs			1,600			
To office expenses			5,000			
To Baddebts (5000+3000)			8,000			
To Advertisements- free samples			1,000			
To interest on capital 50,000x5/100			2,500			
To R.B.D. (32,000 x5/100)			1,600			
To net profit (Transfer to capital A/C)			10,150			
			44,000			44,000

Balance Sheet of Prakash as on 31-03-2007

		Rs.			Rs.
Capital	50,000		Buildings		5,000
Add N.P	10,150		Plant & Machinery	20,000	
Add interest on capital	2,500		Add erection charges	1,000	
	62,650			21,000	
Less Drawings 6,500			Less Depreciation	2,100	18,900
Less Drawings of goods 3,000			Closing stock		35,000
Less Income tax 500	10,000	52,650	Bills Receivable		600
Bank loan		14,000	Debtors	35,000	
Creditors		23,300	Less Baddebts	3,000	
Bills payable		5,000		32,000	
Out standing Expenses			Less R.B.D. 5%	1,600	30,400
Wages		1,500	Bank		1,800
Salaries		450	Cash		5,600
Rent		400			
		97,300			97,300

5. The trial Balance of Sri. Govind on 31-03-08 was as under. Prepare Trading and P&L account and Balance sheet.

	Dr Rs.	Cr Rs.
Capital & Drawings	6,000	40,000
Plant & Machinery	15,000	
Furniture & Fixtures	2,000	
Patent Rights (for 10 years from 1.4.07)	10,000	
Stock on 1.4.07	10,000	
Purchases & sales	42,500	66,000
Salaries	3,700	
Wages	7,500	
Debtors & Creditors	10,200	6,000
Loan from syam (@ 6% on 1.10.07)		5,000
Postage & Telegrames	250	
Loose tools	500	
Rent, Rates & Taxes	1,800	
Baddebts written off	200	
Discount		300
Trade expenses	100	
Interest on the loan of syam	75	
Insurance	400	
Travelling Expenses	250	
Legal expenses	150	
Cash in hand	1,525	
Cash at bank	5,150	
	1,17,300	1,17,300

Adjustments :

1) Stock on 31.03.08 Rs. 13,600/- and loose tools Rs. 350/-

2) New machine purchased on 1.1.2008 for Rs. 1,500 but no entry is passed in the books of account. Expenses for erection of the machine Rs. 500/- were included in wages.

3) Depreciate plant by 20% and Furniture by 10% P.A.

4) Write off Rs. 200/- as Baddebts and provide 5% for Baddebts and 2% for Discount on Debtors.

5) Manager shall be given a commission of 5% on N.P. before charging such commission.

6) Fire occured in the godown on 25.03.08 and goods of Rs. 2500 were destroyed. The insurance company agreed the claim in full.

7) Unexpired insurance Rs. 200/-

Solution:-

Dr Trading & P&L A/C of Sri Govind for the year ended 31-03-08 Cr.

		Rs.		Rs.
To opening stock		10,000	By sales	66,000
To purchases		42,500	By closing stock	13,600
To wages	7,500		By loss due to fire	2,500
less erection charges				
of Machine	500	7,000		
To G.P		22,600		
		82,100		82,100
To Salaries		3,700	By G.P	22,600
To Postage & Telegrams		250	By Discount	300
To Rent, Rates & Taxes		1,800		
To Bad debts (200+200)		400		
To Trade Expenses		100		
To interest on loan	75			
Add out standing	75	150		
To insurance	400			
Less un expired	200	200		
To Travelling		250		
To legal expenses		150		
To depreciation :				
Loose tools (500-350)		150		
Furniture		200		
Plant		3,100		
Patents		1,000		
To R.B.D		500		
To Reserve for discount on debtors		190		
To N.P(before charging commission)				
Balance C/D		10,760		
		22,900		22,900

To Manager's commission 10,760x5/100	538	By Bal B/D	10,760
To Net profit (Transfer to capital A/C)	10,222		
	10,760		10,760

Balance Sheet of Sri Govind as on 31-03-2007

		Rs.			Rs.
Capital	40,000		Plant (15000+1500+500-3100)		13,900
Add N.P	10,222		on 15,000 = Rs.	3,000)	
	50,222		on 2,000 for 3 months	100)	
Less Drawings	6,000	44,222		3,100	
Syam's Loan		5,000	Furnuiture (2,000-200)		1,800
Sundry creditors		6,000	Patents (10,000-1,000)		9,000
Out standing Expenses			Insurance claim due		2,500
Manager's commission		538	Closing stock		13,600
For machinery		1,500	Loose tools		350
Interest on loan		75	Unexpired insurance		200
			Debtors	10,200	
			Less Baddebts	200	
				10,000	
			Less R.B.D.	500	
				9,500	
			Less Reserve for discount	190	9,310
			Bank		5,150
			Cash		1,525
		57,335			57,335

6. The following Trial Balance relate to Suresh. Prepare final accounts

Debit Balances	Rs.	Credit Balances	Rs.
Drawings	3,000	Capital	28,000
Debtors	20,100	Creditos	10,401
Interestan loans	300	Mortgage loan	9,500
Cash in hand	2,050	Reser for Doubtful debts	710
Stock on 1.1.07	6,839	Sales	1,10,243
Motor vehicles	10,000	Purchase returns	1,346
Bank	3,555	Discount	540
Land & Buildings	12,000	Bills payable	2,614
Baddebts	525	Rent received	250
Purchases	66,458		
Sales Returnes	7,821		
carriage out	2,404		
carriage in	2,929		
Salaries	9,097		
Rent, Rates, insurance	2,891		
Advertisments	3,264		
General Expenses	3,489		
Bills Receivable	6,882		

Adjustments :

1) Depreciation on Land & Buildings 2 $^1/_2$ % on Motor vehicles 20%
2) Interest on loan is not paid for 6 monts @ 6%
3) Goods costing Rs. 500 were sent on Sale or Return basis at Rs. 600 on 31.12.07 but recorded as sales in the books of account.
4) Outstanding salaries Rs. 750/- and Rates Rs. 350/-
5) Prepaid Insurance Rs. 150/-
6) Provide 5% on Debtors for Bad & Doutful debts
7) Manager shall be given a commission of 5% on N.P, after charging such commission.
8) Stock on 31.12.07 Rs. 6,250/-

Solution:-

Dr. Trading & P&L AC of Suresh for the year ended 31-12-07 Cr.

		Rs.				Rs.
To opening stock		6,839	By sales		1,10,243	
To purchases	66,458		Less returun	7821		
Less Returns	1,346	65,112	Less goods			
To Carriage in		2,929	on sale or return	600	8,421	1,01,822
To Gross profit (Transfer to			By closing stock (6250+500)			6,750
P & L AC)		33692				
		1,08,572				1,08,572
To Salaries	9,097		By G.P			33,692
Add out standing	750	9,847	By Discount			540
To interest on loan		585	By Rent			250
To Carriage out		2,404				
To Rent,Rates,Insurances	2,891					
Add outstanding Rates	350					
	3,241					
Less Prepaid insurance	150	3,091				
To Advertisements		3,264				
To Gen. Expenses		3,489				
To Baddebts		525				
To R.B.D. (975 - 710)		265				
To Dep. Land & Buildings		300				
Motor vehicles		2,000				
To Balance C/D		8,712				
		34,482				34,482
To Manager's commission			By Bal. B/D			8,712
8712 x 10/110		792				
To net profit (Transfer to capital A/C)		7,920				
		8,712				8,712

Balance Sheet of Suresh as on 31-03-2007

		Rs.			Rs.
Capital	28,000		Land & Buildings (12000-300)		11,700
Add N.P	7,920		Motor Vehicles (10000 - 2000)		8,000
	35,920		Closing stock		6,750
Less Drawings	3,000	32,920	Detbors	20,100	
Mortgage loan		9,500	Less goods on sale or Return	600	
				19,500	
Bills payable		2,614	Less R.B.D	975	18,525
Creditors		10,401	Bill Recivable		6,882
Out standing Expenses			Cash at bank		3,555
Salaries		750	Cash in hand		2,050
Rates		350	Prepaid insurance		150
Interest on loan		285			
Manager commission		792			
		57,612			57,612

13.2. EXERCISES :

1. From the following ledger balances of " Kapil Dev " prepare final accounts.

	Rs.		Rs.
Capital	1,00,000	Cash in hand	1,200
Purchases	1,20,000	Bills payable	22,000
Stock on 1-4-07	35,000	Debtors	50,000
Creditors	24,000	Plant & Machinery	60,000
Furniture	15,000	Sales	2,00,200
Bills Receivable	20,000	Rent & Taxes	10,000
Wages	16,000	Reserve for Baddebts	1,000
Salaries	20,000		

Adjustments :

1) Stock on 31.03.08 Rs. 40,000.

2) Outstanding Rent Rs. 2,000, wages Rs. 3,000 ; Salaries Rs. 4000/-

3) Depreciation 10% on Furniture ; 5% on Plant & Machinery

4) Increase the Reserve for Baddebts to 2 1/2 %

(**Ans :** G.P. Rs. 66,200 ; N.P. Rs. 24,450/- ; B.S. Rs. 1,80,450/-)

2. The Trial Balance of 'Gavaskar ' was as under on 31-03-08

	Dr Rs.	Cr Rs.
Purchases	3,10,000	
Opening stock	50,000	
Cash	2,100	
Bank	12,000	
Drawings	4,000	
Rent & Taxes	5,000	
Salaries	32,000	
Postage & Telegrams	11,500	
Salesmans commission	35,000	
Insurance	9,000	
Advertisements	17,000	
Furniture	22,000	
Printing & Stationary	3,000	
Motor car	48,000	
Baddebts	2,000	
Cash discount	4,000	
General expenses	15,000	
Carriage in	10,000	
Carriage out	22,000	
Debtors	1,00,000	
Sales		4,15,000
Capital		2,88,600
Creditors		10,000
	7,13,600	7,13,600

Adjustments :

1) Stock on 31.03.08 Rs. 1,45,000/-

2) Goods of Rs. 5000 were with drawn by him for personal use.

3) Baddebts Rs. 5,000/-

4) Reserve for baddebts 5 %

5) Depreciation 10% on Furniture and 20 % on Car

Prepare final accounts.

(**Ans :** G.P. Rs. 34,000 ; N.P. Rs. 3,200/- ; Balance Sheet Rs. 87,200/-)

3. From the following Trial Balance of ' Kalyan ' prepare Final accounts for 2007

	Dr Rs.	Cr Rs.
Plant & Machinery	80,000	
Purchases & sales	1,25,000	2,30,000
Debtors & creditors	50,000	40,000
Opening stock	25,000	
Salaries	16,000	
Resere for Baddebts		750
Capital		50,000
Bills Receivable & Payable	20,000	9,250
Rent & Taxes	5,500	
Furniture	2,500	
Bank loan		20,000
Interest on loan	600	
Discount	650	1,200
Wages	14,850	
Cash	11,100	
	3,51,200	3,51,200

Adjustments :

1) Closing Stock Rs. 45,000/-

2) Out standing liabilities : Rent Rs. 500/- ; Interest Rs. 1,400 ; Wages Rs. 150.

3) Depreciation : 5% on Plant & Machinery ; 10% on Furniture.

4) Increase the R.B.D. on Debtors to 2 1/2 %

5) provide a reserve for discount on creditors at 1 %.

(**Ans :** G.P. Rs. 1,10,000 ; N.P. Rs. 82,200/- ; Balance sheet Rs. 2,03,100/-)

4. From the following Trial Balance of ' Sachin ' on 31.03.08 prepare final accounts.

	Dr Rs.	**Cr Rs.**
Bills receivable and Bills payable	4,000	3,250
Debtors & Creditors	60,000	13,000
Plant & Machinery	70,000	
Purchases, Sales	80,000	2,00,000
Free hold premises	48,000	
Capital		1,00,000
Salaries	10,000	
Wages	12,500	
Postage & stationary	800	
Carriage in	650	
Carriage out	750	
Bad debts	1,000	
Reserve for Baddebts		450
Office, general expenses	1,500	
Cash in hand and at Bank	6,500	
Insurance	1,000	
Opening stock	20,000	
	3,16,700	3,16,700

Adjustments :

1) Interest on capital 5%

2) Reserve for Baddebts 2%

3) Closing stock Rs. 30,000

4) Depreciate machinery by 5%

5) Prepaid insurance Rs. 400

6) Outstanding wages Rs. 1,000/-

(**Ans :** G.P. Rs. 1,16,850; N.P. Rs. 91,950/- ; Balance sheet Rs. 2,14,200/-)

5. Prepare Final Accounts of Mr. Babu for the year 2007

	Rs.		Rs.
Capital	20,000	Machinery	2,500
Drawings	3,500	Furniture	600
Buildings	10,000	Opening stock	12,500
Purchases	75,000	Sales	1,25,000
Reserve for Discount on Debtors	200	9% loan	5,000
Salaries	4,400	wages	8,100
Outstanding wages	600	Outstanding Rent	2,750
Trade expenses	1,250	Carriage in	2,500
Carriage outwards	750	Sales Returnes	5,000
Freight & duty	15,000	Debtors	10,000
Creditors	7,500	Reserve for Baddebts	700
Interest paid	375	Sundry expenses	1,115
Incomes receivable	400	Bad debts	300
Cash & Bank	3,000	Depreciation on Machinery	350
		Bills payable	390

Adjustments :

1) Closing Stock Rs. 14,000.

2) Provide 5% reserve on Debtors for baddebts.

3) Reserve for Discount on debtors 2 1/2%

4) Depreciation on Buildings 2 1/2 %

(**Ans :** G.P. Rs. 20,900 ; N.P. Rs. 9,447/- ; B.S. Rs. 39,512/-)

T. Nageswara Rao
Vice - Principal
Hindu College, Guntur.

Lesson - 14

FINAL ACCOUNTS - PROBLEMS

OBJECTIVES:

By the study of this chapter, you will be able to solve the Final Accounts with adjustments.

STRUCTURE :

14.1. Examples.

14.2. Exercises

14.1. EXAMPLES :

1. The Trial Balance of Chiranjivi on 31.3.08 was as under. Prepare Final Accounts.

	Dr Rs.	Cr Rs.
Capital & Drawings	14,200	85,000
Machinery	23,000	
Stock on 01-04-07	29,200	
Purchases & Returns	2,00,000	3,800
Sales & Returns	4,200	2,38,000
General Expenses	8,800	
Rent & Taxes	6,400	
Apprentice Premium		1,600
Bank O.D.		2,800
Baddebts	3,400	
Debtors & Creditors	64,000	20,000
Reserve of Baddebts		2,000
	3,53,200	3,53,200

Adjustments :

1) Depreciate Machinery by 10 %

2) Increase the reserve for Baddebts upto 55

3) Reserve for Discount on Debtors 2%

4) Goods of Rs. 800/- were with drawn by the proprietor for personal purpose.

5) Purchase of Machinery Rs. 2,000 is wrongly recorded as goods purchased.

6) Balance of stationary on 31.03.08 Rs. 600 is Included in closing stock.

7) Apprentice premium is to be adjusted over 4 years.

8) Purchase of stationary Rs. 800 was included in General Expenses.

9) Transport of machine Rs. 200 is included in General Expenses.

10) Stock on 31-03-08 Rs. 34,000/-

Solution:-

Dr. Trading & P&L AC of Chiranjivi for the year ended 31-03-08 Cr.

Particulars			**Amount Rs.**	**Particulars**		**Amount Rs.**
To opening stock			29,200	By sales	23,000	
To purchases		2,00,000		Less returns	4,200	2,33,800
Less Returns	3800			By Closing stock	34,000	
Less Machinery	2000			Less stationary	600	33,400
Less Drawings	800	6,600	1,93,400			
To G. P.Transfer to cap. A/C			44,600			
			2,67,200			2,67,200
To General expenses		8,800		By G.P		44,600
Less stationary	800			By Apprentice premium	1,600	
Less Transport of Machinery	200	1,000	7,800	Less Received in advance	1,200	400
To stationary		800				
Less closing balance		600	200			
To Rent & Taxes			6,400			
To Baddebts			3,400			

To R.B.D (3200-2000)	1,200		
To Reserve for Discount			
on debtros (60,800 x2/100)	1,216		
To Depreciation on machinery	2,520		
To Net Profit	22,264		
	45,000		45,000

Balance Sheet of Chiranjivi as on 31-03-2008

		Rs.			Rs.
Capital	85,000		Machinery	23,000	
Add N.P	22,264		Add Purchased	2,000	
	1,07,264		Add Transportation	200	
Less Drawings	15,000	92,264		25,200	
Creditors		20,000	Less Dep.	2,520	22,680
Bank O.D.		2,800	Closing stock (34000-600)		33,400
App.Premium received in advance		1,200	Balance of stationery		600
			Debtors	64,000	
			Less R.B.D	3,200	
				60,800	
			Less Reserve for Discount	1,216	59584
		1,16,264			1,16,264

2. From the following Trial Balance prepared from the books of Bala Krishna, Prepare final accounts for the year 2007.

	Dr Rs.	Cr Rs.
Capital & Drawings	5,000	66,500
Debtors & Creditors	40,000	20,000
Loan on mortgage		8,000
Interest on loan on Mortgage	600	
Cash in hand	200	
Reserve for baddebts		1,400
Stock on 01-01-07	8,000	
Machinery	16,000	
Cash at bank	5,000	
Buildings	24,000	
Depreciation	500	
Baddebts	1,000	
Purchases & Returns	1,40,600	10,600
Sales & Returns	14,800	2,20,800
Wages	20,000	
Salaries	12,000	
Carriage	2,000	
Factory expenses	12,000	
Insurance	1,200	
Publicity expenses	1,300	
Discount	800	1,200
Rent	3,000	
Water & Electricity	5,000	
Investments	10,000	
General Expenses	6,000	
Dividends		500
	3,29,000	3,29,000

Adjustments :

1) 4/5th of the water & Electricity expenses shall be charged to Trading A/c.
2) 3/4th of the Rent related to Factory.
3) Depreciate Machinery by 10%
4) Closing stock Rs. 10,800/-
5) Market value of investments on 31.12.07 Rs. 10,500/-
6) Reserve for Baddebts 5%
7) 1% commission shall be payable to factory manager on gross profit.
8) 5% commission on N.P. Shall be payable to General manager after charging such commission.
9) One fourth of the N.P shall be tranfered to General Reserve account.
10) Dividend accrued Rs. 200/-

Solution:-

Dr Trading & P&L AC of Bala Krishna for the year ended 31-12-2007 Cr

		Rs.			Rs.
To opening stock		8,000	By sales	2,20,800	
To purchases	1,40,600		Less returns	14,800	2,06,000
Less Returns	10,600	1,30,000	By Closing stock		10,800
To wages		20,000			
To carriage		2,000			
To Factory expenses		12,000			
To Rent (3,000x 3/4)		2,250			
To water & Electricity (5000x4/5)		4,000			
To G.P. (Transfer to Cap. Ac)		38,550			
		2,16,800			2,16,800

To Salaries	12,000	By G.P		38,550
To Interest on loan	600	By Dividends	500	
To Depreciation	500	Add accrued	200	700
To Baddebts	1,000	By Discount		1,200
To R.B.D (2,000 - 1,400)	600			
To Insurance	1,200			
To Advertisements	1,300			
To Discount	800			
To Rent (3,000 x 1/4)	750			
To water & electricity 5,000 x1/5	1,000			
To General expenses	6,000			
To Depreciation on Machinery	1,600			
To commission to factory				
manager 38,550 x1/100	386			
To Balance C/D	12,714			
	40,450			40,450
To General manager commission		By Balance B/D		12,714
12,714 x5/105	605			
To Balance C/D	12,109			
	12,714			12,714
To General Reserve 12,109 x 1/4	3,027	By Balance B/D		12,109
To Net profit (Transfer to Cap. Ac)	9,082			
	12,109			12,109

Balance Sheet of Bala krishna as on 31-12-07

		Rs.			Rs.
Capital	66,500		Machinery (16,000-1,600)		14,400
Add N.P	9,082 75,582		Buildings		24,000
Less Drawings	5,000	70,582	Investments (M.V. Rs 10,500)		10,000
Creditors		20,000	Closing stock		10,800
Mortgage loan		8,000	Debtors	40,000	
General Reserve		3,027	Less R.B.D	2,000	38,000
Outstanding Commission			Bank		5,000
Factory Manager		386	Cash		200
General Manager		605	Dividend accrued		200
		1,02,600			1,02,600

3. The Trial Balance of Murali Krishna on 31.03.07 was as under.

Debit balances	Rs.	Credit balances	Rs.
Cash in hand	2,800	Capital	90,000
Cash at Bank	3,000	Creditors	20,000
Opening stock	30,000	Bills payable	15,000
Sales returnes	5,000	Reserve for Baddebts	4,000
Purchases	1,50,000	Sales	2,50,000
Carriage out wards	4,200	Purchase returns	3,000
Carriage inwards	6,800	12% Bank loan (on 1-1-2007)	10,000
Wages & salaries	20,000	8% loan form Ram Babu (0n1.10.07)	8,000
Establishment	12,000	Suspense account	800
Land & Buildings	40,000		
Plant & Machinery	80,000		
Debtors	14,000		
Baddebts	1,000		
Bills recivable	6,000		
Bills for collection	4,000		
Drawings	12,000		
Printing & stationary	1,200		
LIC premium on the policy of Proprietor	2,400		
Interest on Bank loan	600		
Rates & Taxes	800		
Furniture	5,000		
	4,00,800		4,00,800

Adjustments :

1) Closing Stock Rs. 40,000/-

2) Outstanding wages Rs. 3,000/- salaries 1,000/-

3) Prepaid Rates & Taxes Rs. 200/-

4) Goods purchased and cheque issued for Rs. 5,000 on 31.03.08 but not entered in the books of account but these goods were included in the closing stocks.

5) On 31.03.08 goods sold for Rs. 4,000 and were entered in the books of account but these goods were still in stock as the goods were not taken over by the customer.

6) Wire off further Rs. 500 as baddebts and provide 5% for baddbets.

7) Depreciatoin : 5% on Buildings , 10% on Machinery and 20 % on Furniture.

8) Reserve for Discount on Creditors 2 %

Prepare Final accounts.

Solution:-

Dr. Trading & P&L A/C of Murali Krishna for the year ended 31-03-08 Cr.

		Rs.			**Rs.**
To opening stock		30,000	By sales	2,50,000	
To purchases	1,50,000		Less returns	5,000	2,45,000
Add additional purchases	5,000		By Closing stock	40,000	
	1,55,000		Less undelivered goods	4,000	36,000
Less Returns	3,000	1,52,000			
To wages & salaries	20,000				
Add outstanding	4,000	24,000			
To carriage in wards		6,800			
To G.P. (Transfer to capital ac)		68,200			
		2,81,000			2,81,000
To Rates & Taxes	800		By Gross profit		68,200
Less prepaid	200	600	By R.B.D. (4000 -675)		3,325
To Bad debts (1000+500)		1,500	By reserve for discount on creditors		
To Establishment		12,000	(20,000 x 2/100)		400
To depreciation					
Buildings		2,000			
Machinery		8,000			
Furniture		1,000			

To Interest on loan (600+600)	1,200		
To Interest on loan from Ram Babu			
8,000 x 8/100 x 6/12	320		
To Carriage outwards	4,200		
To Printing & stationary	1,200		
To N.P. (Transfer to capital A/C)	39,205		
	71,925		71,925

Balance Sheet of Murali Krishna as on 31-03-2007

			Rs.			Rs.
Capital		90,000		Land & Buildings (40,000-2,000)		38,000
Add N.P		39,905		Machinery (80,000-8,000)		72,000
		1,29,905		Furniture (5,000-1,000)		4,000
Less Drawings	12000			Closing stock (40,000-4,000)		36,000
LIC premium	_2400	14,400	1,15,505	Debtors	14,000	
Creditors		20,000		Less Baddebts	500	
Less Reserve for discount		400	19,600		13,500	
Bills payable			15,000	Less R.B.D	675	12,825
12% Bank loan			10,000	Bills Receivable		4,000
Interest outstanding			600	Bills for collection		6,000
8% loan from Ram Babu			8,000	Cash in hand		2,800
Interest outstanding			320	Prepaid Rates & Taxes		200
Bank O.D. (5000 -3000 Cheque for Purchases)			2,000			
Outstanding wages & salaries			4,000			
Suspense account			800			
			1,75,825			1,75,825

4. The Trial Balance of Swamy on 31.03.08 was as under. Prepare Trading & profit & loss Account and Balance sheet.

	Rs.		Rs.
Drawings	12,000	Capital	60,000
Furniture & Fixtures	4,000	Returns	2,000
Plant & Machinery	30,000	Sales	1,30,000
Opening stock	20,000	Creditors	12,000
Purchases	80,000	6% loan on 1.4.07	10,000
Salaries & wages	22,400	Discount	600
Debtors	20,400		
Returns	5,000		
Postage & Telegrams	1,500		
Rent , Rates & Taxes	3,600		
Baddebts written off.	400		
Trade expenses	200		
Intereston loan	150		
Insurance	800		
Travelling expenses	500		
Sundry expenses	300		
Cash in hand	3,050		
Cash at Bank	10,300		
	2,14,600		2,14,600

Adjustments :

1) Closing stock Rs. 21,000

2) Write off Rs. 400 as Baddebts, provide 5% Reserve on Debtors for Baddebts and 2 1/2 for discount.

3) Outstanding salaries Rs. 800/-

4) Interest on capital 6% and Interest on Drawings Rs. 330/-

5) Prepaid insurance Rs. 100/-

6) Depreciation : 5% on Furniture and 10% on Plant & Machinery.

Solution:-

Dr. Trading & P&L AC of Swamy for the year ended 31-03-07 Cr.

		Rs.			**Rs.**
To Opening stock		20,000	By sales	1,30,000	
To Purchases	80,000		Less returns	5,000	1,25,000
Less Returns	2,000	78,000	By Closing stock		21,000
To Gross profit (Transfer to P&L AC)		48,000			
		1,46,600			1,46,600
To Salaries (22400+800)		23,200	By G.P		48,000
To Postage, Telegrams		1,500	By Discount		600
To Rent etc.		3,600	By interest as Drawings		330
To Baddebts (400+400)		800			
To Trade expenses		200			
To Interest on loan (150+450)		600			
To Insurance	800				
Less prepaid	100	700			
To Travelling expenses		500			
To Sundry expenses		300			
To R.B.D 20000 x 5 /100		1,000			
To Reserve for Discount 19,000 x 2.5 /100		475			
To Interest on capital 60,000 x 6/100		3,600			
To Depreciation - Furniture 4,000 x 5/100		200			
P & M 30,000 x 10/100		3,000			
To N.P. (Transfer to Capital A/C)		9,255			
		48,930			48,930

Balance Sheet of Swamy as on 31-03-2007

		Rs.			Rs.
Capital	60,000		Furniture (4000-200)		3,800
Add Interest on capital	3,600		Plant & Machinery 30000-3000		27,000
Add N.P.	9,255		Debtors	20,400	
	72,855		Less Baddebts	400	
Less Drawings				20,000	
12000 +330	12,330	60,525	Less R.B.D	1,000	
Creditors		12,000		19,000	
6% loan		10,000	Less Reserve		
Interest outstanding		450	for discount	475	18,525
Salaries outstanding		800	Cash		3,050
			Bank		10,300
			Closing stock		21,000
			Prepaid Insurance		100
		83,775			83,775

14.2. EXERCISES :

1. From the following Trial Balance of Kiran as on 31.03.08 Prepare Trading & P&L A/c and Balance Sheet.

	Dr Rs.	Cr Rs.
Capital & Drawings	6,000	80,000
Plant & Machinery on 1.4.07	20,000	
Additions on 1.10.07	5,000	
Stock on 1.4.07	15,000	
Purchases, sales	82,000	1,20,000
Returns	2,000	1,000
Sundry Debtors & Creditors	20,600	10,000
Furniture & Fittings	5,000	
Freight & Duty	2,000	
Carriage outwards	500	
Rent & Taxes	4,600	
Printing & Stationary	800	
Trade expenses	400	
Postage & Telegrams	800	
R.B.D		400
Discounts		800
Rent on Buildings upto 30.09.08		1,200
Insurance	700	
Salaries & wages	21,300	
Cash in hand	6,200	
Cash at bank	20,500	
	2,13,400	2,13,400

Adjustments :

1) Stock on 31.03,08 Rs. 14,600
2) Bad debts Rs. 600 and R.B.D. 5%
3) Reserve for Discount on Debtors and Creditors 2%
4) Depreciation = 5% on Furniture and 20% on Plant & Machinery.

5) Prepaid Insurance Rs. 100/-

6) A fire occured on 25th March 2008 and goods of Rs. 5,000 were detroyed. The insurance company agreed to pay the claim in full.

(**Ans :** G.P. Rs. 39,100 ; N.P. Rs. 5,270/- ; B.S. Rs. 89,670/-)

2. The following balances were taken from the books of Lakshman on 31-03-08. Prepare final accounts.

	Rs.		Rs.
Capital of Lakshman	2,58,000	Bills payable	5,000
Drawings of Lakshman	42,000	Stock on 1.4.07	49,175
Purchases	1,96,000	Wages	62,000
Free hold property	60,000	Sundry creditors	40,000
Plant & Machinery	1,00,000	Postage & Telegram	1,406
Purchase Returns	7,000	Insurance	3,200
Salaries	42,000	Gas	2,700
Office expenses	12,500	Baddebts	600
Office Furniture	25,000	Office rent	12,600
Discount (Dr)	1,200	Freight & Duty	9,000
Sundry Debtors	26,600	Loose tools	7,000
Loan to aravind (1.5% on 1.4.07)	40,000	Factory lighting	1,600
Cash at bank	26,000	Reserve for Doubtful debts	800
Cash in hand	3,625	Interest on loan to Aravind	3,000
		Sales	4,10,400

Adjustments :

1) Stock on 31.03.08 Rs. 66,000/-

2) Outstanding Salaries Rs. 3,600 ; Wages Rs. 4,600.

3) Prepaid Insurance Rs. 800

4) New machine purchased on 31.12.07 for Rs. 14,000 is neither paid not entered in the books of account. Erection charges of Machinery Rs. 1,000/- were included in wages account.

5) Value of loose tools on 31.03.08 were Rs. 5,000/-

6) Depreciation : 7 1/2 on Furniture ; 10% on plant & Machinery and 2% on Free hold.

7) Baddebts to be written off Rs. 600/-

8) R.B.D. 5% , Reserve for Discount on Debtors and Creditors 2%

9) Manager shall be given a commission of 5% on N.P. before charging such commission.

(**Ans :** G.P. Rs. 1,59,325 ; N.P. Rs. 70,268/- ; Balance sheet Rs. 3,56,181/-)

3. The following is the Trial Balance of ' Babu ' as on 31.03.08. Prepare Final accounts.

	Dr Rs.	**Cr Rs.**
Capital		70,000
Debtors & Creditors	52,000	41,800
Stock on 01.4.07	25,000	
Purchases & sales	80,000	1,33,500
General Reserve		20,000
R.B.D		1,000
Carriage	1,500	
Discount	1,200	
Returns	3,000	4,000
Furniture	10,000	
Buildings	60,000	
Travelling expenses	900	
Salaries	24,000	
Outstanding salaries		2,000
Miscellaneous expenses	5,500	
Repairs	1,300	
Baddebts recovered		200
Cash at bank	8,000	
Petty cash	100	
	2,72,500	2,72,500

Adjustments :

1) Stock on 31.03.08 Rs. 30,000/-

2) Depreciation : 10% on Furniture 5% on Buildings

3) R.B.D Rs. 800/-

4) Interest on capital 5%

5) Fire occured on 27.03.08 and goods of Rs. 5,000/- were destroyed (not insured).

6) Transfer 5% of N.P. to General Reserve.

(**Ans :** G.P. Rs. 63,000 ; N.P. Rs. 17,100/- ; Balance sheet Rs. 1,55,300/-)

4. From the following Trial Balance of 'Venkata Ramana ' on 31.03.08, prepare final accounts.

	Rs.		Rs.
Capital	1,19,400	Drawings	10,550
Creditors	59,630	6 % loan	20,000
Cash at Bank	18,970	Cash in hand	3,030
Debtors (including dishonoured		Bill receivable	9,500
bill of Mr x Rs. 1000/-)	62,000	R.B.D	2,500
Furniture & Fixtures	8,970	Plant & Machinery	28,800
Opening stock	89,680	Purchases	2,56,590
Manufacturing wages	40,970	Sales	3,56,430
Returns inwards	2,780	Salaries	11,000
Rent & Taxes	5,670	Discount allowed	5,870
Travelling expenses	1,880	Repairs	3,370
Insurance (Including Rs. 300		Baddebts	3,620
paid for the year ended 30.09.08)	400	Commission received	5,600

Adjustments :

1) Closing stock Rs. 1,28,960

2) Half of the dishonoured bill of x shall be written off as bad.

3) R.B.D : 5%

4) Interest on capital 5%

5) Erection charges of Machinery purchased last year Rs. 1,200 were included in wages.

6) Depreciation : 5% Machinery and 10% Furnuture & Fixtures.

(**Ans :** G.P. Rs. 96,570; N.P. Rs. 60,108/- ; Balance sheet Rs. 2,55,758/-)

5. From the following Trial Balance and Adjustments, Preapre final accounts.

	Rs.		Rs.
Drawings	3,250	Capital	15,000
Stock (1.4.07)	17,445	Purchase Returns	840
Returns Inwards	554	Interest on loans	25
Carriage in	1,240	Outstanding Rent	130
Deposit with Mr A	1,375	Creditors	3,000
Carriage out	725	Reserve for Baddebts	1,200
5% Loan to D on 1.4.07	1,000	Sales	27,914
Rent	820		
Purchases	12,970		
Debtors	4,000		
Goodwill	1,730		
Advertisements	954		
Baddebts	400		
Patent rights	500		
Cash	62		
Discount allowed	330		
Wages	754		
	48,109		48,109

Adjustments :

1) Manager shall be given a commission of 10% on N.P. after charging such commission.

2) Baddebts to be written off Rs. 600, R.B.D. 10 % and Reserve for discount on Debtor is 5%

3) Goods destroyed by fire on 29-03-08 Rs. 1500. but the insurance company agreed to pay Rs. 950/- only.

4) Rs. 200 of the advertisments to be carried forward to the next year.

5) Stock on 31.03.08 Rs. 4,000/-

(**Ans :** G.P. Rs. 1,291 ; N.P. Rs. 2,091/- ; B.S. Rs. 12,789/-)

6. From the following is the Trial Balance of ' Sandhya ' prepare Final accounts. Trial Balance as on 31.03.08.

	Dr Rs.	Cr Rs.
Machinery	46,000	
Opening stock	58,400	
Purchases & sales	4,00,000	4,76,000
Returns	8,400	7,600
General Expenses	20,000	
Stationary	2,000	
Cash	12,650	
Interest on loan (up to 31.12.07)	150	
Apprentice premium		3,200
6% loan		10,000
Baddebts	6,800	
Debtors & Creditors	1,28,000	40,000
R.B.D		4,000
Capital of sundhya (after deducting her drawings as 28,400)		1,41,600
	6,82,400	6,82,400

Adjustments :

1) Purchases include the purchase of Machinery in January Rs. 4,000/-
2) Exection charges of Machinery Rs. 2,000/- were included in wages.
3) Interest on captial 5%
4) Depreciation on Machinery 10%
5) R.B.D. 5% on Debtors.
6) Apprentice premium to be adjusted over 4 Years.
7) Closing stock Rs. 34,000/-

(**Ans :** G.P. Rs. 54,800 ; N.P. Rs. 12,500/- ; Balance sheet Rs. 2,15,050/-)

7. The Tiral Balance of 'Gopal ' on 31.03.08 was as under.

	Dr Rs.	Cr Rs.
Capital & Drawings	10,000	80,000
Stock on 1.4.07	25,000	
Purchases & sales	35,000	70,000
Salaries	3,000	
Wages	5,000	
Power	2,000	
Commission to sales men	1,500	
Debtors & creditors	5,000	8,000
Cash at bank	10,000	
Cash in hand	12,000	
Baddebts	2,000	
Furnuiture & Fixture	10,000	
Commission	2,000	1,500
Plant & Machinery	20,000	
Buildings	17,000	
	1,59,500	1,59,500

Adjustments :

1) Stock on 31.03.08 Rs. 15,000/-

2) Bouns payable to worker for 2007 - 08 Rs. 1,000/-

3) Write 5% as Baddebts and provide 1% for doubtful debts.

4) Depreciation : 15% on plant & Machinery ; 10% on Furniture and 5 % on Buildings.

(**Ans :** G.P. Rs. 18,000 ; N.P. Rs. 4,852/- ; Balance sheet Rs. 83,852/-)

8. The Tiral Balance of 'Atma Ram ' on 31.03.08 was as under.

	Rs.		Rs.
Drawings	6,000	Capital	80,000
Debtors	19,000	Creditors	10,000
Baddebts	1,000	R.B.D	3,100
Bills Receivable	12,000	Bills payable	11,000
Furniture	5,000	6% Bank loan	8,000
Plant & Machinery	46,000	Sales	1,75,000
Land & Buildings	40,000		
Cash in hand	1,960		
Closing stock 31.03.08	12,000		
Cost of goods sold	1,20,000		
Carriage out	1,200		
Salaries	13,800		
Rates & Taxes	1,300		
Printing & stationary	1,800		
Insurance	1,600		
Bank interest	240		
Travelling Expenses	3,000		
Commission	1,200		
	2,87,100		2,87,100

Adjustments :

1) Out standing salaries Rs. 1200/-
2) Baddebts to be written of Rs. 1,000/-
3) Bills Receivable dishonoused Rs. 2,000/-
4) R.B.D 5%, Reserve for Discount on Debtors & Creditors 2%
5) Manager shall be given a commission of 2% on G.P.
6) Depreciation : 10% on plant & Machinery and 5% on Land & Buildings.

(**Ans :** G.P. Rs. 55,000 ; N.P. Rs. 21,640/- ; Balance sheet Rs. 1,26,980/-)

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Lesson 15

Consignment Accounts

15.0 Objective

After going through this lesson you will be able to understand

1. Consignment meaning and method of business
2. Distinction between consignment and sales
3. Important terms in consignment
4. Method of writing entries and preparing accounts
5. Valuation of closing stock and losses
6. Proforma invoice and memorandum method of consignment business.

Structure:

15.1: Consignment – Meaning

15.2: Consignment vs. Sales

15.3: Consignment – Important terms

15.4: Books of Consignor

15.5: Books of Consignee

15.6: Valuation of Closing Stock

15.7: Loss of Stock in Consignment

15.7.1: Normal Loss

15.7.2: Abnormal Loss

15.7.3: Loss of Goods Insured

15.8: Proforma Invoice Price

15.9: Memorandum Column Method

15.10: Try Yourself

15.11: Summary

15.12: Glossary

15.13: Self Assessment Questions

15.1: Consignment – Meaning:

When a manufacturer or the wholesaler wants to sell goods in far away places, sends goods to agents and ask them to sell goods on his behalf. The person sending goods are called as consignor, and the agent or the person selling goods on the behalf of the consignor is called as consignee. The whole process is called consignment business. Sending goods is called sending on consignment. When goods are sent to Hyderabad, it is called as Hyderabad consignment.

15.2: Consignment vs. Sales:

There are differences between consignment and sales. They are as follows:

Consignment	Sales
1. Consigner and consignee are parties in Consignment.	1. Seller and Buyer are parties in sales.
2. There is owner and agent relationship between consignor and consignee.	2. There is creditor and debtor relationship between seller and buyer.
3. Though goods are sent on consignment, ownership on goods lies with the consignor.	3. When goods are sold, ownership Transfers from seller to buyer.
4. Consignee can return goods to consignor time.	4. Unless there is agreement, once sold at any Goods cannot be taken back.
5. Consignee gets remuneration in the form of Commission.	5. In sale deed seller gets profit or loss.
6. Consignor has to bear for any loss or damage.	6. Once sale is over, seller is not responsible for any loss or damage.
7. Consignee collects all expenses from the consignor relating to consignment.	7. Expenses after sales should be borne By the buyer only.
8. After a specific period consignee sends Account of sales to the consignor.	8. No account sales required here.
9. Sometimes consignor sends goods on proforma invoice basis.	9. Seller sells at general invoice.

15.3: Consignment – Important terms:

1. **Account Sales:** It is a practical statement prepared by the consignee consisting of – details of goods received, sales made, expenses incurred, commission charged, remittances made, and balances due by him to the consignor. The consignee often submits this statement to the consignor to reveal the current position.
2. **Proforma Invoice:** Sometimes consignor sends goods to consignee on proforma invoice. Like ordinary invoice, it is a price fixed by the consignor. But it naturally is higher than the invoice price. However, Consignor records goods at their actual price in his books. Sending goods on proforma basis helps the consignor to sell the goods not less than a minimum price.
3. **Expenses:** Consignment expenses can be divided into two categories direct and indirect. *Direct expenses* are incurred for placing the goods in a saleable condition. All expenses till the goods reach the godown of the consignee come in this category. These expenses are of a non-recurring nature and increase the value of goods. Examples of such expenses are freight, carriage, insurance, loading and unloading charges etc. Indirect expenses incurred after the goods reach the consignee's godown. They are of a recurring nature

and do not increase the value of goods. Examples of such expenses are godown rent, storage charges, advertisement expenses, salaries of salesmen, etc.

The distinction between direct and indirect expenses is of special importance at the time of the valuation of the unsold stock. Direct expenses form a part of the cost and, therefore, a proportion of such expenses is included in the cost of stock, while the indirect expenses do not form part of the cost and, therefore, excluded while valuing the unsold stock.

4. **Commission:** It is the remuneration payable to the consignee for sale made by him. This can be simple, over-riding and del-credre. *Simple commission* is calculated as per terms laid down by the consignor. Usually this is a fixed percentage on total sales. In order to give further incentive, sometimes an extra commission termed as *over-riding commission* is allowed to consignee, in case the sales exceed a specified amount. It is also calculated on total sales. Where the consignee agrees to meet any loss, which the consignor may suffer by reason of bad debts, one more extra commission as *del-credre commission* is given to consignee. This is normally calculated on total sales.
5. **Advance:** The consignor may ask the consignee to deposit some money with him to be kept by him as security in respect of the goods sent by him on consignment. It is usually a certain percentage of the value of goods sent on consignment.

15.4: Books of Consignor:

To know profits or losses on each consignment, consignor opens separate accounts for each consignment. On debit side of the consignment account – the cost of goods sent on consignment, expenses incurred by the consignor and consignee and consignee commission are to be recorded. On credit side of the account - sales of the consignee and closing stock if any need to be shown. The excess of credit over debit will give profit on consignment.

Consignee personal account needs to be opened in consignor books. As consignee is not a debtor to the consignor, when goods sent on consignment they shall not be debited to his account. The sales of consignment are to be debited to his account and consignee advance, expenses and commission are to be credited. The debit balance of the consignee account is the amount to be given to the consignee.

Journal entries:

The following are the entries required in the books of consignor relating to consignment.

1. When goods are sent on consignment:

    Consignment A/C Dr

        To Goods sent on consignment

2. For expenses incurred:

    Consignment A/C Dr

        To bank

3. When cash or bill received from consignee as advance:

Bank/Bills receivable A/C Dr

To consignee

After receiving account sales,

4. For sales made by consignee:

Consignee A/C Dr

To Consignment

5. For expenses incurred by the consignee:

Consignment A/C Dr

To consignee

6. For transferring profit on consignment to profit & loss account:

Consignment A/C Dr

To P & L A/C

7. For transferring loss on consignment to profit & loss account:

P &L A/C Dr

To Consignment

8. When the amount receivable from consignee received:

Bank A/C Dr

To consignee

9.When goods sent on consignment transferred to Trading account treating them as sales:

Goods sent on consignment A/C Dr

To Trading account

15.5: Books of Consignee:

As consignee do not hold any propriety rights on goods received from consignment, he need not write any entries when he receives goods and for consingnor expenses. He writes entries for accepting bill drawn by the consignor or cash sent by him, expenses incurred and commission earned.

Journal entries:

The following are the entries to be written in the books of consignee:

1. When goods received on consignment:

No Entry

2. For expenses incurred by consignor:

No Entry

3. Bill accepted or cash paid as advance:

Consignor A/C Dr

To Bills payable/Cash

4. For expenses incurred by consignee:

Consignor A/C Dr

To bank

5. For cash sales

Bank A/C Dr

To Consignor

6. For credit sales

Debtors A/C Dr

To Consignor

7. For commission earned:

Consignor A/C Dr

To commission

8. For remitting bill or cash due to consignor:

Consignor A/C Dr

To bank/bills payable

To know much about journal entries, consignment account and consignee account in consignor books and journal entries and consignor account in consignee books, let us observe some illustrations.

Illustration 1:

Raman & Co of Waltair sent 50 cases of goods at Rs.200 each to Nadhan & Co of Mumbai on consignment. Consignor paid insurance Rs.200 and travel expenses Rs.300.

As per the account sales received from Nadhan & co., sales are Rs.14, 000, carriage Rs.80, godown rent Rs.100, and freight charges Rs.20. Consignee gets a commission of 3 % on sales. Consignee sents cheque to the consignor for the amount due.

Write journal entries in the books of Raman & Co. and Nadhan & Co and Nadhan & Co account in Raman & Co. and vice versa.

Solution:

Journal entries in the books of Raman & Co:

1. Consignment A/C	Dr	10,000	
To goods sent on consignment			10,000
(Being goods sent on consignment)			
2. Consignment A/C	Dr	500	
To Bank			500
(Being expenses paid)			
3. Nadhan & Co. A/C	Dr	14,000	

To consignment A/C			14,000
(Being sales made as per the account sales)			
4. Consignment A/C	Dr	200	
To Nadhan & Co.			200
(Being expenses paid by the consignee)			
5. Consignment A/C	Dr	420	
To Nadhan & Co.			420
(Being commission at 3% to be paid to the consignee)			
6. Consignment A/C	Dr	2,880	
To P & L A/C			2,880
7. Bank A/C	Dr	13,080	
To Nadhan & Co.			13,080
(Being the due amount received from consignee)			

Mumbai consignment Account

To Goods sent on consignment	10,000	By Nadhan & Co.- sales	14,000
To Bank – expenses	500		
To Nadhan & Co.- expenses	200		
To Nadhan & Co.- commission 3%	420		
To P & L A/C	2,880		
	14,000		**14,000**

Nadhan & Co. Account

To Consignment account	14,000	By Consingment A/C- expenses	500
		By Consingment A/C-commission	420
		By Bank	13,080
	14,000		**14,000**

Journal entries in the books of Nadhan & Co:

1. Raman & Co. A/C	Dr	500	
To bank			500
(Being expenses paid)			
2. Bank A/C	Dr	14,000	
To Raman & Co.			14,000
(Being goods sold on cash)			
3. Raman & Co. A/C	Dr	420	

To commission 420

(Being commission receivable)

4. Raman & Co. A/C Dr 13,080

To bank 13,080

(Being cheque sent to consignor)

Raman & Co.

To Bank – expenses	500	By Bank – sales	14,000
To Commission	420		
To Bank	13,080		
	14,000		**14,000**

15.6: Valuation of Closing Stock:

By the time account sales are prepared if all the goods received on consignment sold, there won't be any closing stock. But when there is closing stock, its cost should be calculated. While calculating stock, the value of stock and also the expenditure, which adds value, shall be taken into consideration. Transport expenses, customs duty, port duty, transport insurance, expenses of loading and unloading etc., add the value of goods. Therefore, while calculating stock they should be taken proportionately. These non-recurring expenses shall be taken into consideration, irrespective of whether paid by the consignor or consignee. Godown rent, godown insurance premium, advertising expenses, sales personnel salaries, etc., do not add the value to the goods. These are to be excluded while calculating closing stock.

Consignor expenses and expenses up to goods reaching godown adds value to the goods. However, when consignee expenses are not given separately, they will be treated as sales expenses and should not be added to closing stock. The closing stock should be shown on credit side of the consignment account.

Illustration 2:

A consignor from Cochin sends 10,000 boxes of goods to a consignee at Colombo. Their cost of purchase is Rs.18, 000. The expenses paid by the consignor are –freight Rs. 2,000, ocean insurance Rs. 800, transport Rs. 900.

As per the account sales of consignee, 6,000 boxes are sold for Rs.17, 200. The consignee paid this expenses- carriage to godown Rs. 150, import duty Rs. 450, carriage up to godown of the purchaser Rs.500, sales expenses Rs.50. Consignee commission Rs. 1,080. Write consignment account in the books of consignor and ascertain profit.

Solution:

Colombo Consignment Account

To Goods sent on consignment	18,000	By Consignee – Sales		17,200
To Bank- expenses:		By Stock at consignment	8,920	

Freight	2,000			
Insurance	800			
Transport	900	3,700		
To Consignee – expenses:				
Carriage	150			
Import duty	450			
Carriage	500			
Sales exp.	50	1,150		
To Consignee – Commission		1,080		
To P & L A/C – Profit		2,190		
		26,120		**26,120**

Closing Stock:

Original cost of remaining 4,000 boxes (18,000/10,000x4, 000)			7,200
Add: Proportionate expenditure of consignor (3600/10,000x4000)			1,420
Add: Carriage to godown	150		
Import duty	450	600 (600/10000x4000)	240
			8,920

Note: The carriage up to purchaser godown and selling expenses do not increase the value of stock. Therefore, these should not be included in closing stock.

Illustration 3:

Rajkumar of Mumbai sent Rs.1, 29,000 worth of 140 cases to Velayudhan of Cochin. Velayudhan gets a commission of 5 % on sales and 2% del credre commission.

In Mumbai Rajkumar paid freight Rs.200, loading charging Rs. 210, insurance Rs.3, 290 and other expenses Rs. 40.

Velayudhan sold all 140 cases at Rs.1500 each. Bad debts appeared Rs. 4,310. The expenses paid by Velayudhan are unloading expenses Rs.470, godown rent Rs.1, 300 and packing and sales expenses Rs.1, 580.

Write journal entries and ledger accounts in the books of Rajkumar.

Solution:

Journal entries in the books of Rajkumar:

1. Consignment A/C	Dr	1,29,000	
To Goods sent on consignment			1,29,000
(Being 140 cases of goods sent on consignment)			
2. Consignment A/C	Dr	3,740	

To bank			3,740
(Being various expenses paid)			
3. Velayudhan A/C	Dr	2,10,000	
To Consignment			2.10,000
(Being sales made by consignee)			
4. Consignment A/C	Dr	3,350	
To Velayudhan			3,350
(Being expenses met by consignee)			
5. Consignment A/C	Dr	14,700	
To Velayudhan			14,700
(Being commission payable to consignee)			
6. Consignment A/C	Dr	59,210	
To P & L A/C			59,210
(Being profit on consignment transferred to p&l account)			

Cochin consignment Account

To Goods sent on consignment	1,29,000	B Velayudhan – sales	2,10,000
To Bank – expenses	3,740		
To Velayudhan – expenses	3,350		
To Velayudhan – commission@ 7%	14,700		
To P & L A/C – profit	59,210		
	2,10,000		**2,10,000**

Velayudhan Account

To Consignment account – sales	2,10,000	By Cosnsignment – expenses	3,350
		ByConsignment–commission	14,700
		By Balance C/D	1,91,950
	2,10,000		**2,10,000**
To Balance B/D	1,91,950		

15.7: Loss of Stock in Consignment:

While sending goods to consignee, goods may be subjected to fire accident, theft, damage, leakage etc in transit and that leads to loss to the consignor. Similarly, while downloading or at godown some damage may occur to the goods while they are in the control of consignee. These losses can be divided in two categories: one normal loss and the other abnormal loss.

15.7.1: Normal Loss:

In some situations, loss of stock is inevitable. Depending on the nature of stock, there occurs some depreciation while in transit or while in stock. This is called normal loss. For example, when coal is sent on consignment, it is natural that some part of coal becomes ash while it is loading and unloading. This is a normal loss, and nobody can avoid this. For normal loss, no special entry is required. It reflects in sales automatically. While calculating closing stock, the net stock with the consignee needs to be taken into consideration.

Illustration 4:

On June 1st 2007 Coal company pvt. Ltd. sent 2000 Kgs. of coal at Rs.7.50 per kg. On consignment to Sales company ltd. Transport expenses being Rs.2 per Kg. On June 25th Sales company ltd, send account sales. According to it - sales are 1000 tons at Rs.16 each, sales expenses Rs.880, insurance Rs.120, brokerage 14% and commission 21/2%. Consignee while sending the bill for the amount due informed the consignor that 40 kgs of coal is depreciated. Write Consignment account and consignee account in the books of consignor.

Solution:

Consignment Account

To Goods sent on consignment (2,000x7.50)	15,000	By Sales company ltd.	16,000
To Bank – expenses	4,000	By Consignment stock	9,306
To Sales company ltd- expenses	1,000		
To Sales company ltd-commission (14% + 21/2% = 161/2%)	2,640		
To P & L A/C – Profit	2,666		
	25,306		**25,306**

Sales company ltd Account

To Consignment Account	16,000	By Consignment A/C – expenses	1,000
		By Cosingment A/C - commission	2,640
		By bills receivble	12,360
	16,000		**16,000**

Closing stock = (goods on consignment+ consignor expenses)/(goods reached to consignee – depreciation) x closing stock

= (15,000+4,000)/(2000-40) x960 = 9,306.

15.7.2: Abnormal Loss:

Some losses occur due to accidents or negligence. Loss of goods in accident and theft come under abnormal loss category. This type of loss is not normal loss and does not occur often. This does not show impact on the value of goods. Therefore, it is to be debited to profit &

loss account and credited to consignment account. Otherwise, the profit on consignment looks less. The calculation of abnormal loss should be like the stock that is remaining. The following journal entry is required for abnormal loss:

Profit & Loss A/C Dr

To Consignment

Illustration 5:

Pratap & Co. of Delhi sent 1000 cycles of Rs.500 each to Manian of Ceylon on consignment. It paid Rs. 12,000 for freight. In transit 100 cycles are damaged and they are thrown into the sea. Manian took the delivery of remaining cycles after paying Rs.15, 000 towards customs duty.

Manian sent Rs.3, 00,000 to Pratap & Co. as advance in the form of bank draft. He showed that 800 cycles are sold for Rs.750 each. He paid Rs.3, 000 towards godown rent and advertisements. A credit sale relating to 5 cycles is not received. Manian cleared his account immediately. Prepare consignment account, Manian account and Profit and Loss Account in the books of Pratap & Co.

Solution:

Books of Pratap & Co.

Ceylon Consignment Account

To Goods sent on consignment (1000 X 500)	5,00,000	By Manian A/C- Sales (800X750)	6,00,000
To Bank – expenses	12,000	By P & L A/C – Abnormal Loss.	51,200
To Manian A/C – expenses	18,000		
To Manian A/C- commission	30,000	By Closing stock	52,867
To Manian A/C- bad debts	3,750		
To P & L A/C	1,40,317		
	7,04,067		**7,04,067**

Manian Account

To Consignment – sales	6,00,000	By Bank – advance	3,00,000
		By Consignment – expenses	18,000
		By Consignment – commission	30,000
		By Consignment – bad debts	3,750
		By Bank – full settlement	2,48,250
	6,00,000		**6,00,000**

Profit and Loss Account

To Consignment A/C	51,200	By Consignment	1,40,317

Goods sent on Consignment

To Trading A/C	5,00,000	By Consignment	5,00,000

Calculation of closing stock:

Cycles sent	1,000		
Less: lost	100		
Sold	800		
Remaining	100		
Cost of 100 cycles 100 x 500	50,000		
Proportionate expenses of consignor			1,200
(100 x 1200/1000)			
Proportionate expenses of consignee			
For 900 cycles	15,000		
For 100 cycles 100/900 x 15,000		1,667	
		52,867	

Calculation of abnormal loss:

Cost of 100 cycles	50,000
Add: Proportionate expenses of Consignor	1,200
	51,200

Note: As there is no del credre commission, the bad debts are to be borne by the consignor only. That is why bad debts are treated as loss and debited to consignment account and credited to consignee account to reduce his payable amount. If there were del credre commission, there would have been no entry in consignment account.

15.7.3: Loss of goods insured:

If goods are insured, the loss will be borne by the insurance company. The amount to be receivable from the insurance company is to be credited to consignment account. The following entry is to be passed:

Insurance claim A/C Dr

Or

Abnormal A/C Dr

To Consignment

When cash comes from insurance company, bank account need to be debited and insurance claim account or abnormal account to be credited. If the insurance company pays only part of the loss, the remaining loss to be debited to profit and loss account. In case the insurance amount is more than the loss, the difference is to be credited to profit and loss account.

Illustration 6:

On April1 2007 Rajani sent 40,000 kgs of castor oil at Rs.2 per kg. to Chakri on consignment. Rajani paid Rs. 10,000 for insurance. 50 kgs. of goods are lost in transit in an accident and Rajani received Rs.900 from the insurance company.

Chakri after receiving the delivery accepted a 3 months bill for Rs.20, 000. On 30th June, Chakri sent an account sales mentioning that he sold castor oil of 35,000 kgs at Rs.3 per kg. He paid Rs.400 towards godown rent, Rs. 2,000 towards advertisements, and Rs. 4,000 towards salesmen salaries.

Chakri is eligible for 3 % commission and 3 more percent of del credre commission. Neelakumari, a customer who purchased for Rs.19, 000 became insolvent and only 50 paise collected from her in full settlement. Prepare necessary accounts in the books of both the parties assuming that the consignee sent the draft to the consignor for the amount due

Solution:

Books of Rajani

Consignment Account

To Goods sent on consignment	80,000	By Chakri – sales	1,05,000
To Bank – expenses	10,000	By Chakri – sales	19,000
To Chakri – expenses	6,400	By Insurance claim – bank	900
To Chakri – commission	7,440	By P & L A/C – Ab. Loss.	225
	1,25,125		**1,25,125**

Chakri Account

To Consignment account	1,24,000	By Bills receivable	20,000
		By Consignment A/C	6,400
		By Consignment A/C	7,440
		By Bank	90,160
	1,24,000		**1,24,000**

Goods sent on consignment Account

To Trading Account	80,000	By Consignment A/C	80,000
	80,000		**80,000**

Calculation of abnormal loss:

Cost of 50 Kgs.	1,000
Add: proportionate expenses	125

(10,000x5000/40,000)

1,125

Less: Amount received from Insurance Co. 900

225

Books of Chakri

Rajani Account

To Bills payable	20,000	By Bank – sales	1,05,000
To Bank – expenses	6,400	By Neelakumari –sales	19,000
To Commission	7,440		
To Bank	90,160		
	1,24,000		**1,24,000**

Neelakumari Account

To Rajani account	19,000	By Bank	9,500
		By bad debts	9,500
	19,000		**19,000**

Calculation of commission:

6% on 1,05,000	6,300
6% on 19,000	1,140
	7,440

Note: As there is del credre commission, consignor does not have any relation with bad debts.

15.8: Proforma Invoice Price:

In certain situations, consignor sends goods to consignee showing higher prices than the cost price. This may be sale price or near sale price. It is called as proforma invoice price. The main purpose of this method is to make the consignee not aware of the actual profit on the consignment. In fact, this price does not show any difference in profit or loss of the business. However, while writing journal entries, there are certain differences. These differences appear only in writing journal entries relating to goods sent on consignment.

Journal entries:

1.When goods sent on consignment:

Consignment A/C Dr

To goods sent on consignment

2.To reduce the invoice price to the cost price level:

Goods sent on consignment A/C Dr

To consignment

3.When there is closing stock:

Stock on consignment A/C Dr

To consignment A/C

4. To reduce the invoice price on the closing stock:

Consignment A/C Dr

To Reserve on stock on consignment/suspense account

Except the above, there won't be any changes either in consignor books or in consignee books.

Illustration 7:

On 1st July 2007 Mahesh of Delhi sent goods on consignment to Ramesh of Hyderabad at invoice price of Rs. 3,750 whose cost was Rs.3, 000. He paid freight charges Rs.250 and draws a bill on Ramesh for Rs.1500. Ramesh sold 3/4ths of the stock for Rs.3, 500. He paid for expenses Rs.300. He is eligible for a commission of 6% on sales. He sent a draft to Mahesh for the amount due. Show ledger accounts in the books of Mahesh.

Solution:

Books of Mahesh

Hyderabad Consignment Account

To Goods sent on consignment	3,750	By Ramesh – sales	3,500
To Bank – expenses	250	By Goods sent on consignment	750
To Ramesh – expenses	300	By Stock on consignment	1,000
To Ramesh – commission	210		
To Reserve on stock on consignment	188		
To P & L A/C – Profit	552		
	5,250		**5,250**

Ramesh Account

To Consignment A/C	3,500	By Bills receivable	1,500
		By Consignment A/C	300
		By Consignment A/C	210
		By Bank	1,490
	3,500		**3,500**

Goods sent on consignment

To Consignment A/C	750	By Consignment A/C	3,750
To Trading A/C	3,000		
	3,750		**3,750**

Closing Stock:

Goods sent on invoice prices	3,750
Add: consignor expenses	250

Value of stock	4,000
Remaining stock after sales 1/4th	1,000
Reserve on closing stock:	
Excess of invoice over cost price (3,750-3,000)	750
Remaining stock 1/4th (750 x ¼)	188

15.9: Memorandum Column Method:

Instead of showing invoice price and reducing it to the original price, a separate column can also be shown in consignment account to show invoice price. This is called as memorandum column method. This invoice column is useful for information purpose. There won't be any difference in profit or loss of consignment in this method also.

Let us solve the above problem under this method.

Books of Mahesh

Hyderabad Consignment Account

Particulars	Memorandum	Cash	Particulars	Memorandum	Cash
To Goods sent on congnt.	3,750	3,000	By Ramesh	3,500	3,500
To Bank – expenses	250	250	By Closing stock	1,000	812
To Ramesh – expenses	300	300	By Loss	10	
To Ramesh – commission	210	210			
To P & L A/C		552			
	4,510	**4,312**		**4,510**	**4,312**

Goods sent on consignment Account

To Trading Account	3,750	3,000	By Consignment A/C	3,750	3,000
	3,750	**3,000**		**3,750**	**3,000**

15.10: Try yourself:

1. On 1st April 2007, Aditya Mills Ltd. Delhi consigns 500 pieces of shirting costing Rs.5, 000 to Birla Stores, Mumbai. The consignee is entitles to 5% selling commission and 1% del credre commission.

The consignor incurred following expenses:

Carriage	Rs.200
Insurance	Rs.100
Freight	Rs.150

Aditya Mills Ltd. draws a bill of exchange for Rs. 2,000 on Birla stores, Mumbai, which was duly accepted by them. It is discounted for Rs. 1,950.

On 31st May 2007, Birla Stores send the Account Sales, which shows that they have sold goods for Rs.7, 500, and paid expenses amounting to Rs.150. Stock in consignee's hands on 31st May 2007 is valued at Rs.1, 500.

Birla Stores enclose a sight draft with the Account Sales, for the net amount due to Aditya Mils Ltd. Give journal entries and ledger accounts in the books of the consignor.

(Profit on consignment Rs. 2,950)

2. G. Mehta consigns 100 radiograms to H.Singh. Each radiogram costs Rs.800. G. Mehta pays the following expenses:

Freight	Rs.1, 000
Insurance	400
Carriage	500

H.Singh pays the following expenses:

Customs duty	2,000
Dock dues	500
Godown rent	500
Salary to salesman	300

At the end of the year 25 radiograms remained with H. Singh. The market value of each radiogram is Rs.850. You are required to calculate the value of stock lying with H. Singh.

(Value of stock Rs. 21,100)

3. A consigned 2,000 tons of coal @ Rs.50 per ton to B of Delhi. He paid Rs.20, 000 as freight. Due to normal wastage B received only 1950 tons. He also paid Rs.5, 000 as unloading and cartage charges. The goods unsold amount to 650 tons. You are required to calculate the value of closing stock.

4. A consigned to B 100 cases of tea costing Rs.100 per case. He paid Rs.1, 000 as freight and cartage. B could take deliver of only 90 cases since 10 cases were lost in transit. He paid Rs.2, 000 as unloading and carriage charges. At the end of the year he reported that he ahs sold away 80 case at Rs.150 per case. You are required to calculate i) the value of abnormal loss and ii) the value of closing stock.

(Value of closing stock Rs. 1,322, Value of abnormal loss Rs.1, 300)

5. Vyas of Chennai sent on consignment 100 boxes at Rs.30 per box to Sitaram of Hyderabad. He paid for packing Rs.40, transport Rs.20, and railway freight Rs.40. Sitaram took delivery of only 90 boxes as 10 boxes are damaged in transit. Sitaram paid Rs.10 for cartage and Rs.40 for godown rent. He sold the boxes with him at Rs.35 per box. After deducting his expenses and 5% commission, Sitaram sent the money due along with account sales. Vyas received Rs.180 from railways as compensation. Write necessary accounts in the books of Vyas.

(Profit on consignment Rs.152)

6. Davar sent 5,000 kgs. of onions to Swarup at Rs.8 per kg. on consignment. He paid Rs.50 for freight, Rs.25o for transport and Rs.200 for insurance. When 500 kgs. of onions are damaged in transit, the insurance company paid Rs.2, 500 in full settlement to Davar.

After 3 months, Swarup informed that he sold 3,500 kgs of onions at Rs.9.50 per kg and paid Rs.500 as rent and Rs.750 as salary to salesman. Swarup is eligible for a commission of 5% on sales. He also informed that 20 kgs of onions are damaged due to humidity. Prepare necessary accounts in the books of Davar.

(Profit on consignment Rs. 1,857)

7. A Jute mill of Kolkata used to send jute goods to Anuradha & Co of Hoogly on its own risk. For that it receives a del credre commission of 15 % on sales.

Opening stock at the beginning with the agent	20,000 kgs.
Its cost	Rs.50, 000

Goods sent on consignment 1,60,000 kgs. at Rs. 5 per kg.

Total sales 1,50,000 kgs. at Rs.5 per kg

Amount received from agent	Rs.60, 00,000
Freight paid by agent	Rs.40, 000

Because of insolvency of a customer, Anuradha & Co. failed to collect Rs. 15,000. Because of damage of 5,000 kgs in transit, the agent collected Rs.8, 000 from railways. The damaged goods are sold for Rs.2 per kg. Record the above transactions in the books of Jute mill and ascertain profit or loss.

(Profit on consignment Rs. 1,24,250)

15.11: Summary:

Consignment is a business where consignor, the owner sends goods and the consignee as agent sells on his behalf of consignor. He is eligible for certain agreed commission for his services. In case consignee is offered for del credre commission, he is responsible for bad debts if any. Normal or abnormal loss has to be borne by the consignor himself. Sometimes goods on consignment will also be priced for proforma invoice.

15.12: Glossary:

Account Sales is a periodical statement prepared and sent by the consignee to the consignor containing details of goods received, sales made, expenses incurred, commission charged, remittances made and balance due by him to the consignor.

Del credre commission is offered to the consignee to meet the risk of bad debts. This normally calculated in addition to the normal commission.

Proforma Invoice is the invoice price fixed by the consignor above the cost price. It is fixed for the purpose of not identifying the original cost price of goods consigned.

15.13: Self Assessment Questions:

1. What is consignment? How is it different from ordinary business?
2. How normal loss and abnormal loss are treated in consignment?
3. How stock is calculated in the books of consignor?
4. Write about proforma invoice and memorandum column methods in consignment.

- Dr.R.Jayaprakash Reddy.

Lesson: 16

Joint venture Accounts

16.0 Objective:

After going through the lesson you will able to understand the following:

1. Meaning of Joint Venture and its distinction with partnership and consignment
2. Method of recording accounts in Joint venture
3. Method of maintaining joint bank account and other related accounts

Structure:

16.1: Joint Venture –Meaning:

A joint venture is an association of two or more than two persons who have combined for the execution of a specific transaction and divide the profit or loss thereof in the agreed ratio. For example if A and B undertake the job of construction of a bridge for a sum of Rs.2 crores their coming together for this specific job will be termed as a joint venture and each one of them will be termed as a co-venturer. The venture will be over as soon as this transaction is over i.e. the bridge is completed.

16.2: Joint venture and Partnership:

There is slight difference between partnership and joint venture. According to Indian Partnership Act, 'partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all'. Thus, both in joint venture and partnership there is some business activity whose profit or loss is agreed to be shared by two or more than two persons. In fact, joint venture is also a type of partnership. The main difference between these two is that joint venture is limited to an activity taken up by the co-venturers, whereas the partnership is a continuous activity. Thus, joint venture can be called as 'temporary partnership' or 'partnership for a specific venture' or 'particular partnership'.

16.3: Joint Venture and Consignment:

In joint venture two or more persons join together and do a particular business and they depart after completion of that business. But in consignment there is only one proprietor and he sends goods on consignment to an agent or consignee and do business. He pays commission to the consignee for his services. The consignor enjoys profits and bears losses and it is a sole trade business.

16.4: Accounting Records:

There are three ways in which joint venture accounts are kept. They are as follows:

1. When one venturer keeps accounts: In this case entire work is entrusted to one of the venturers and the rest simply contribute their share of investment and place it at the disposal of the working venturer.

2. When all venturers keep accounts: In this case each venturer keeps accounts of joint venture separately.

3. When separate set of books is kept: When the venture is of big in nature, this type of keeping books separately is followed.

16.4.1: When venturer keeps accounts:

Under this method one of the venturers keeps accounts of joint venture. Other co-venturers contribute capital, participate in management but do not write accounts. The person who writes accounts may be paid some commission or extra amount. After completion of the accounts, he finds the profit and informs the co-venturers and pays the share of their profits and thus closes the accounts.

Model journal entries:

1. When goods bought for joint venture:

    Joint Venture A/C Dr

        To Goods

2. When cash paid for purchases:

    Joint Venture A/C Dr

        To Bank

3. When co-Venturer bought goods for business:

    Joint Venture A/C Dr

Co-Venturer

4. When different expenses paid for joint venture:

Joint Venture A/C Dr
To Bank

5. When Co-Venturer pays for expenses:

Joint Venture A/C Dr
To Co-Venturer

6. When goods are sold:

Bank A/C Dr
To Joint Venture

7. When Co-Venturer sells goods:

Co-Venturer A/C Dr
To Joint Venture

8. When bill accepted for Co-venturer:

Co-Venturer A/C Dr
To Bills payable

9. When Co-Venturer accepts the bills:

Bills receivable A/C Dr
To Co-Venturer A/C

10. When bill discounted with the bank:

Bank A/C Dr
Discount A/C Dr
To Bills receivable

11. When discount transferred to joint venture:

Joint Venture A/C Dr
To Discount

12. For commission earned:

Joint Venture A/C Dr
To Commission

13. When commission paid to Co-Venturer:

Joint Venture A/C Dr
To Co-Venturer

14. When the remaining goods of joint venture taken:

Goods A/C Dr
To Joint Venture

15. When Co-Venturer takes remaining goods:

Co-Venturer A/C Dr

To Joint Venture

16. When profit earns and shares among venturers:

Joint Venture A/C Dr

To P & L A/C

To Co-Venturer

17. When the account of Co-Venturer settles:

Co-Venturer A/C Dr

To Bank

18. When the amount receivable from the co-venturer received:

Bank A/C Dr

To Co-Venturer

Illustration 1:

Syam and Santosh decided to run a Joint Venture of cotton business and share profits equally. Santosh receives 4 % commission for his service of selling goods of the business. Syam purchased and sent to Santosh 100 bales of cotton for Rs. 20,000 and paid Rs.1, 000 towards insurance. Santosh also purchased cotton worth Rs.16, 000. He paid Rs.300 towards godown rent and Rs.200 towards miscellaneous expenses. Santosh sold the total cotton for Rs.50, 000 and send the due amount to Syam by a cheque.

Santosh is maintaining books of Joint venture. Show Joint venture entries and accounts.

Solution:

Journal entries in the books of Santosh:

1. Joint Venture A/C	Dr	20,000	
To Syam			20,000
(Being goods purchased by syam for joint venture)			
2. Joint Venture A/C	Dr	1,000	
To Syam			1,000
(Being expenses paid by syam)			
3. Joint Venture A/C	Dr	16,000	
To Bank			16,000
(Being goods purchased for joint venture)			
4. Joint Venture A/C	Dr	500	
To Bank			500
(Being expenses paid)			
5. Bank A/C	Dr	50,000	
To Joint Venture			50,000

(Being goods sold)

6. Joint Venture A/C	Dr	2,000	
To Commission			2,000
(Being commission payable)			
7.Joint Venture A/C	Dr	10,500	
To P & L A/C			5,250
To Syam			5,250
(Being profit on joint venture shared equally)			
8. Syam A/C	Dr	26,250	
To Bank			26,250
(Being amount paid to Syam)			

Joint Venture Account

To Syam- goods		20,000	By Bank	50,000
To Syam – commission		1,000		
To Bank – goods		16,000		
To Bank – expenses		500		
To Commission		2,000		
To P & L A/C	5,250			
To Syam A/C	5,250	10,500		
		50,000		**50,000**

Syam Account

To Bank	26,250	By Joint Venture – goods	20,000
		By Joint Venture – expenses	1,000
		By Joint Venture – profit	5,250
	26,250		**26,250**

16.4.2: When all venturers keep accounts:

Under this method, all venturers keep accounts relating to their joint venture in their books. Each venturer opens a joint venture account and other co-venturers accounts. Except this, the procedure of writing journal entries and preparation of accounts are same as shown above.

Illustration 2:

Anil and Sunil are joint venturers and share profits equally. Anil purchased goods worth Rs.25, 000 for joint venture and sent to Sunil. He spent Rs.2, 000 for expenses. Sunil purchased Rs.20, 000 worth of goods and spent Rs.2, 000 for expenses. Sunil sold the goods for Rs.60, 000 and he gets a commission of 5 % on sales. After closing the accounts, Sunil sent a draft to Anil for the amount due. Write journal entries and prepare accounts in the books of Anil and Sunil.

Solution:

Journal entries in the books of Anil:

1. Joint Venture A/C	Dr	25,000	
To Bank			25,000
(Being goods purchased for joint venture)			
2. Joint Venture A/C	Dr	2,000	
To Bank			2,000
(Being expenses paid)			
3. Joint Venture A/C	Dr	20,000	
To Sunil			20,000
(Being goods purchased by Sunil for joint venture)			
4. Joint Venture A/C	Dr	2,000	
To Sunil			2,000
(Being expenses paid by Sunil)			
5. Sunil A/C	Dr	60,000	
To Joint Venture			60,000
(Being goods of joint venture sold)			
6. Joint Venture A/C	Dr	3,000	
To Sunil			3,000
(Being 5 % commission payable to Sunil)			
7. Joint Venture A/C	Dr	8,000	
To P & L A/C			4,000
To Sunil			4,000
(Being 50% of profit transferred and the remaining to Sunil account)			
8. Bank	Dr	31,000	
To Sunil			31,000
(Being cheque received from Sunil for full settlement)			

Joint Venture Account

To Bank	25,000	By Sunil	60,000
To Bank	2,000		
To Sunil A/C	20,000		
To Sunil A/C	2,000		
To Sunil A/C	3,000		
To P & L A/C	4,000		
To Sunil A/C – Profit	4,000		
	60,000		60,000

Sunil Account

To Joint Venture A/C-sales	60,000	By Joint Venture A/C –goods	20,000
		By Joint Venture A/C- goods	2,000
		By Joint Venture –commission	3,000
		By Joint Venture - profit	4,000
		By Bank	31,000
	60,000		**60,000**

Journal entries in the books of Sunil:

1. Joint Venture A/C	Dr	20,000	
To Bank			20,000
(Being goods purchased)			
2. Joint Venture A/C	Dr	2,000	
To Bank			2,000
(Being expenses paid)			
3. Joint Venture A/C	Dr	25,000	
To Anil		25,000	
(Being goods purchased by Anil)			
4. Joint Venture A/C	Dr	2,000	
To Anil		2,000	
(Being expenses paid by Anil)			
5. Bank A/C	Dr	60,000	
To Joint Venture			60,000
(Being joint venture goods sold)			
6. Joint Venture A/C	Dr	8,000	
To P & L A/C			4,000
To Anil		4,000	
(Being profit earned and 50% sent to Anil)			
7. Anil A/C	Dr	31,000	
To Bank			31,000
(Being amount sent to Anil in full settlement)			

Joint Venture Account

To Bank	20,000	By Bank	60,000
To Bank	2,000		
To Anil – goods	25,000		
To Anil – expenses	2,000		

To Commission	3,000		
To P & L A/C	4,000		
To Anil – Profit 4,000			
	60,000		**60,000**

Anil Account

To Bank	31,000	By Joint Venture – goods	25,000
		By Joint Venture – expenses	2,000
		By Joint Venture – profit	4,000
	31,000		**31,000**

16.4.3: When separate set of books is kept:

The following three accounts are required under this method:

1. Joint Bank Account
2. Joint Venture Account
3. Ventureres Personal Accounts

1. Joint Bank Account: To record cash transactions joint bank account is opened. When joint venturers bring cash into the business, it is debited to joint bank account and credited to their personal accounts. The joint venture payments are credited and receipts are debited to this account.
2. Joint Venture Account: The goods purchased for joint venture and the expenses paid are debited to this account as usual. If the venturers bring goods from their personal resources, they are debited to joint venture account and credited to their personal accounts. Contrary to this, if the ventureres take back goods remaining in the joint venture at the end of the business, their accounts are debited and joint venture account is credited. Thus, profit on joint venture is ascertained. The profit or loss on joint venture is distributed among the venturers according to their agreed ratios.
3. Venturers Personal Accounts: Immediately after the venturers bring cash into joint venture, their personal accounts are opened and credited with those amounts. Their accounts are credited with the amounts when they bring goods and debited if they take back. The profit on joint venture will be credited and loss will be debited to the personal accounts. Finally, the personal accounts are settled through receipts and payments among the joint venturers.

Illustration 3:

A, B, and C decided to start a joint venture and share profits in the ratio of 6:3:1 respectively. They have deposited the following the amounts into joint bank account: A- Rs.12, 000, B- Rs.8, 000, and C – Rs.4, 000. They have purchased goods for Rs. 20,000 from joint funds and sold them for Rs.50, 000. A has taken some damaged goods for Rs.300. A, B, and C paid Rs.1, 000, Rs.500 and Rs.500 respectively for expenses. Write journal entries and joint venture account assuming that the accounts are maintained separately.

Solution:

Journal Entries:

1. Joint Bank A/C	Dr	24,000	
To A's A/C			12,000
To B's A/C			8,000
To C's A/C			4,000
(Being capitals of joint venturers are deposited at joint bank account)			
2. Joint Venture A/C	Dr	20,000	
To Joint Bank			20,000
(Being goods purchased for joint venture)			
4. Joint Bank A/C	Dr	50,000	
To Joint Venture A/C			50,000
(Being goods sold on joint venture)			
5. A's A/C	Dr	300	
To Joint Venture A/C			300
(Being damaged goods taken by A)			
6. Joint Venture A/C	Dr	2,000	
To A's A/C			1,000
To B's A/C			500
To C's A/C			500
(Being expenses met by the joint venturers)			
7. Joint Venture A/C	Dr	28,300	
To A's A/C			16,980
To B's A/C			8,490
To C's A/C			2,830
(Profits of joint venture distributed amount joint venturers)			
8. A's A/C	Dr	29,680	
B's A/C	Dr	16,990	
C's A/C	Dr	7,330	
To Joint Bank A/C			54,000
(Being venturers accounts settled)			

Joint Venture Account

To Joint Bank A/C – purchases	20,000	By Joint Bank A/C- sales	50,000
To A's A/C - expenses	1,000	By A's A/C	300
To B's A/C – expenses	500		
To C's A/C – expenses	500		

To A's A/C – profit	6,980			
To B's A/C – profit	8,490			
To C's A/C – profit	2,830	28,300		
		50,300		**50,300**

A's Account

To Joint Venture A/C	300	By Joint Bank A/C	12,000
To Joint Bank A/C	29,680	By Joint Venture – expenses	1,000
		By Joint Venture A/C	16,980
	29,980		**29,980**

B's Account

To Joint Bank A/C	16,990	By Joint Bank A/C	8,000
		By Joint Venture A/C	500
		By Joint Venture A/C	8,490
	16,990		**16,990**

C's Account

To Joint Bank A/C	7,330	By Joint Bank A/C	4,000
		By Joint Venture A/C	500
		By Joint Venture A/C	2,830
	7,330		**7,330**

Joint Bank Account

To A's A/C	12,000	By Joint Venture A/C	20,000
To B's A/C	8,000	By A's A/C	29,680
To C's A/C	4,000	By B's A/C	16,990
To Joint Venture A/C	50,000	By C's A/C	7,330
	74,000		**74,000**

Illustration 4:

A and B agreed to construct a building on joint venture. The contract amount is Rs.20, 00,000. They opened a joint account and deposited A-Rs.50, 000 and B-30, 000. In the contract amount Rs.1, 50,000 collected in installments. The following are the joint transactions:

Rs.60, 000 paid for wages

Rs. 1,40, 000 paid for goods

A sent Rs.10, 000 worth of goods from his shop.

B sent Rs.8, 000 worth of goods from his shop.

A paid Rs.4, 000 to the architect.

The building construction was completed and received the remaining balance A accepted to take the remaining stock for Rs.20,000 and joint venture closed.

A and B share profits in 3:1 ratio. Show profit or loss of joint venture showing joint venture account. Show cash distribution between them.

Solution:

Joint Venture Account

To Joint bank A/C-goods	1,40,000	By Joint bank A/C	2,00,000
To Joint bank A/C-wages	60,000	By A's A/C-stock	20,000
To A's A/C –goods	10,000	By A's A/c – loss	1,500
To B's A/C-goods	8,000	By B's A/C –loss	500
To A's A/C – architect fee	4,000		
	2,22,000		**2,22,000**

Joint Bank Account

To A's A/C	50,000	By Joint venture A/C	2,00,000
To B's A/C	30,000	By A's A/C	42,500
To Joint venture A/C (Contract amount)	2,20,000	By B's A/C	37,500
	2,80,000		**2,80,000**

A's Account

To Joint venture A/C – stock	20,000	By Joint bank A/C	50,000
To Joint venture A/C-loss	1,500	By Joint venture A/C-goods	10,000
To Joint bank A/C-cash	42,500	By Joint venture A/C-exps.	4,000
	64,000		**64,000**

B's Account

To Joint venture A/C-loss	500	By Joint bank A/C	30,000
To Joint bank A/C-cash	37,500	By Joint venture A/C-goods	8,000
	38,000		**38,000**

Illustration 5:

X, Y, and Z entered joint venture to share profits equally. X, Rs.60, 000, Y Rs.60, 000 and Z Rs.70, 000 invested in the venture and deposited in the joint bank. They bought Rs.1, 50, 000 worth of goods from A. They paid Rs.10, 000 towards transport expenses. They sold goods for cash Rs.1, 00, 000 and for credit to B for Rs.80, 000. B accepted a bill for the due amount and the same bill is discounted with the bank for Rs.76, 000. X receives 2% commission for this transaction. Accounts are finalized through cheques. Pass journal entries and prepare ledger accounts assuming that books are maintained jointly.

Solution:

Journal entries:

1. Joint Bank A/C	Dr	1,90,000	
To A's Capital A/C			60,000

To B's Capital A/C			60,000
To C's Capital A/C			70,000
(Being amount brought by the venturers deposited in the bank)			
2. Joint Venture A/C	Dr	1,50,000	
To A's A/C			1,50,000
(Being goods purchased from A)			
3. A's A/C	Dr	1,50,000	
To Joint Bank A/C			1,50,000
(Being cash paid to A)			
4. Joint Venture A/C	Dr	10,000	
To Joint Bank A/C			10,000
(Being transport expenses paid)			
5. Joint Bank A/C	Dr	1,00,000	
B's A/C	Dr	80,000	
Joint Venture A/C			1,80,000
(Being goods sold on cash and credit)			
6. Bills receivable A/C	Dr	80,000	
To B's A/C			80,000
(Being bill received from B for the amount due)			
7. Joint Bank A/C	Dr	76,000	
Discount A/C	Dr	4,000	
To Bills receivable			80,000
(Being bill discounted with the bank)			
8. Joint venture A/C	Dr	4,000	
To Discount A/C			4,000
(Being discount charged to joint venture account)			
9. Joint venture A/C	Dr	3,600	
To X's A/C			3,600
(Being commission payable to X at 2% on 80,000)			
10. Joint venture A/C	Dr	12,400	
To X's Capital A/C			4,133
To Y's Capital A/C			4,133
To Z's Capital A/C			4,134
(Being profit on joint venture distributed)			
11. X's Capital A/C	Dr	67,733	

Y's Capital A/C	Dr	64,133	
Z's Capital A/C	Dr	74,134	
To Joint bank A/C			2,06,000

(Being balances due taken by the joint venturers)

Joint Venture Account

To A's Account – goods	1,50,000	By Joint bank A/C	1,00,000
To Joint bank – expenses	10,000	By B's A/C	80,000
To Discount	4,000		
To X's A/C – commission	3,600		
To X's Capital A/C –profit	4,133		
To Y's Capital A/C – profit	4,133		
To Z's Capital A/C - profit	4,134		
	1,80,000		**1,80,000**

A's Account

To Joint bank A/C	1,50,000	By Joint venture A/C	1,50,000
	1,50,000		**1,50,000**

B's Account

To Joint venture A/C	80,000	By Bills receivable	80,000
	80,000		**80,000**

X's Capital Account

To Joint bank A/C	67,733	By Joint bank A/C	60,000
		By Joint venture A/C-comn.	3,600
		By Joint venture A/C-profit	4,133
	67,733		**67,733**

Y's Capital Account

To Joint bank A/C	64,133	By Joint bank A/C	60,000
		By Joint venture A/C – profit	4,133
	64,133		**64,133**

Z's Capital Account

To Joint bank A/C	74,134	By Joint bank A/C	70,000
		By Joint venture A/C – profit	4,134
	74,134		**74,134**

Illustration 6:

Banerjee and Mukherjee agree to import Russian timber into India. On 1st July 2007 they opened a joint bank account with Rs.25, 000 towards which Banerjee contributed Rs.15, 000 and Mukherjee contributed Rs.10, 000. They agree to share profits and losses in proportion to their cash contributions.

They remitted to their agent in Russsia Rs.20, 000 to pay for timber purchases, and later Rs.2, 100 in settlement of his account. Freight, insurance and dock charges amounted to Rs.3, 900. On December 31 2007 the sales amounted to Rs.28, 740 which enabled them to repay themselves with cost originally advanced. They then decided to close the venture and Mukerjee agreed to take over the timber unsold for Rs.1, 260, which is to be deducted from his share of profit.

Prepare the necessary accounts showing the amount of cash available for division by way of profits and how the same is divisible between Banerjee and Mukherjee.

Solution:

Joint Venture Account

To Joint Bank A/C	20,000	By Joint Bank A/C – sales	28,740
To Joint Bank A/C - commission	2,100	By Mukherjee - stock	1,260
To Joint Bank A/C – Freight etc.,	3,900		
To Benerjee – profit	2,400		
To Mukherjee – profit	1,600		
	30,000		**30,000**

Joint Bank Account

To Banerjee	15,000	By Joint venture A/C	20,000
To Mukherjee	10,000	By Joint venture A/C	2,000
To Joint venture A/C	28,740	By Joint venture A/C	3,900
		By Banerjee	17,400
		By Mukherjee	10,340
	53,740		**53,740**

Banerjee Account

To Joint bank A/C	17,400	By Joint bank A/C	15,000
		By Joint venture A/C	2,400
	17,400		**17,400**

Mukerjee Account

To Joint venture A/C	1,260	By Joint bank A/C	10,000
To Joint bank A/C	10,340	By Joint venture A/C	1,600
	11,600		**11,600**

Illustration 7:

Rao and Raja have taken up a contract in July 2006 as a Joint Venture to lay roads in an industrial establishment for Rs.3, 00,000. Rao brought in Rs.40, 000 and Raja Rs.30, 000 as capital; these amounts were deposited in a joint bank account, which was opened for this purpose. They agreed to share profit or loss equally after providing for interest on capital at 8% per annum.

The work was completed on 30th June 2007 and the following expenses were incurred and paid for from the joint bank account:

Materials	Rs.1, 00,000
Wages	Rs.50, 000
Machinery & stores	Rs.30, 000

Payments from the industrial establishment were received periodically and remitted into the joint bank account; but 1% of the contract amount was not paid because of defective work. They agreed to provide depreciation on machinery and stores at 10% for the year ending on 30th June 2007. Half of the machinery and stores was purchased by Raja at book value; the other half was sold at a profit of 10% on the book value to outsiders.

Prepare necessary accounts in the ledger of the Joint Venture.

Solution:

Joint Venture Account

To Joint bank A/C	1,80,000	By Joint bank A/C	2,97,000
To Rao- interest	3,200	(3,00,000-3,000)	
To Raja – interest	2,400	By Raja – machinery	13,500
To Rao – profit	69,875	By Joint bank	14,850
To Raja – profit	69,875		
	3,25,350		**3,25,350**

Joint Bank Account

To Rao	40,000	By Joint venture	1,80,000
To Raja	30,000	By Rao	1,13,075
To Joint venture	2,97,000	By Raja	88,775
To Joint venture	14,850		
	3,18,850		**3,18,850**

Rao Account

To Joint bank	1,13,075	By Joint bank	40,000
		By Joint venture	3,200
		By Joint venture	69,875
	1,13,075		**1,13,075**

Raja Account

To Joint venture	13,500	By Joint bank	30,000
To Joint bank	88,775	By Joint venture	2,400
		By Joint venture	69,875
	1,02,275		**1,02,275**

Working Notes:

Value of Machinery:	Cost at the beginning	30,000
	Less: Depreciation for 1 year (10%)	3,000
	Written down value as on 30th June 2007	27,000
	Less: Machine taken over by Raja ½	13,500
	Value of Remaining ½ machine	13,500
	Add: 10%	1,500
	Selling price of machine	14,850

Contract Price:	3,00,000
Less: deducted for defective	3,000
Cash received	2,97,000

16.5: Try yourself:

1. Rajiv and Shyam enter into a joint venture to import silk. On 1st January 2007, they opened a Joint Bank Account with the Syndicate Bank, Rajiv contributing Rs.20, 000 and Shyam Rs.10, 000. They agreed to share profits in the ratio of the capital introduced by them. On 15th February 2007, they remitted to a manufacturer in Japan Rs.25, 000 for goods received and incurred an expense of Rs.800 for freight, insurance, etc. The goods were sold for Rs.33, 000 for which the selling expenses were as follows:

Godown rent Rs.200; Commission payable to Shyam on the gross amount of sales 10%; and Miscellaneous expenses Rs.300.

Give journal entries and the necessary ledger accounts showing the final distribution of cash among he co-venturers.

(Profit on Joint venture Rs.3, 400, Rajiv gets Rs.22, 267 and Shyam gets Rs.14, 433 in final settlement)

2. Ram and Lakshman were participants in a joint venture, sharing profits and losses in 2:3 ratio. Each party maintains a complete record in his own books. Ram supplies goods to the value of Rs.15, 000 and incurs an expenditure of Rs.600 on them and Lakshman supplies goods to the extent of Rs.12, 000 and his expenses amount to Rs.900. Ram sells all the goods for Rs.36, 000 for which he is entitled to receive a commission at 5%. Accounts are settled by bank draft. Give the necessary journal entries and the ledger accounts in the books of Ram to record the above transactions.

(Profit on Joint venture Rs.5, 700; Amount payable to Lakshman Rs.14, 800)

3. Shaw and Desai joined in a joint venture to make an advertising film to the government. Government will pay Rs.1, 50,000. Shaw bought Rs.30, 000 and Desai Rs.20, 000 for this purpose. This money is deposited in the joint bank account.

They paid the following from joint bank account:

Wages Rs.40, 000; Materials Rs.25, 000; Camera Rs.5, 000.

Shaw supplied Rs.5, 000 worth of settings. After making the film, the government paid reducing 20% in the agreed amount because of certain defects in the film. Desai took the camera for Rs.2, 000. Shaw takes back the settings for Rs.1, 000.

Show Shaw and Desai accounts along with joint bank account and joint venture account.

(Profit on joint venture: Rs.48,000; Shaw receives Rs.58,000; Desai receives Rs.47, 000)

4. Reddy, Rao and Chowdary jointly undertake to erect a theatre building for Purna Pictures Ltd., at a price of Rs.5, 00,000 to be paid as to Rs.4, 00,000 in cash by installments, and Rs.1, 00,000 in Debentures of the company.

They contribute: Reddy Rs.60, 000, Rao Rs.75, 000 and Chowdary Rs.40, 000. These amounts are deposited in a Joint Bank account.

Reddy gets the plans prepared and pays Rs.7, 000 architect's fees. Rao brings into the venture a concrete mixer of the value of Rs.25, 000 and Chowdary brings into the venture a motor truck of the value of Rs.20, 000.

They buy a plant for Rs.24, 000. Materials worth Rs.2, 40,000 are purchased for cash and Rs.1, 95,000 is paid for wages.

On completion of the venture, Reddy takes over unused materials to the value of Rs.14, 000; Rao takes back the concrete mixer at a valuation of Rs.12, 000; and Chowdary takes back the motor truck at Rs.8, 000. The plant is sold as scrap for

Rs.6, 000. When the contract price was fully received, Reddy took over the Debentures at a valuation of Rs.80, 000.

Show the Joint Venture Account, the Joint Bank Account and the accounts of the Venturers, after the final distribution and the settlement of accounts.

(Profit on Joint venture Rs.9,000; Rao receives Rs.91,000; Chowdary receives Rs.55,000)

16.6: Summary:

Joint venture is also one type of partnership. It is limited to a particular job or work. When the agreed business is over, the joint venture closes and the venturers depart after sharing their profits or losses. Account books are prepared either by one venturer or all the venturers or opening separate books for joint venture along with joint bank account.

16.7: Glossary:

Joint Venture: It is an association of two or more than two persons who have combined for the execution of a specific transaction and divide the profit or loss thereof in the agreed ratio.

16.8: Self Assessment Questions:

1. What is Joint venture? How is it different from Partnership and Consignment?

2. What are the different of accounting in Joint venture?

3. How Joint bank account works in preparing joint venture accounts? Explain with an example.

- Dr.R.Jayaprakash Reddy.

Lesson - 17

DEPRECIATION

OBJECTIVES:

By the sutdy of this Chapter, you will be able to understand the meaning and definition of Depreciation, Concepts & Causes of Depreciaton, Factors influencing depreciation, and various methods of Depreciation.

STRUCTURE:

17.1. INTRODUCTION :

The traditional view of depreciation is that it is meant to be a provision for replacing depreciable assets. Therefore, it is left to the management to decide as to when they should provide for it and when they can dispense with it. Some managements provide for depreciation only when the firm made profits and dispense with it during the years when the firm incurres losses. Even the Companies Act of 1956 has made charging of depreciation compulsory only if the company desired to declare dividends. The accounting practice of showing profits before charging depreciation first, and then later profits after charging depreciation, confirms the view that it has to be regarded as an appropriation of profit. But the modern view is different. All the fixed assets are considered to be "future services" to be used by the enterprise over the entire period of the economic life (estimated useful life) of such assets. Therefore, the cost of acquisition must be properly allocated over the period of its useful economic life. The amount charged to each period is called depreciation (the expired portion of the capital expenditue on the asset) and it is a technique employed by the accountants to recover the investment in fixed assets. The effects of charging of depreciation in the accounts are:

(1) it reduces the value of the fixed asset to the extent to which it has been used up;

(2) it reduces the profits of the concern;

(3) it is possible to show a true and fair view of the value of the fixed assets in the balance sheet;

(4) funds are made available to replace the old asset at the end of its useful economic life.

17.2. MEANING & DEFINITION :

Since the cost of fixed asset is nothing but "the price paid for a series of future services", it is necessary to spread it's cost over a number of years during which benefit of the asset is received. This process of spreading the cost of fixed asset is termed as "depreciation". AICPA in its Accounting Research Bulletin No.22, writes that; "depreciation accounting is a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be group of assets) in a systematic and rational manner. It is a process of allocation not of valuation. Depreciation for the year is the portion of the total cost of the fixed assets that is allocated to the year. Although the allocation may properly take into account occurences during the year, it is not intended to be the measurement of the effect of all such occurrences".

The views of the Institute of Chartered Accountants in Australia are: "depreciation represents that part of the cost of a fixed asset to its owner, which is not recoverable when the asset is finally put out of use by him. Provision against this loss of capital is an integral cost of conducting the business during the effective commercial life of the asset and it is not dependent upon the amount of profit cleared. J.N. Carter's definition runs as follows; "depreciation is the gradual decrease in the value of an assets from any cause". According to IASC-4 depreciation is the allocation of the depreciable amount of an asset over its estimated useful life. As per the standard, depreciation is to be provided only for assets which (a) are expected to be used during more than one accounting period; (b) have a limited useful life, and (c) and held by an enterprise for use in the production of supply of goods and services, for rental to others or for administratives purposes.

17.3. CAUSES OF DEPRECIATION :

Depreciation may be said to arise from two causes-internal and external. Internal depreciation is that arising from the operation of any cause natural to, or inherent in the asset. External depreciation is that arising from the operation of forces outside the asset itself. These are discussed below.

Internal Causes :

(a) **Wear and Tear:** "Wear and tear" is an important cause of depreciation in the case of tangible fixed assets like buildings, machinery, furniture, fixtures, tools, fitting etc. "Wear and tear" results from friction, vibration, strain, chemical reaction, weathering intensity of the use, care in handling, standard of maintenance, minor accidents inevitable in the handling of plant etc. The term 'depreciation' (not "amortization") in generally used to indicate the expired utility of an asset due reasons mentioned above.

(b) **Depletion:** Depletion is also one of the internal causes of decrease in the value of wasting asets such as mine, quarries, oil-wells and forest-stands; The term "depletion" (neither "amortization" not 'depreciation") is correctly used to refer to the expired utility of the wasting asset.

External Causes :

(a) **Obsolescence:** It is an experience in every day life that many times a particular machine is discharged before it is completely worn-out. This means that there are some external factors too which are responsible for throwing out of use an asset which is in a good condition. Among the external causes, "obsolescence" or "suppression" is the prominent factor. Obsolescence is induced by new investions, improvement, loss of demand due to change in fashion, changes in governmental requirements. Loss in demand, for any reason, has a direct impact on the economic life of the asset. Since the market for the product collapses, the machine, if not adaptable to different uses, goes out of use or is obsoleted.

(b) **Effluxion of Time:** There are some intangible fixed assets which decrease in value as time elapses. For example, if Rs.50,000 are paid for a certain lease (excluding lease of mine) for 10 year, then with the lapse of every year, the value of the asset goes down by Rs.50,000, whether utilised or not. Its value is reduced to zero at the end of the 10th year. Copyrights, patent rights are other examples of intangible fixed assets which decrease in value due to effluxion of time.

17.4. NEED AND OBJECTIVES :

One unfortunate thing about depreciation is that it is not visible like other expenses till the very end. In case of other expenses, the expenditure is patent and hence such expenses are provided for. It is not so with depreciation. Some firms do not deduct depreciation form their gross earnings to ascertain the net profit. This is not correct. Provision for depreciation is necessary firstly, for ascertaining true profit, secondly, for retaining funds in the business so that the asset can be replaced at the proper time, and thirdly, for presenting a true balance sheet. Depreciation of current assets is taken care of by valuing them for balance sheet purposes at cost or market prices which ever is less.

It is necessary that a reasonable amount is provided for as depreciation, every year, on fixed assets owing to the following reasons:

(i) to ascertain correct profits of the period,

(ii) to present financial position in the balance sheet,

(iii) to include the depreciation in cost of production, to arrive at true cost of production,

(iv) to provide funds for replacement of the asset at the end of the life of the original asset,

(v) to recover the cost of the fixed assets spread over their useful life; to keep the capital in tact,

(vi) to conserve the cash resources of the concern (to the extent of depreciation) from being distributed as dividends (profits get reduced when depreciation is charged),

(vii) to save tax payable on profits (as the profits get reduced to the extent of depreciation, which is a permissible deduction as per the Income Tax Act), and

(viii) to get an approximate idea of the amount for which the used asset can be sold in the second-hand market.

17.5. METHODS OF DEPRECIATION :

There are two ways of recording depreciation in the books of account:

First Method: When no provision for depreciation account is maintained :

Under this method, depreciation is directly charged to the asset account by debiting depreciation accont and crediting the asset account. At the end of the accounting period, depreciation account is closed by transferring it to the profit and loss account. In the balance sheet, the asset appears at its written down value (cost less depreciation provided to date). Here, the actual cost of an asset and the total amount of depreciation that has been provided (to-date) cannot be ascertained from the balance sheet. The following are the journal entries passed under the first method:

		Rs.	**Rs.**
1.	When the asset is purchased :		
	Asset account .... Dr	xxx	
	To cash account		xxx
2.	Installation charges, reconditioning or over handling expenses incurred on second hand machine should also be charged to the asset account. The entry is :		
	Asset account .... Dr	xxx	
	To cash account		xxx
3.	For providing depreciation at the end of the year :		
	Depreciation account ....Dr	xxx	
	To Asset account		xxx

4.	For transfer of depreciation to profit and loss account :		
	Profit and loss account.........................Dr	xxx	
	To Depreciation account		xxx
5.	It the asset is sold, for the amount realised on the sale of asset :		
	Cash account ....Dr	xxx	
	To Asset account		xxx
6.	For depreciation on the asset to the date of sale :		
	Depreciation account ....Dr	xxx	
	To Asset account		xxx
7.	(a) For the profit on sale of asset :		
	Asset account ....Dr	xxx	
	To profit and loss account		xxx
	(or)		
	(b) For the loss on sale of asset :		
	Profit and loss account ....Dr	xxx	
	To Asset account		xxx

Second Method: When Provision for depreciation account is maintained

Under this method (in contrast to the above), depreciation is not directly charged to the asset account. The depreciation for the period is debited to depreciation account and credited to "accumulated depreciation account" or "provision for depreciation account". As in the previous method, depreciaiton account is closed by transferring it to the profit and loss account. In the balance sheet, the asset appears at its original cost and the accumulated depreciation is shown as a deduction from the asset account. Here, from the balance sheet, the original cost of the asset and the totaldepreciation to-date that has been charged on that asset, can be easily ascertained. As the year passes, the balance of the accumulated depreciation goes on increasing since constant credit is given to this account in each accounting year. After the expiry of the useful life, these two accounts are closed by debiting accumulated depreciation account and crediting the asset account - any balabce in asset account is transferred to the profit and loss account. The following are the journal entries passed under the second method.

	Every year accounting period	Rs.	Rs.
1.	Depreciation account ....Dr.	xxx	
	To provision for depreciation account		xxx
	(Being depreciation written of)		
2.	Profit and loss account ....Dr.	xxx	
	To Depreciation account		xxx
	(Being depreciation charged to profit and loss account)		
	In the year in which the assest is sold :		
3.	Cash account ....Dr.	xxx	
	To Assest account		xxx
	(Being the amount realised on the sale of the asset)		
4.	Depreciation account ....Dr.	xxx	
	To provision for depreciation		xxx
	(Being depreciation on the asset upto the date of sale written off)		
5.	Profit and loss account ....Dr.	xxx	
	To Depreciation account		xxx
	(Being depreciation charged to profit and loss account)		
6.	Provision for depreciation account ....Dr.	xxx	
	To Asset account		xxx
	(Being the transfer of provision to asset account)		
7.	Asset account ....Dr.	xxx	
	To profit and loss account		xxx
	(Being the profit on sale of asset)		
8.	Profit and loss account ....Dr.	xxx	
	To Asset account		xxx
	(Being the loss on sale of asset)		

17.6. METHODS OF PROVIDING DEPRECIATION :

As has been pointed out earlier, the total depreciation to be written off during the life time of the asset is original cost less scrap value or residual value. But there are different medhods of calculating the amount of depreciation to be charged every year. They vary from asset to asset depending on its nature and also from concern to concern. The following are the various methods used for providing depreciation:

(1) Fixed Instalments of Straight Line Method

(2) Diminishing Balances or Reducing Installment Method.

(a) Written Down Value Method

(b) Double Declining Balance Method

(3) Annuity Method

(4) Depreciation Fund or Sinking Fund Method

(5) Insurance Policy Method

(6) Sum of Digits Method

(7) Depletion Method

(8) Revaluation Method

(9) Machine Hour Rate Method

(10) Mileage Method

$$\frac{\text{Annual depreciation}}{\text{[Cost of asset+Erection charges]-Residual value}} \times 100$$

17.7. FIXED INSTALMENT METHOD :

This method is also known as “Equal Instalment” or “Straight Line” method. According to this method, a fixed and equal amount is charged as depreciation every year during the life time of the asset. When the amount of depreciation is presented on a graph, it would be a straight line. The amount is such that at the end of the useful life of the asset the asset gets reduced to zero or its residual value. This can be calculated using the following formula.

$$\text{Annual depreciation} = \frac{\text{[Cost of asset+Erection charges]-Residual value}}{\text{Life of the asset in terms of years (life period)}}$$

Similarly, the rate of depreciation is calculated as under:

Rate of depreciation =

ILLUSTRATIONS

Illustration-1:

Calculate the amount of annual depreciation for three years by straight line method when (i) Cost of machinery Rs.30,000 (ii) Expected life of asset 3 years (iii) Scrap value Rs.3,000.

Solution:

Straight Line Method

$$\text{Annual depreciation} = \frac{\text{Original cost - Scrap value}}{\text{Life of asset}}$$

$$= \frac{30{,}000 - 3{,}000}{3 \text{ Years}}$$

$$= \frac{27{,}000}{3} \quad = \text{Rs.}9{,}000$$

Therefore, annual depreciation is Rs.9,000.

Illustration-2:

A company purchased a plant for Rs.50,000; the useful life of the plant is 10 years and the residual value is Rs.5,000. Determine the rate and amount of depreciation to be charged every year.

Solution:

$$\text{Depreciation to be charged every year} = \frac{\text{Original cost-Residual value}}{\text{Life of the plant}}$$

$$= \frac{50{,}000\text{-}5{,}000}{10}$$

$$= \frac{45{,}000}{10} = \text{Rs.}4{,}500$$

Rate of depreciation = x 100

= x100 = x 100=10 %

Illustration-3:

Saicharan purchased a machine by cheque for Rs.1,80,000 on 1st January 1998. Its probable working life was estimated at 10 years and its probable scrap value at the end of that time as Rs.20,000. It was decided to write off depreciation by equal annual instalments. You are required to pass necessary journal entries for first two years and show necessary accounts and the balance sheet:

(a) when no provision for depreciation account is maintained.

(b) when provision for depreciation account is maintained.

[It was decided to close books each year on December, 31st]

Solution:

Annual depreciation= $\frac{\text{Rs.1,80,000-Rs.20,000}}{10} = \frac{1,60,000}{10}$ = Rs.16,000

(a) When no provision for depreciation account is maintained:

In the books of Saicharan Journal Entries

Date	**Particulars**	**L.f**	**Rs.**	**Rs.**
1998 Jan.1	Machinery account..........................Dr		1,80,000	
	To Bank account			1,80,000
	(Being the purchase of machinery by cheque)			
1998 Dec.31	Depreciatoin account.......................Dr		16,000	
	To Machinery account			16,000
	(Being depreciation charged to machinery)			
1998 Dec.31	Profit and loss account ....Dr		16,000	
	To Depreciation account			16,000
	(Being the depreciation transferred to profit & loss account)			

1999 Dec.31	Depreciation account....................Dr	16,000	
	To Machinery account		16,000
	(Being depreciation charged to machinery)		
1998 Dec.31	Profit and loss account ....Dr	16,000	
	To Depreciation account		16,000
	(Being depreciation transferred to profit & loss account)		

Machinery Account

Dr. **Cr.**

Date	**Particulars**	**L.f**	**Rs.**	**Date**	**Particulars**	**L.F.**	**Rs.**
1998 Jan. 1	To Bank		1,80,000	1998 Dec.31	By Depreciation		16,000
				,,	By Balance c/d		1,64,000
			1,80,000				1,80,000
1999 Jan. 1	To Balance		1,64,000	1999 Dec.31	By Depreciation		16,000
				,,	By Balance c/d		1,48,000
			1,64,000				1,64,000
2000 Jan. 1	To Balance b/d		1,48,000				

Depreciation Account

Dr.							Cr.
Date	Particulars	L.F	Rs.	Date	Particulars	L.F.	Rs.
1998				1998			
Dec. 31	To Machinery A/c		16,000	Dec.31	By P & L A/C		16,000
1999				1999			
Dec.31	To Machinery A/c		16,000	Dec.31	By P & L A/C		16,000

Balance sheet as on 31-12-98

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Machinery A/c.	1,80,000	
			Less : Depreciation	16,000	1,64,000

Balance sheet as on December 31, 1999

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Machinery A/c.	1,64,000	
			Less : Depreciation	16,000	1,48,000

(b) When provision for depreciation account is maintained:

In the books of Saicharan Journal Entries

Date	Particulars	L.F	Rs.	Rs.
1998				
Jan.1	Machinery account..........................Dr		1,80,000	
	To Bank account			1,80,000
	(Being the machinery purchase by cheque)			
1998				
Dec.31	Depreciatoin account.......................Dr		16,000	
	To provision for depreciation account			16,000
	(Being depreciation provided for the accounting period)			

1998			
Dec.31	Profit and loss account ....Dr	16,000	
	To Depreciation account		16,000
	(Being the depreciation transferred to profit & loss account)		
1999			
Dec.31	Depreciation account....................Dr	16,000	
	To provision for depreciation account		16,000
	(Being depreciation provided for the accounting period)		
1998			
Dec.31	Profit and loss account ....Dr	16,000	
	To Depreciation account		16,000
	(Being depreciation transferred to profit & loss account)		

Machinery Account

Dr. **Cr.**

Date	**Particulars**	**L.F**	**Rs.**	**Date**	**Particulars**	**L.F.**	**Rs.**
1998				1998			
Jan. 1	To Bank A/c		1,80,000	Dec.31	By Balance c/d		1,80,000
1999				1999			
Jan. 1	To Balance b/d		1,80,000	Dec.31	By Balance c/d		1,80,000
2000							
Jan. 1	To Balance b/d		1,80,000				

Provision for depreciation Account

Dr. **Cr.**

Date	Particulars	L.f	Rs.	Date	Particulars	L.F.	Rs.
1998				1998			
Dec. 31	To Balance c/d		16,000	Dec.31	By Depreciation A/c		16,000
1999				1999			
Dec.31	To Balance c/d		32,000	Dec.31	By Balance b/d		16,000
				Dec.31	By Depreciation A/c		16,000
			32,000				32,000
				2000			
				Jan. 1	By Balance b/d		32,000

Depreciation Account

Date	Particulars	L.F	Rs.	Date	Particulars	L.F.	Rs.
31.12.98	To Provision for Depreciation		16,000	31.12.98	By P & L A/C		16,000
31.12.99	To Provision for Depreciation		16,000	31.12.99	By P & L A/C		16,000

Balance sheet as on December 31, 1998

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Machinery	1,80,000	
			Less : Provision for depreciation	16,000	
					1,64,000

Balance sheet as on December 31, 1999

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Machinery	1,80,000	
			Less : Provision for depreciation	32,000	
					1,48,000

Advantages of Fixed Instalment Method

(1) It is simple to calculate and easy to understand

(2) It can reduce the book value of the asset to zero

(3) The valuation of the asset each year in the balance sheet is resonably fair.

Disadvantages of Fixed Instalment Method

(i) This methods ignores the fact that the service yielding ability of the assets tends to fall but the repairs and maintenance costs increase with passage of time. Thought each year's charge for depreciation is the same, the charge for repairs and renewals goes on increasing as the asset becomes old. Therefore, the charge to the profit and loss account increases over the years.

(ii) If an additional assets is acquired, the amount to be charged as depreciation needs to be recalculated.

17.8. DIMINISHING BALANCE OR REDUCING INSTALMENT METHOD:

The most important defect of the fixed instalment method is that the burden (along with repairs and renewals) on the Profit and loss account of various years is disproportionate. To remedy this defect, the reducing instalment methods of depreciation are devised so that the total burden on the profit and loss account is the same every year, while the depreciation instalments will be decreasing, the repairs and renewal charges will be increasing year after year. There are two important methods under the diminishing balance system. They are:

(i) Written down value method.

(ii) Double-declining balance method

(i) Written Down Value Method: Under this method, depreciation is charged at a fixed rate on the reducing balance of the asset every year. Every year the depreciation charge will get reduced because depreciation is calculated on the opening balance of the asset. Since the depreciation is calculated in the written down value of the asset each year, it is known as written down value method. Under this method also, repairs and renewals have to be separately charged to the profit and loss account and provision for replacement of the asset has also to be made separately.

Current year depreciation=Current year beginning value of the asset x Rate/100.

Here, the calculation of rate of depreciation involves a complex procedure. The formula used for calculating the rate under this method is:

$$\text{Rate of depreciation} = 1 - n\sqrt{\frac{\text{Scrap value}}{\text{Cost of the asset}}}$$

n = the expected useful life in years.

Illustration- 6:

Calculate the amount of annual depreciation for three years by reducing balance method from the following particulars

i. Cost of machinery is Rs. 40,000

ii. expected life is 3 years

iii. rate of depreciation 33 1/3%

iv. Scrap value is Rs. 40,000.

Solution :

	Rs.
Reducing balance Method :	
Original cost	40,000
Less : depreciation for first year (33 1/3% x 40,000)	13,333
Written down value (WDV)	26,667
Less : depreciation for second year (33 1/3% x 26,667)	8,889
Written down value	17,778
Less : depreciation for thrid year (33 1/3% x 17,778)	5,926
Written down value	11,852

Illustration- 7:

A company purchased a machinery on 1.1.1998 for Rs. 1,50,000. It was decided to write off the machinery by using diminshing balance method. The rate of depreciation was 15% p.a., on 1.7.1999 the machine was sold for Rs. 1,00,000 show the Machine account for the year 1998 and 1999.

Solution :

Date	Particulars	L.F	Rs.	Date	Particulars	L.F.	Rs.
1998				1998			
Jan. 1	To cash A/c.		1,50,000	Dec.31	By Depreciation A/c		22,500
				,,	By Balance c/d		1,27,500
			1,50,000				1,50,000
1999				1999			
Jan. 1	To Balance c/d		1,27,500	July 1	By cash A/c.		1,00,000
				,,,	By Depreciation A/c		9,563
				Dec.31	By profit and loss A/c.		17,937
			1,27,500				1,27,500

Illustration- 8:

On 1st April 1998 Sahitya Ltd. purchased a second - hand machine for Rs. 98,000 and spend Rs. 2,000 on its erection. On 1st July. 2000 this machine was sold for Rs. 48,000.

Prepare the machinery account for the first 3 years according to the written down value method taking the rate of depreciation as 10% p.a.

Solution :

Working Notes :

Profit and Loss on sale of Machinery

	Rs.
Book value of the machine as on date of sale (83,250 - 4,162,50)	79,087,50
Less : Sale of machinery	48,000,00
Loss on sale of machinery	31,087,50

In the Bookd of Sahitya Ltd.

Machinery Account

Date	Particulars	L.f	Rs.	Date	Particulars	L.F.	Rs.
1998				1998			
April 1	To cash A/c.		98,000	Dec.31	By Depreciation A/c		7,500
"	To cash A/c.		2,000				92,500
			1,00,000				1,00,000
1999				1999			
Jan. 1	To Balance b/d		92,500	Dec.31	By Depreciation A/c		9,250
				Dec.31	By balance c/d		83,250
			92,500				92,500

2000			2000		
Jan. 1	To Balance b/d	83,250	July 1	By Depreciation A/c	4,162,50
			July 1	By cash A/c.	48,000,00
			Dec.31	By profit and loss A/c.	31,087,50
		83,250			83,250

(ii) Double Declining Balance Method: Under this method also, depreciation is charged onthe reduced balance at the beginning of the period, but the rate is arrived at by doubling the straight line rate. The rate under this method, is calculated on the residual value of the asset.

Illustration-9:

Sudheer & Co, purchased a plant on January 1, 1997 for Rs. 21,000 and spent Rs. 1,000 on its erection. The asset is expected to last for 4 years, after which its break up value is estimated to be Rs. 2,000. Find out the amount of depreciation to be charged every year under double declining balance method and show how the plant account would appear for the 4 years assuming that it is sold away for Rs. 1,700 at the end.

$\frac{22,000}{4}$ $\cancel{83,250x} \frac{10}{100} \times \frac{6}{12}$

Solution :

The rate can be arrived at as follows :

Cost of the assest to be depreciated (including erection charges)	Rs. 22,000
Estimated life	4 year
Depreciation per annum =	Rs 5,500

Rate of depreciation under straight line method ; $\frac{100x5,500}{22,000}$ = 25%

Rate of depreciation under double declining balance method 2 x 25 = 50% [of the balance at the beginning of each year]

The amount charged as depreciation during the 4 years of life would be as follows :

	Balance at the beginning	Rate	Depreciation
	Rs.		Rs.
1st Year	22,000	50%	11,000
2nd Year	11,000	50%	5,500
3rd Year	5,500	50%	2,750
4th Year	2,750	50%	1,375
Balance left at the end of assets - life	1,375		

Dr Plant Account Cr

Date	Particulars	L.F	Rs.	Date	Particulars	L.F.	Rs.
1997				1997			
Jan. 1	To cash A/c.		21,000	Dec.31	By Depreciation A/c		11,000
"	To cash A/c. (erection charges)		1,000		By balance c/d		11,000
			22,000				22,000
1998				1998			
Jan. 1	To Balance b/d		11,000	Dec.31	By Depreciation A/c		5,500
				Dec.31	By balance c/d		5,500
			11,000				11,000
1999			1999				
Jan. 1	To Balance b/d		5,500	Dec.31	By Depreciation A/c		2,750
				Dec.31	By balance c/d		2,750
			5,500				5,500

2000			2000		
Jan. 1	To Balance b/d	2,750	Dec.31	By Depreciation A/c	1,375
Dec.31	To P& L A/c	325	Dec.31	By cash c/d	1,700
		3,075			3,075

Advantages of Diminishing Balance Method

1. As the decreasing charge for depreciation cancels out the increasing charges for repairs over the years, it gives a fair charge for depreciation.
2. No recalculation is necessary when additional assets are purchased.
3. This method is applicable for income tax purposes.

Disadvantages:

1. This method lacks simplicity - the ascertainment of the percentage to be applied.
2. This method cannot be applied for assets with a very short life.
3. The assets is never fully depreciated.

Illustration-10:

A plant is purchased for Rs. 20,000. It is depreciated at 5% p.a. on reducing balance method for five years when it becomes obsolete due to new method of production and is therefore scrapped. The scrap produces Rs. 5,385. Show the plant account in the ledger.

Plant Account

Date	Particulars	L.F	Rs.	Date	Particulars	L.F.	Rs.
I yrs.	To cash A/c.		20,000	II yrs.	By Depreciation A/c (20,000x 5/100)		1,000
					By balance c/d		19,000
			20,000				20,000
II yrs.	To balance A/c.		19,000	II yrs.	By Depreciation A/c (19,000x 5/100)		950
					By balance c/d		17,147
			19,000				19,000

III yrs.	To balance A/c.	18,050	III yrs.	By Depreciation A/c (18,050x 5/100)	903
				By balance c/d	18,050
		18,050			18,050
IV yrs.	To balance A/c.	17,147	IV yrs.	By Depreciation A/c (17,147x 5/100)	857
				By balance c/d	16,290
		17,147			17,147
V yrs.	To balance A/c.	16,290	V yrs.	By Depreciation A/c	815
			"	By cash A/c	5,385
				By P & L A/c (loss on sale of plant)	1,090
		16,290			16,290

17.9 ANNUITY METHOD :

This method takes into account not only the shrinkage in the utility value of the asset (depreciation) but also the loss by way of interest on the capital invested in the purchase of the asset. The amount invested in the asset would have earned some interest if it was not invested in that particular asset. Thus, the loss of interest foregone also has to be taken into account. The asset account is debited every year with the annual interest on the (diminishing) value of the asset account appearing at the beginning of each year, and the value of the asset plus interest is sought to be completely written off during a given period by this method. Thus, the amount written off as depreciation is the same each year, but the interest to be debited will diminish year after year. The fixed amount to be charged every year as depreciation is calculated from the annuity table, an extract of which is given below:

Amount required to be written off Re.1 by annuity method

Year	Interest on 3%	Interest on 4%	Interest on 5%	Interest on 6%
1	1.0300	1.0400	1.0500	1.0600
2	0.5226	0.5302	0.5378	0.5454
3	0.3535	0.3603	0.3672	0.3741
4	0.2690	0.2755	0.2820	0.2885
5	0.2184	0.2246	0.2310	0.2374
6	0.1846	0.1908	0.1907	0.2034
7	0.1605	0.1666	0.1728	0.1791
8	0.1425	0.1485	0.1547	0.1610
9	0.1284	0.1345	0.1407	0.1470
10	0.1172	0.1233	0.1295	0.1359
15	0.0838	0.0899	0.0963	0.1030
20	0.0672	0.0736	0.0802	0.0872
25	0.0574	0.0640	0.0710	0.0782

This method of depreciation can only be applied to an asset, the life of which will extend to a known period, e.g., a lease. Since the depreciation charge is same and the interest charges decrease each year (because interest is calculated on reducing balance). The net charge for depreciation (depreciaton less interest) gradually decreases.

	Accounting entries	Rs.	Rs.
1.	Asset A/c ....Dr.	xxx	
	To Interest A/c.		xxx
	(Being interest debited to asset A/c.)		
2.	Depreciaton A/c........................Dr.	xxx	
	To Asset A/c.		xxx
	(Being deprecaition charges)		

Illustration-14:

Bhargavi Ltd., took a lease on 1st January, 1995, costing Rs.1,00,000 for a period of 5 years. The company decided to amortise the lease by annuity method, interest at the rate of 5% p.a. being charged. If annuity of Re.1 for 5 years at 5% is 0.230975, show lease account for the whole period.

Solution:

Annual instalment=1,00,000 x 0.230975 = Rs.23,097.50

In the Books of Bhargavi Ltd. Lease Account

Dr. **Cr.**

Date	**Particulars**	**L.f**	**Rs.**	**Date**	**Particulars**	**L.F.**	**Rs.**
1995				1995			
Jan. 1	To cash A/c.		1,00,000	Dec.31	By Depreciation A/c		23,097.50
Dec.31	To interest A/c.		5,000	"	By balance c/d		81,902.50
			1,05,000				1,05,000
1996				1996			
Jan. 1	To Balance b/d.		81,902.50	Dec.31	By Depreciation A/c		23,097.50
Dec.31	To interest A/c.		4,095.13	"	By balance c/d		62,900.13
			85,997.63				85,997.63
1997				1997			
Jan. 1	To Balance b/d.		62,900.13	Dec.31	By Depreciation A/c		23,097.50
Dec.31	To interest A/c.		3,145.00	"	By balance c/d		42,947.63
			66,045.13				66,045.13
1998				1998			
Jan. 1	To Balance b/d.		42,947.63	Dec.31	By Depreciation A/c		23,097.50
Dec.31	To interest A/c.		2,147.38	"	By balance c/d		21,997.51
			45,095.01				45,095.01

1999			1999		
Jan. 1	To Balance b/d.	21.997.51	Dec.31	By Depreciation A/c	23,097.50
Dec.31	To interest A/c.	1,099.99			
		23,097.50			23,097.50

Note: (difference between last year opening balance and annual installment = last year interest).

We give below a table showing the amount of interest and depreciation charged each year and net debit to profit and loss account:

Year	Depreciaton (debited P&L A/C)	Interest (credited to P&L A/C)	Net (debited to P&L A/C)	Remarks
1995	23,097.50	5,000	18,097.50	Note that:cost
1996	23,097.50	4,095.13	19,002.37	of lease and
1997	23,097.50	3,145.00	19,952.50	interst is
1998	23,097.50	2,147.38	20,950.12	equal to the
1999	23,097.50	1,099.99	21,997.51	total depreciation
Total	1,15,487.50	15,487.50	1,00,000.00	

Illustration-15:

A trader takes a lease of 5 years for Rs.5,000. He decided to write off lease by annuity method presuming the rate of interest at 5% p.a. The annuity table shows that annual amount necessary to write off Re.1 in 5 years at 5% p.a. is Re.0.230975.

Show the lease account for 5 years.

Solution:

Annual instalment =5,000 x .230975=1,154.88

Lease Account

Dr. **Cr.**

Date	Particulars	L.F	Rs.	Date	Particulars	L.F.	Rs.
I Yr.	To Cash		5,000.00	I yr	By Depreciation A/c		1,154.88
	To Interest		250.00		By Balance c/d		4,095.12
			5,250.00				5,250.00

II Yr.	To Balance b/d	4,095.12	II yr	By Depreciation A/c	1,154.88
	To interest	204.76		By balance c/d	3,145.00
		4,299.88			4,299.88
III Yr.	To Balance b/d	3,145.00	III yr	By Depreciation A/c	1,154.88
	To interest	157.25		By balance c/d	2,147.37
		3.302.25			3.302.25
IV Yr.	To Balance b/d	2,147.37	IV yr	By Depreciation A/c	1,154.88
	To interest	107.37		By balance c/d	1,099.86
		2,254.74			2,254.74
V Yr.	To Balance b/d	1,099.86	V yr	By Depreciation A/c	1,154.88
	To interest	55.02			
		1,154.88			1,154.88

Notes: (i) The amount of depreciation is fixed for all the years.

(ii) The amount of interest is reduced every year for the reason it is calculated on the written down balance.

(iii) The toal charge to profit and loss account can be found out by striking out the balance of depreciaton and interest. The net amount to be charged to the profit and loss account in the above example has been given in the following list:

Year	**Depreciation debited Rs.**	**Interest credited Rs.**	**Net charge against profit Rs.**
1	1,154.88	250.00	904.88
2	1,154.88	204.76	950.12
3	1,154.88	157.25	997.63
4	1,154.88	107.37	1,047.51
5	1,154.88	55.02	1,099.86
	5,774.40	774.40	5,000.00

(iv) It should be noted that net charge against profit increase year after year for the reason depreciation is a fixed amount while interest credited reduces every year.

(v) Cost price of the asset Rs.5,000.00

Rs. 774.40

Total Depreciation Rs.5,774.40

17.10. DEPRECIATION FUND METHOD :

This method is also known as "Sinking fund" method. This method is followed when provision for replacement of the asset has to be made. Under this method, a fixed amount is charged for depreciation to the profit and loss account every year and credited to 'depreciation fund' account and on equal amount of money is invested in outside securities every year. These investments are allowed to accumulate at compound for replacement of the used asset through the realisation of the securities. The asset account will remain at its original value in the ledger till the end of its life and closed at the end, by tranferring the balance in the 'depreciation fund' account to the asset account.

Since the securities always earn some interest, it is not necessary to write off the full cost of the asset as depreciation. Something less will be adequate. Ultimately, the total depreciation written off and interest earned on securities should be equal to the original cost of the asset. Hence, under this method the depreciation charge will be less than what it would be under other methods. In addition, this method has an added advantage of providing ready funds for replacement of the old asset at the end of its life.

It is necessary to refer to sinking fund table to arrive at the depreciation to be provided every year, as the interest (at a fixed rate) eanred on the proposed investments is also to be takne into account. An extract of sinking fund table is given below:

Sinking Fund Table

Periodic deposit which will amount to Re.1

Years	1%	2%	3%	4%	5%	6%
1	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
2	0.4975	0.4951	0.4926	0.4902	0.4878	0.4854
3	0.3300	0.3268	0.3235	0.3203	0.3172	0.3141
4	0.2463	0.2426	0.2390	0.2355	0.2320	0.2286
5	0.1960	0.1922	0.1884	0.1846	0.1810	0.1174
6	0.1625	0.1585	0.1546	0.1508	0.1470	0.1434
7	0.1386	0.1345	0.1305	0.1266	0.1228	0.1191

8	0.1207	0.1165	0.1125	0.1082	0.1047	0.1010
9	0.1067	1.1025	0.0984	0.0945	0.0907	0.0870
10	0.0956	0.0913	0.0872	0.0833	0.0795	0.0759
15	0.0621	0.0578	0.0538	0.0499	0.0463	0.0430
20	0.0454	0.0412	0.0372	0.0336	0.0302	0.0272
25	0.0354	0.0312	0.0274	0.0240	0.0219	0.0182

Accounting Treatment

The entries to be recorded under this method are as follows:

I. At the end of first year:

		Rs.	**Rs.**
(a)	For providing annual depreciation :		
	Depreciation A/c ....Dr.	xxx	
	To Depreciation fund A/c.		xxx
(b)	For investing the amount of depreciation:		
	Depreciation Fund investmensts A/C...Dr.	xxx	
	To Bank A/c.		xxx
(c)	For transferring depreciation to profit and loss A/c :		
	Profit and Loss A/c ....Dr.	xxx	
	To Depreciation A/c.		xxx

II. At the end of second and subsequent years upto last but one year:

(a)	For interest received on investments purchased out of depreciation fund :		
	Cash A/c ....Dr.	xxx	
	To Depreciation fund A/c.		xxx
(b)	For annual instalment of depreciation :		
	Depreciation A/c ....Dr.	xxx	

To Depreciation fund A/c. xxx

(c) For investing the amount of depreciation of this year and interest earned on investment of fund :

Depreciation fund investments A/c .....Dr. xxx

To cash A/c. xxx

(d) For transferring depreciation to profit and loss A/c :

Profit and Loss A/c ....Dr. xxx

To Depreciation A/c. xxx

III. At the end of the last year of the life of the asset :

(a) For annual instalment of depreciation :

Depreciation A/c ....Dr. xxx

To Depreciation fund A/c. xxx

(b) For transferring depreciation to profit and loss A/c :

Profit and Loss A/c ....Dr. xxx

To Depreciation A/c. xxx

(c) For sale of investments :

Cash A/c ....Dr. xxx

To Depreciation funds investments A/c. xxx

(d) For profit earned on sale of investments :

Depreciated Fund Investments A/c ....Dr. xxx

To Depreciation funds A/c. xxx

(If there is a loss reverse entry has to be passed)

(e) For writting off the old asset :

Depreciation Fund A/c ....Dr. xxx

To Asset A/c. xxx

(f) For transferring the balance of depreciation fund account :

(i) If it shows credit balance :

Depreciation Fund ....Dr.	xxx	
To profit and loss A/c.		xxx

(ii) If it shows debit balance :

Profit and loss A/c. ....Dr.	xxx	
To Depreciation Fund A/c.		xxx

(g) For purchasing new asset :

New Asset A/c ....Dr.	xxx	
To Bank A/c.		

Illustration-16:

A company purchased 3 years lease on January, 1997 for Rs.1,00,000. It has decided to provide for the replacement of the lease at the end of 3 years by setting up a depreciation fund. It is expected that investments will fetch interest at 5%. Sinking fund table shows that 0.317208 at 5% will accumulate to Re.1 in 3 years.

Investments are sold on 31.12.1999 at the book value. Pass necessary journal entries and record for three years in the books of the company.

Solution:

Depreciation (annual contribution)

=Rs.1,00,000 x 0.317208 = Rs.31,720.80

Journal Entries in the books of company

Date	Particulars	L.F	Rs.	Rs.
1997				
Jan.1	Lease A/c.........................Dr		1,00,000	
	To Cash A/c			1,00,000
	(Being the purchase or lease for 3 year)			
Dec.31	Depreciatoin A/c......................Dr		31,720.80	
	To Depreiation Fund A/c			31,720.80
	(Being depreciation written off)			

Dec.31	Depreciatoin Fund investments A/c..Dr	31,720	
	To Cash A/c		31,720
	(Being the amount invested in Securities)		
Dec.31	Profit and loss account ....Dr	31,720.80	
	To Depreciation account		31,720.80
	(Being transfer of depreciation to profit & loss account)		
1998			
Dec.31	Cash A/c...................Dr	1,586	
	To Depreciation Fund A/c.		1,586
	(Being the interest on depreciation fund investments received)		
Dec.31	Depreciatoin A/c.....................Dr	31,720.80	
	To Depreiation Fund A/c		31,720.80
	(Being depreciation written off)		
Dec.31	Depreciatoin Fund investments A/c..Dr	33,306	
	To Cash A/c		33,306
	(Being depreciation written off)		
Dec.31	Profit and loss account ....Dr	31,720.80	
	To Depreciation account		31,720.80
	(Being transfer of depreciation to profit & loss account)		
1998			
Dec.31	Depreciatoin A/c.....................Dr	31,720.80	
	To Depreiation Fund A/c		31,720.80
	(Being depreciation written off)		
Dec.31	Profit and loss account ....Dr	31,720.80	
	To Depreciation account		31,720.80
	(Being transfer of depreciation to profit & loss account)		

Dec.31	Cash A/c ....Dr	65,026	
	To Depreciation fund investments A/c.		65,026
	(Being the sale of investment)		
Dec.31	Depreciation Fund A/c ....Dr	99,999.82	
	To Lease A/c.		99,999.82
	(Being writing off the old lease)		
Dec.31	Profit and loss A/c ....Dr	0.18	
	To Lease A/c.		0.18
	(Being transfer of the balance of lease A/c. to profit and loss A/c.)		

Ledger Account in the books of the company
Depreciation Fund Investments Account

Dr. **Cr.**

Date	**Particulars**	**L.F**	**Rs.**	**Date**	**Particulars**	**L.F.**	**Rs.**
1997				1997			
Dec.31	To Cash A/c		31,720	Dec.31	By Balance c/d		31,720
			31,720				31,720
1998				1998			
Jan. 1	To Balance b/d		31,720	Dec.31	By balance c/d		65,026
Dec.31	To Cash A/c		33,306				
			65,026				65,026
1998				1998			
Jan. 1	To Balance b/d		65,026	Dec.31	By cash A/c. (sale of investments)		65,026
			65,026				65,026

Depreciation Fund Account

Dr.							Cr.
Date	**Particulars**	**L.F**	**Rs.**	**Date**	**Particulars**	**L.F.**	**Rs.**
1997				1997			
Dec.31	To Balance c/d		31,720.80	Dec.31	By Depreciation		31,720
			31,720.80				31,720.80
1998				1998			
Jan. 1	To Balance b/d		65,027.64	Dec.31	By balance c/d		31,720.80
				Dec.31	To Cash (interest) A/c.		1,586.04
					By Depreciation A/c.		31,720.80
			65,027.64				65,027.64
1999				1999			
Jan. 1	To Lease A/c		1,00,000.00	Dec.31	By balance b/d		65,027.64
				Dec.31	To Cash (interest) A/c.		3,251.56
					By Depreciation A/c.		31,720.80
			1,00,000.00				1,00,000.00

Lease Account

Dr.							Cr.
Date	**Particulars**	**L.F**	**Rs.**	**Date**	**Particulars**	**L.F.**	**Rs.**
1997				1997			
Jan. 1	To cash A/c		1,00,000	Dec.31	By Balance c/d		1,00,000

1998			1998		
Jan. 1	To Balance b/d	1,00,000	Dec.31	By Balance c/d	1,00,000
1999			1999		
Jan. 1	To Balance b/d	1,00,000	Dec.31	By Depreciation Fund A/c	1,00,000
		1,00,000			1,00,000

Depreciation Account

Dr. **Cr.**

Date	**Particulars**	**L.F**	**Rs.**	**Date**	**Particulars**	**L.F.**	**Rs.**
1997				1997			
Dec.31	To Depreciation Fund A/c.		31.720.80	Dec.31	By Profit and loss A/c.		31.720.80
1998				1998			
Dec.31	To Depreciation Fund A/c.		31.720.80	Dec.31	By Profit and loss A/c.		31.720.80
1999				1999			
Dec.31	To Depreciation Fund A/c.		31.720.80	Dec.31	By Profit and loss A/c.		31.720.80

17.11. INSURANCE POLICY METHOD :

This is similar to the sinking fund method but, instead of investing the money in securities, the amount is used in paying premium on a policy taken out with an insurance company. The policy should mature immediately after the expiry of the useful life of the asset. The money that is received from the insurance company is used to replace the asset. Though the interest received is lower than could be obtained by investing in securities, the risk of loss on realization of securities is avoided. To be more conservative, some accountants are of the opinion that the policy account should be adjusted, at the year end, at its surrender value, because the policy is for a fixed sum and there is no intention of surrendering it.

The following are the journal entries passed under this method:

During the first and sebsequent years, except in the last year:

(a)	For payment of yearly premium	Rs.	Rs.
	Depreciation insurance policy A/c...........Dr.	xxx	
	To Bank a.c.		xxx
(b)	For yearly depreciation:		
	Depreciation A/c...................................Dr.	xxx	
	To Depreciation fund A/c.		xxx
	or		
	To Insurance fund A/c.		
(c)	For transfering to profit and loss A/c.		
	Profit and Loss A/c. ....Dr.	xxx	
	To Depreciation A/c.		xxx

During the last year:

(d)	For realisation of insurance policy:		
	Cash A/c..Dr.	xxx	
	To Depreciation insurance policy A/c.		xxx
(e)	For the excess amount transferred to depreciation fund account:		
	Depreciation insurance policy A/c...........Dr.	xxx	
	To Depreciation fund A/c.		xxx
	or		
	To Insurance fund A/c.		
(f)	For writing off the old asset:		
	Depreciation fund A/c ....Dr.	xxx	
	or		
	Insurance fund A/c.................................Dr.		
	To Old asset A/c.		xxx
(g)	For purchase of new asset:		
	New Asset A/c. .... Dr.	xxx	
	To Cash A/c.		xxx

Illustration-19:

On 1st January 1996, a lease of premises was purchased four years for Rs.1,00,000 and decided to make provision for the replecement of the lease by means of an insurance policy purchased for an annual premium of Rs.24,000. Show depreciation fund A/c. lease on premises A/c. and depreciation insurance policy A/c. for four years.

Solution:

Depreciation Fund Account or Insurance Fund A/c.

Dr.							**Cr.**
Date	**Particulars**	**L.F**	**Rs.**	**Date**	**Particulars**	**L.F.**	**Rs.**
1996				1996			
Dec.31	To Balance c/d		24,000	Dec.31	By Deprciation		24,000
			24,000				24,000
1997				1997			
Dec.31	To Balance c/d		48,000	Jan.1	By Balance c/d		24,000
				Dec.31	By Depreciation A/c.		24,000
			48,000				48,000
1998				1998			
Dec.31	To Balance b/d		72,000	Dec.31	By balance c/d		48,000
				Dec.31	By Depreciation A/c.		24,000
			72,000				72,000
1999				1999			
Dec.31	To Lease on premises A/c		1,00,000	Dec.31	By balance b/d		72,000
				Dec.31	By Depreciation A/c.		24,000
					By Depreciation insurance policy A/c.		4,000
			1,00,000.				1,00,000

Depreciation Insurance Policy Account

Dr. **Cr.**

Date	Particulars	L.F	Rs.	Date	Particulars	L.F.	Rs.
1996				1996			
Jan. 1	To cash A/c		24,000	Dec.31	By Balance c/d		24,000
1997				1997			
Jan. 1	To balance b/d		24,000	Dec.31	By Balance c/d		48,000
Jan. 1	To cash A/c		24,000				
			48,000				48,000
1998				1998			
Jan. 1	To balance b/d		48,000	Dec.31	By Balance c/d		72,000
Jan.1	To cash A/c		24,000				
			72,000				72,000
1999				1999			
Jan. 1	To balance b/d		72,000	Dec.31	By cash A/c		1,00,000
Jan.1	To cash A/c		24,000				
Dec. 31	To Depreciation Fund A/c		4,000				
			1,00,000				1,00,000

Lease on Premises Account

Dr. **Cr.**

Date	Particulars	L.F	Rs.	Date	Particulars	L.F.	Rs.
1996				1996			
Jan. 1	To cash A/c		1,00,000	Dec.31	By Balance c/d		1,00,000
1997				1997			
Jan. 1	To balance b/d		1,00,000	Dec.31	By Balance c/d		1,00,000
1998				1998			
Jan. 1	To balance b/d		1,00,000	Dec.31	By Balance c/d		1,00,000
1999				1999			
Jan. 1	To balance b/d		1,00,000	Dec.31	By Depreciation Fund A/c		1,00,000

17.12. SUM OF DIGITS METHOD :

This method is an improvement over written down value method. In this method also, the depreciation charge gets reduced year after year, but the depreciation is not calculated on the balance at the beginning of each year. Since a constantly declining rate is applied to the original cost (plus erection charges minus residual value, if any), the asset value is reducible to zero. Under this method, the individual years (in the asset's life) in reverse order is taken as numerator and the total life of the asset in years is taken as the denominator. The cost is multiplied with this factor.

For example: The cost of the asset to be depreciated is Rs.30,000. Life of the asset is 3 years.

Sum of the years=1+2+3=6 will be taken as denominator, individual years, i.e., 1, 2 & 3 (in reverse order) will be taken as numerator. Thus, depreciation to be charged in each of the years will be:

	Rs.		Rs.
1 st year	30,000 x	=	15,000
2 nd year	30,000 x	=	10,000
3 rd year	30,000 x	=	5,000

Illustration-20:

Sainath & Co., purchased a cold storage plant on January 1, 1996 for Rs.10,500 and spent Rs.500 on its erection. The asset is expected to last for 4 years, after which its break up value is estimated to be Rs.1,000. On 31st December, 1999 the plant was sold for Rs.850. Find out the amount of depreciation to be charged every year under sum of digits method and show the plant account for 4 years.

Solution:

Sum of the year=1+2+3+4=10 will be taken as denominator.

Individual years i.e., 1, 2, 3 & 4 (in reverse order) will be taken as numerator. Thus depreciation to be charged in each of the years will be:

Rs.	Rs.		Rs.
1st year [10,500+500-1,000]	10,000 x	=	4,000
2nd year	10,000 x	=	3,000

3rd year	10,000 x	=	2,000
4th year	10,000 x	=	1,000

Plant Account

Dr. **Cr.**

Date	**Particulars**	**L.F**	**Rs.**	**Date**	**Particulars**	**L.F.**	**Rs.**
1996				1996			
Jan. 1	To cash A/c		10,500	Dec.31	By Depreciatoin		4,000
"	To cash A/c. (erection charges)		500	"	By Balance c/d		7,000
			11,000				11,000
1997				1997			
Jan. 1	To Balance b/d		7,000	Dec.31	By Depreciation A/c.		3,000
					By Balance c/d		4,000
$\frac{2}{10}$			7,000				7,000
1998				1998			
Jan. 1	To Balance b/d		4,000	Dec.31	By Depreciation A/c.		2,000
					By Balance c/d		2,000
			4,000				4,000
1999				1999			
Jan. 1	To Balance b/d		2,000	Dec.31	By Depreciation A/c.		1,000
					By Cash A/c.		850
					By Loss on sale of asset A/c.		150
							2,000
			2,000				2,000

Depletion Method:

This method is specially suited to mines, quarries, oil-wells, timber stands etc., from which a certain quantity of out put is expected to be raised. For example, the value of a mine depends upon the quantity of mineral that is obtained. Hence, it can be said that the mine depreciates according to the quantity of mineral mined. It is advisable in such cases not to calculate the depreciation in terms of years. Rather it is most appropriate to compute the cost per unit by dividing the total cost with total qunatity of units that can be obtained and charge the depreciation every year based on the number of units obtained. For example, if the unit cost is Re.1 and in a year 1,000 units are obtained, the depletion value will be 1,000 units x Re.1 = Rs.1,000. The following illustration will clarify the position further:

Illustration-21:

Sai Timber Company acquired a timber tract for Rs.7,500 and spent Rs.1,500 on developing the tract. The tract was estimated to contain 5 lakh board feet of timber. It was estimated that the cut over land could to be sold for Rs.500.

Calculate the depletion charge if 50,000 board feet were cut in 1999.

Solution:

Depletion=

Depletion per 1000 Board Feet= x 50,000= Rs.850/-

For the year 1999 depletion (i.e., depreciation) is = 850/-

17.13. REVALUATION METHOD :

This method is also known as "inventory method". It is adopted where the assets to be depreciated consist of a large of small and diverse items of small unit cost. Example are loose tools, sacks, bottles etc., when there are large numbers of items of small value, too much clerical work will be necessary to maintain individual accounts.

Under this method, the asset in question are revalued at the end of every year. Usually the value at the end of the period will be less than at the beginning of the period. The difference, i.e., the fall in the value is charged as depreciation by debiting the profit and loss A/c. and crediting the asset A/c.. It may be noted that the depreciation amount is not accumulated and credited to depreciation fund account.

Illustration-22:

M/s. Raj Bros., has loose tools valued at Rs.10,000 on the 1st January 1999. On July 1, 1999 they purchased additional tools to the tune of Rs.6,000. On December 31, 1999 the entire stock of tools are revalued at Rs.11,000. Pass the necessary journal entries and show the asset account for 1999.

Solution:

Journal Entries

Date	Particulars	L.F	Dr. Amount . Rs.	Cr. Amount Rs.
1999				
Dec.31	Depreciation A/c...........Dr.		5,000	
	To Loos tools A/c			5,000
	(Being the depreciation on revaluation of loose tools written off)			
	Profit and Loss A/c.......Dr.		5,000	
	To Depreciaton A/c.			5,000
	(Being transfer of depreciaton to profit and loss A/c.)			

Loose Tools Account

Dr. **Cr.**

Date	Particulars	L.F	Rs.	Date	Particulars	L.F.	Rs.
1999				1999			
Jan. 1	To Balance b/d		10,000	Dec.31	By Depreciation A/c.		5,000
July . 1	To Cash A/c.		6,000	Dec.31	By Balance c/d		11,000
			16,000				16,000

17.14. MACHINE HOUR RATE METHOD

This method is useful in the case of machines. The life of machine is sometimes fixed in terms of number of hours it can work. Then the cost of the machine is divided by the estimated total number of hours the machine can work and the hourly rate of depreciation arrived at. This rate is multiplied with the number of hours the machine has worked in a given period, to arrive at the depreciation charged for that period. For example: a machine costing Rs.50,000 is expected to be used for 24,000 hours in all. It has a scrap value of Rs.2,000. Then the hourly rate of depreciation is

$$\frac{\text{Rs.50,000-Rs.2000}}{24{,}000} = \frac{48{,}000}{24{,}000} = \text{Rs.2}$$

If the machine has worked for 2,000 hours in a year total depreciation to be written off that year would be Rs.2 x 2,000 = Rs.4,000.

17.15. MILEAGE METHOD :

This method is used in the case of buses, cars, trucks, rolling stock etc., whose working life depends upon the number of kilometers they are driven. Suppose a car costing Rs.75,000 was purchased and its useful life was estimated to be 50,000 km. Then the rate of depreciation would be Rs.1.50 per km. During a given period if the car is driven for 10,000 km, the depreciation to be charged for that period will be 1.50 x 10,000= Rs.15,000.

17.16 QUESTIONS :

I. Short Answer Type:

1. Define depreciation. Explain the reasons for providing depreciation.
2. What are the causes of depreciation?
3. What is an annuity?
4. What is meant by sinking fund?

II.Essay Type:

1. What is depreciation? Why is it needed?
2. Define depreciation and explain the objectives and causes there of?
3. Discuss the various methods of depreciation
4. Why is the straight line method so called? What are its advantages and disadvantages?
5. What are the methods based upon diminishing balances? Discuss the differences between these methods in calculating depreciation?
6. What do you understand by the annuity method? How is it different from the depreciation fund method?

EXERCISES :

1. Sridhar & Co., purchased a machinery on January 1, 1996 at 72,000. The Scrap value in ten years time is expected to be Rs.17,000. If depreciation is written off by equal installments every December 31, show the machinery account for the first three years. Calculate rate of depreciation.

   [Ans: Balance at the end of third year Rs.55,500 rate 7.64%]

2. A machine was purchased on 1st January 1997. Depreciation was written off at 10 percent per annum on diminishing balance method. At the end of 1999 the depreciated value of asset was Rs.72,000. Find out the cost price of the asset.

   [Ans: Rs.1,00,000]

3. Prasad purchased machinery for Rs.60,000. The asset has estimated life of 10 years and the residual value of Rs.10,000. If depreciation has to be provided on straight line basis, what would be the annual depreciation to be provided in percentage terms?

[Ans: Rate of depreciation 10%]

4. On 1st January, 1996 Ganga purchased a plant for Rs.1,00,000. Rate of depreciation is 10% p.a. Prepare plant account for 4 years under strength line method of depreciation.

[Ans: Balance Rs.60,000]

Straight Line Method

1. A machinery was purchased on 1.1.1997 for Rs.3,00,000. 10% depreciation is to be calculated every year. Prepare machinery account for three years assuming the method of depreciation. (Calculation followed is diminishing balance method and straight line method.)

[Ans: S.L.M. balance Rs.2,10,000: D.B.M. balance Rs.2,18,700]

2. An asset was purchased for Rs.50,000 on 1st January 1996. What would be its value after 3years when the method of depreciation is straight line method and written down value method at the rate of 10% p.a. Prepare a ledger account.

[Ans: S.L.M. balance Rs.35,000, W.D.V. balance Rs.36,450]

3. On 1st January, 1996 Chandra purchased a machinery for Rs.80,000. Again on July 1, 1997 he purchased an additional machinery worth Rs.20,000. On 1st April, 1998 he bought another machinery for Rs.10,000. Accounts are closed 31st December every year. Write off depreciation @ 10% p.a. as per diminishing balance method. Prepare machinery account for first 3 years and find out the balance of machinery account as on 31.12.1998.

[Ans: Machinery A/c. balance as on 1.4.1999 Rs.84,670]

4. A truck costing Rs.40,000 was purchased on 1.1.1998 and used for two years. 10% depreciation was provided on diminishing balance method and sold for Rs.24,000 at the end of the second year. Show the truck account for two years.

[Ans: Loss on sale of Truck Rs.84,00]

5. A company purchased a plant for Rs.8,000 on January 1, 1995. It further spent on it for installation and other capital expeneses Rs.1,000. It was brought in use from Ist of May, 1995. You are required to draw the following ledger accounts for the first four years when the rate of depreciation is 10% p.a. on straight line method; (a) Asset account and (b) provision for depreciation account the accounts of the company are closed on December 31 each year.

[Ans: Provision for depreciation account credit balance Rs.3,300]

6. Madhu Ltd., purchased a machine on the 1st of March, 1996 for Rs.80,000 and spent Rs.4,000 on it erection, which was completed on 31.3.1996. The machine was put to use on 1.4.1996. If the machine is tobe depreciated under the fixed instalment method at Rs.8,400 per annum, show the asset account for the first 4 years.

[Ans: Balance Rs.52,500]

7. On 1.1.1996 Nitish bought a machine for Rs.42,000 and installed it by incurring Rs.4,000 towards installation expenses. On 1st July 1996 he purchased additional machinery worth Rs.24,000. On 31.12.1997 he sold the machinery purchased on 1st July 1996 for Rs.22,000. Nitish decided to write off depreciation @ 10% p.a. as per fixed instalment method. Prepare machinery account for 2 years assuming that the accounting year closes on 31st December every year.

[Ans: Machinery A/c. balance as on 1.1.1998 Rs.36,800]

8. Chakravarthi purchased a second hand machine for Rs.18,000 on 1st April, 1996. He spent Rs.2,000 on its overhaul and installation. Depreciation is written off at 10 per cent annum on the original cost. On 30th June 1999, the machine was found to be unstuitable and sold for Rs.8,000. Prepare the machine account from 1996 to 1999 assuming that the accounts are closed on 31st December every year.

[Ans: Loss on sale of machine Rs.5,500]

9. Ranga purchased on 1st January, 1998 a machine for Rs.6,000. On 1st July. 1998 he purchased another machine for Rs.5,000. On 1st July, 1999 he sold the machine purchased on 1st January 1998 for Rs.4,000. It was decided that depreciation @ 10% p.a. was to be written off every year under the diminishing balance method. Assuming the accunts were closed on 31st December every year, show the mahcine account for the year 1998 and 1999.

[Ans: Balance Rs.4,275]

10. On 1.1.1999, balance of machinery A/c. was Rs.48,600. On 1.7.1999, a new machinery was purchased for Rs.24,000, installment cost Rs.1,000. On 1.9.1999 machinery was sold for Rs.6,000. The original cost of the machinery sold was Rs.10,000 On 1.1.1997. Machinery is depreciated at 10% p.a. under the diminishing balance method. Show machinery A/c. for the year 1999. The books are closed on 31st December every year.

[Ans: Machinery A/c. balance Rs.60,200]

11. A limited company bought a machinery for Rs.12,000 on 1st January, 1997. On 30th June, 1998 another machinery was purchased for Rs.2,000. On 31st March, 1999 the company sold a machine from those acquired on 1st January 1997 costing Rs.500 (Actual price) for Rs.50 as it is found to be defective.

    On the same day another new machine is bought or Rs.800.

    Assuming that the depreciation is written off @ 15% p.a. as per diminishing balance method. Prepare machinery account for first 3 years.

[Ans: Machinery A/c. balance as on 1.1.2000 Rs.9,345]

Annuity Method

12. A Lease is purchased on 1st January 1996 for 5 years at a cost of Rs.50,000. It is proposed to depreciate the lease by annuity method charging 5% interest. A reference to the annuity table shows but to depreciate Re.1 by annuity method over 5 years, chrging 5% interest, the amount to be written off is 0.230975. Show the lease A/c. for five years.

13. A firm purchased a lease hold property for a period of five years for Rs.1,00,000 on 1.1.1995. It was decided to write off the lease by annuity method presuming the rate of interest 5% p.a. The annuity table shows that the annual amount necessary to write off Re.1 at 5% is 0.230975. You are required to prepare lease account for the five years show the net amount to be charged to profit and loss account for these five years.

14. Ram & Co., Ltd., acquired a seven-year lease for a sum of Rs.60,000. It is proposed to depreciate it under the annuity method after charging interest at 4% p.a. Reference to the annuity table indicated that 0.1666091 at 4% p.a. is required to write off Rs.1 in seven years. You are required to show lease account for the first five yers.

[Ans: Balance at the end of fifth year Rs.18,854.59]

15. A plant is bought on 1.1.1995 for a sum of Rs.1,00,000 which has got a useful life of 5 years. It is estimated that it will fetch a scrap value of Rs.16,000 at the end of 5 years. It is decided to charge depreciation according to depreciation fund method. The investments are expected to earn 5% interest. Sinking fund table shows that Rs.0.180975 invested yearly at 5% produces Re.1 at the end of 5 years.

    The investments are sold at the end of 5th year for Rs.64,000. The scrap realised Rs.17,000.

    Show the necessary accounts.

[Ans: Loss on sale of investments Rs.14002.49]

16. M. Ltd. purchased machnery costing Rs.25,000 on 1st January, 1995. The company establishes a depreciation fund, investment are expected to realize 4% interest and the expected life of the machinery is 10 years. Table shows that to produce Re.1 at the end of 10 years at 4%, an annual investment of Rs.0.08329 is required.

    At the end of fifth year the machinery has to be sold off as scrap. It realised Rs.7,000, investments were realized at 5% less then the book value. New machinery costing Rs.35,000 was purchased.

    Show the necessary accounts.

[Ans: Loss on sale of machinery Rs.7,163.93]

17. Ram & Co., purchased a four years lease an January 1, 1995 for Rs.50,000. It is decided to provide for the rental of the lease at the end of four years by setting up a depreciation fund. It is expected that investments will fetch interest at 4% p.a. Sinking fund table shows that 0.235490 invested each year will produce Re.1 at the end of four years at 4% p.a.

    On 31st December, 1998, the depreciation fund investments are sold for Rs.36,455.22. Prepare the necessary ledger accounts.

[Ans: Loss and sale of investments Rs.300.06]

Insurance Policy Method

18. A firm purchases a lease for 3 years for Rs.30,000 on 1.1.1996. It has decided to provide for its replacement by means of insurance policy for Rs.30,000. The annual premium is Rs.9,500. On 1.1.1999 the lease is renewed for a further period of three years for Rs.30,000. You are required to show the necessary ledger accounts.

[Ans: Profit on realisation of policy Rs.1,500]

19. Sri Ram has acquired manganese mines on payment of Rs.1,00,000 on 1st April, 1995. The lease period is five years. He proposes to provide for its replacement by means of an insurance policy for Rs.1,00,000. The annual premium is Rs.9,750. In 1st April, 2000 the lease is renewed for a further period of five years for the same amount. Show the necessary ledger accounts.

[Ans: Profit on the realisation of policy Rs.51,250]

Sum of Years Digits Method

20. Mahesh purchased an asset for Rs.8,400. Estimated life of the asset is 6 years, You are requested to open the asset account for the first three years when depreciation is charged by sum of years digit method.

[Ans: Balance at the end of third year Rs.2,400]

Depletion Method

21. Avinash Timber Co., acquired a timber tract for Rs.21,000 and spent Rs.1,000 on its development. The tract is estimated to contain 5 lakh board feet of timber, is expected that the cut over the land can be sold for Rs.2,000. Calculate the depletion per hundred board feet: and depletion if 80,000 board feet were cut in 1998.

[Ans: Rs.4 per 100 board feet Rs.3,200]

Revaluation Method

22. Rakesh Bearings Ltd., purchased tools on the 1st of January, 1997 for Rs.4,000. During the year additions were made to the extent of Rs.800. On the 31st December, 1997 the tools were valued at Rs.4,400 and at the end of 1998 at Rs.3,600. Prepare the loose tools account for 1997 and 1998.

[Ans: Depreciation under revaluation method 1st year Rs.400;

2nd year Rs.800]

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Lesson - 18

PROVISIONS AND RESERVES

OBJECTIVES:

By the study of this Chapter, you will be able to understand the classification of Reserves & Provisions. Secret Reserve, Provision for Bad & Doubtful Debts, Provision for Discount on Debtors & Creditors etc.,

STRUCTURE:

18.1 Introduction

18.2 Provisions and Reserves Distinguished

18.3 Classification of Reserves and Provisions

18.4 Secret Reserves

18.5 Provision for Doubtful Debts

18.6 Provision for Discount on Debtors

18.7 Provision for Discount on Creditors

18.8 Questions

18.9 Exercises

18.1. INTRODUCTION

'Reserves' refer to undistributed profits set aside for the purpose of meeting some liability, contingency of some other commitment. Creation of reserves reduces the profits available for distribution to the owners. The presence of reserves strengthens the financial position of the organisation. As they are created out of profits, reserves show a credit balance and posted on the liabilities side of the balance sheet. When a reserve is represented by some specific investment made outside the business, the word 'fund' is added to denote the same, however, when no such outside investment is made the account is merely called a reserve. The word 'provision' refers to the amounts set aside as a charge against the profits. Reserve and reserve funds, generally speaking, refer to amounts set apart out of the profits. The purpose of creating them may be any one of the following:

(i) For meeting future (anticipater anticipated) liabilities or losses; eg., provisions for repairs, provision for doubtful debts etc.,

(ii) For fulfilling some specific purpose e.g., equalisation of dividednd

(iii) For redemption of liabilities e.g., repayment of redeemable preference shares or debentures etc.,

(iv) For replacing assets e.g., depreciation fund for replacement of machinery, lease etc., and

(v) For strengthening the financial position of the organisation e.g., general reserve.

18.2. PROVISIONS AND RESERVES DISTINGUISHED :

Provisions :

The term, “provision”, refers to any amount retained for meeting any known liability or loss amount of the liability may not be accurately known. However, if the amount of the liability can be accuretely ascertained, it will be considered a liability and not a provision. The uncertainty regarding the amount makes it necessary to create some provision which makes it possible to meet any liability as and when it actually occurs. Thus, the provision made may be less than adequate or more than adequate to meet the actual purpose for which it has been created. However, as the amount of the estimated provision is based on what the most experience indicates, it should generally be sufficient to meet any liability or loses in respect thereof. The exmple of “provision” are provisions for depreciation; provision for doubtful debts; provision for taxation; provision for repairs and renweals; provision for contingencies etc.

Reserves :

The term “reserve” is used to denote any sum which is created by appropriating profit for the purpose of meeting any contingency commitment etc. Creation of reserves generally improves financial strength of the business concern. Usually, the amount represented by the reverse is retained within the business and thus adds to the working capital available for conducting the operations. Sometimes, the reserve amount is not invested within the business, but is taken out and invested outside the business e.g., purchase of securities. The purpose of investing the amount outside the business is to ensure that when the amounts are actually needed the outside securities can be readily disposed off and the amounts realised in cash. On the contrary, if the amounts are reinvested within the business, it may be difficult to have adequate cash readily available for meeting the particular purpose for which the reserve is created. Whenever, a reserve is represented by amounts invested outside the business, it is called “reserve fund”. Thus the suffix “fund” generally denotes the presence of specific outside investments.

Distinction :

The following are the important points of distinction between a provision and a reserve:

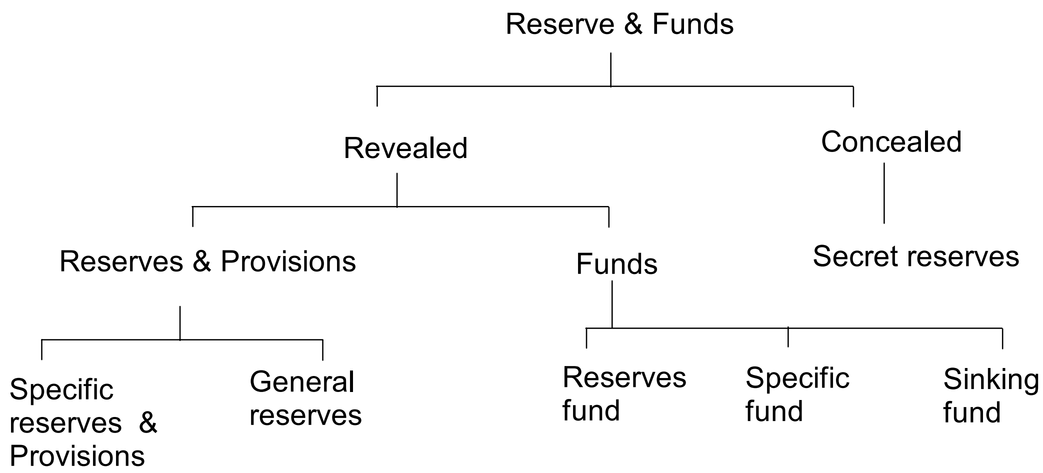
(1) A provision is a charge to the profit and loss A/c and is created whether profits exist or not. A reserve is an appropriation of profit. Which is otherwise available for distribution as dividends to owners, Provisions are created by debiting the profit and loss A/c before clculating the net profit or loss; reserves are created by debiting profit and loss appropriation A/c whch means that reserves can be created only when there are profits.

(2) Creation of provisions is usually a matter of necessity; but creation of reserves is a matter of business prudence.

(3) Provisions are generally shown as deductions from the concerned asset item on the asset side of the balance sheet. This helps the showing of asset items at the expected realisable values. Reserves are shown on the liabilities side of the balance sheet, but are not to be treated as a liability. Reserves represent accumulations from divisible profits which otherwise belongs to the owners and hence a part of the net profit.

18.3. CLASSIFICATION OF RESERVES AND PROVISIONS :

The reserves and funds may be created for a short or specified period or may remain in existence continuously for long periods. Further, such a reserve might have been created for meeting a know liability or for an unknown liability, i.e., contingency. Again the reserves created may be revealed in the books of accounts or may remain concealed. Keeping in view these points, the reserves and funds can be classified as follows:



The basic purpose of creating reserves and provisions is to meet with greater cofidence the uncertainties and unforeseen commitments that are natural in the conduct of any business.

Reserves can be classified as:

(i) Statutory reserves;

(ii) Capital reserves; and

(iii) Revenue reserves.

(i) Statutory Reserves: Statutory reserves are those whose creation has become an obligation on account of certain provisions in the relevant statues; e.g., statutory reserve required under the provisions of Section 17, Banking Companies Act, 1949.

(ii) **Capital Reserves:** Sometimes, a concern acquired certain capital profits. These capital profits cannot be considered to have been earned in the context of day to day trading operations and hence cannot be treated as readily available for distribution amongst the shareholders. When reserves are created out of such capital profits, they are called capital reserves. Examples of such reserves are; premium on the issue of shares and debentures; profits made on the reissue of foreited shares; profits, if any, earned prior to incorporation. Profit on sale of a part of the business profit on redemption of debentures etc.

(iii) **Revenue Reserves:** These are reserves which are created out of revenue surpluses only and are thus otherwise available for distribution as dividends to the share holders. Example of revenue reserves are general reserve, debebture redemption reserve, investment fluctuation reserve, contingency reserve, dividend equalisation reserve etc.

Reserve can also be classified as -

(a) General reserve, and

(b) Specific reserves.

(a) **Genral Reserves:** General reserves, as the name implies are not created for any specific purpose. Thus, they must be considered available for meeting unexpected future losses or any other contingencies. So long as the amounts are available, they can be utilized for financing the expansion of the business. Thus, they generally represent the provisions of additional working capital and help in strengthening the financial position of the business.

(b) **Specific Reserves:** Specific reserves are those which are created for a definite or specific purpose and are generally utilized to meet that definite purpose. Stirctly speaking, nothing prevents the owners from utilising the unspent balances on these reserves. But in practice, it is considered as a self imposed restriction and acts as a restrainst or check on making use of funds for any other purpose other than the originally intended one. Examples are dividend equalisation reserves and debenture redemption reserves.

Sinking Fund:

A Sinking fund is a fund that is created to have some money readily available at the end of a specific period for replacement of an asset or redemption of a liability.

18.4. SECRET RESERVES :

A secret reserve is a reserve whose existence is not revealed in the balance sheet. Thus, the amount with which the secret reserve exists is also not disclosed in the balance sheet. The creation of secret reserves is prohibited under the provisions of the Companies Act 1956 (except in the case of banks) such a prohibition is to ensure that all material facts regarding the financial position of the concern are fully disclosed or made known in the final accounts. Secret reserves are created in the following ways:

(i) By charging excessive depreciation: Though the asset is appearing at a very low or nominal value. The business continues to have the fullest advantage of the asset in question.

(ii) By undervaluing good will or stock in trade: Profits are understated and the real strength/ success of the concern remains concealed.

(iii) By creating certain accounts like provisions for bad debts with for larger amounts than are needed or warranted by circumstances. This step also results in the suppression of profits.

(iv) By charging capital expenditure as revenue expenditure to profit and loss account. Installation charges have to be capitalised along with the cost of machinery. But by writing them off to the profit and loss account the profits get understed and this measure results in the creation of secret reserves because the asset also now gets understated. Certain other measures that are resorted to for the creation of secret reserves can be stated as:

(a) suppressing the sales:

(b) showing some contingent liability as a real liability

(c) grouping certain free reserves along with creditors.

Advantages of Secret Reserves: Secret reserves are permitted only when it is important for the concern to enjoy the public confidence without interruption. The presence of secret reserves ensures the following advantages:

1. The financial position of the concern is strengthened.
2. As profits and financial position are both understated, the presence of secret reserves discourages potential competitors, thereby ensuring continuous market share and profits.
3. It helps to tide over unfavourable times i.e., lower profits in any year can be manipulated and the payment of a regular dividend becomes possible.

Objections to the Creation of Secret Reserves

1. As the method of creating secret reserves is by understating or omitting the assets and by overstating the liabilities, the balance sheet does not furnish a true picture of the financial position of the concern.
2. As the charging of excessive depreciation is one of the methods of creating secret reserves, the profit and loss account will not disclose the true profit earned and thus the published accounts do not reveal the correct position.
3. The presence of secret reserves may encourage mismanagement, conceal the inefficiency or cover up the manipulations by the management, as it is only they who are aware of the existence and size of the secret reserves.

Classification of Provisions :

The provisions may be classified as -

(i) Provision for doubtful debts, and

(ii) Provision for discount on debtors and creditors.

18.5. PROVISION FOR DOUBTFUL DEBTS :

When credit sales are made, some of the amounts might not have been realised by the end of the year and so would appear as sundry debtors. As both cash sales and credit sales (including the unrealised portion of credit sales) are taken on the credit side of the trading and profit and loss account. The profit is determined on accrual basis i.e., the porfit might have not yet been actually realised in cash and the profit figure represents “profit earned” and not “profit received or realised”. Further it is possible that all the sundry debtors may not pay the amounts due from them. When some of them become insolvent, either the whole amount may be lost or only a part of it is realised and thus the remaining part must be considered as bad debts. Business experience dictates that as the determination of the profits during the current year are based on the unrealised credit sales it would be prudent to set aside a part of the current year’s profits as provision for doubtful debts to meet the probable loss that might arise in the ensuring period on account of some of the debts becoming bad.

The creation of a provision for doubtful debts from out of the profits of an accounting period simultaneously achieves the following two purposes:

(a) Brings down the profits for the year to a more reasonable level;

(b) Helps the sundry debtors to appear at an expected realisable level on the assets side of the balance sheet.

It is true that no one can accuratley determine the actual loss that would arise in the next accounting period and that is why an estimate is made. The sundry debtors are classified into good and doubtful debtors and as regards the doubtful, the amount is estimated as a probable loss of account of bad debts. However for all practical purposes the provision to be made is given as a specified percentage of the total sundry debtor’s amount.

Accounting Treatment

			Rs.	Rs.
1.	For creating a provision for doubtful debts A/C.			
	Profit & Loss A/C	Dr	xxx	
	To provision for doubtful debts A/C			xxx
	(Being the provision for doubtful debts)			

2. When ever a bad debts occur the following entry is passed

Bad debts A/C	Dr	xxx	
To concerred debtors A/C		xxx	

(Being bad debts written off)

3. When a provision for doubtful debts account exists, the bad debts account balance is transferred to the provision account. The entry being-

Provision for doubtful debts A/C	Dr	xxx	
To Bad debtors A/C			xxx

(Being bad debts written off against the provision)

The debit balance on bad debts A/c represent the total loss on account of bad debts in that year, whereas the provision was created at the end of the previous year to meet bad debts losses that might arise from out of the sundry debtors receivable at the end of the year. Thus, if some debtors of the ccurent year also became bad during the current year then such bad debts losses also would get transfereed to the provisions for doubtful debts account. After transferrring bad debts to "provision for doubtful debts account". The provision for doubtful debts accunt may show;

(a) a credit balance, which means that the provision made last year is more than the loss incurred during the current year, or

(b) a debt balance indicating that the loss on account of bad debts is more than the provisions made.

After ascertaining the balance on the provision for doubtful debts account, debit or credit balance, the amount of provision required to be created the end of the year so as to be carreid forward to the next year, is again estimated. Now the balance on the provision for doubtful debts account is adjusted against the new provision required to be made. This implies that

(a) if a credit balance appears on the provision account (after transferring the bad debt losses) it would be compared with the provision required for the coming year usually. The available credit balance would be less than the amount required for the new provision. Hence for the difference which is needed to be provided , now the entry No.1 given above will be passed;

(b) if the credit balance appearing on the provision account is more than adequate to cover the provision for the coming year also leaving a balance, it would represent surplus, i.e., the provision made in the previous year is more than adequate to meet the combined amount of current years bad debts losses and the new provision required for the coming year. This surplus amout will be transferred back to the profit and loss account by means of the following entry

Provision for doubtful debts A/c Dr. To Profit and Loss A/c (Being the surplus amount credited back)			xxx

Though the surplus amount is credited back to profit and loss accounts till a new provision account exists and this new provision account has to be deducted from sundry debtors on the asset side of the balance sheet.

Illustration-1:

A Trader's book showed sundry Debtors as Rs.1,00,000 as on the 31st Dec. 1997. He has decided to open a provision for doubtful debts A/c at 5% on the debtors. During the year 1998 bad debts amounted to Rs.8,000; his sundry debtors on the 31st December 1998 was Rs.3,00,000; he wanted to continue maintaining a provision for doubtful debts account at 5% on debtors. During the year 1999 his bad debts amounted to Rs.3,000; his sundry debtors as on the 31st December 1999 was Rs.2,00,000; he desired to continue the policy of maintaining a provision account at 5% on Debtors.

Show the journal entries and the necessary ledger accounts and also how these items appear in the final accounts during the 3 years period.

Solution :

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Date	Particulars	L.f	Rs.	Rs.
1997				
Dec.31	Profit and loss A/C..........................Dr		5,000	
	To provision for doubtful debts A/C			5,000
	(Being the provision for doubtful debts)			
1998				
Dec.31	Bad debts A/C..........................Dr		8,000	
	To Sundry debtors A/C			8,000
	(Being bad debts written off)			
1998				
Dec.31	provision for doubtful debts A/C....Dr		8,000	
	To Bad debts A/C			8,000

(Being the transfer of bad debts)

1998			
Dec.31	Profit and loss A/C...................Dr	3,000	
	To Sundry debtors A/C		3,000
	(Being bad debts written off)		
1998			
Dec.31	Provision for doubtful debts A/C....Dr	3,000	
	To Bad debts A/C		3,000
	(Being the transfer of bad debts)		
1998			
Dec.31	Provision for doubtful debts A/C....Dr	2,000	
	To Profit and loss A/C		2,000
	(Being the transfer of surplus amount to profit and loss account the excess amount on provision account after meeting both the bad debt loss and the amount required for a new provision for the coming year.)		

LEDGER

Bad debts Account

Dr. **Cr.**

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
1998				1998			
	To sundry debtors A/C		8,000	Dec.31	By provision for doubtful debts A/C		8,000
			8,000				8,000
1999				1999			
	To sundry debtors A/C		3,000	Dec.31	By provision for doubtful debts A/C		3,000

Provision for Dobtful Debts Account

Dr.							Cr.
Date	**Particulars**	**L.F.**	**Rs.**	**Date**	**Particulars**	**L.F.**	**Rs.**
1997				1997			
Dec. 31	To Balance c/d		5,000	Dec.31	By P&L A/C		5,000
			5,000				5,000
1998				1998			
Dec.31	To bad debts A/C		8,000	Jan .1	By Balance b/d		5,000
Dec.31	To Balance c/d		15,000		By P&L A/C		18,000
			23,000				23,000
1999				1999			
Dec.31	To bad debts A/C		3,000	Jan .1	By Balance b/d		15,000
Dec.31	To P&I A/C		2,000				
Dec.31	To Balance c/d		10,000				
			15,000				15,000

Profit & Loss Account

Dr.							Cr.
Date	**Particulars**	**L.F.**	**Rs.**	**Date**	**Particulars**	**L.F.**	**Rs.**
1997							
	To provision for		5,000				
1998							
	To Bad debts 8,000 Provision required 15,000 23,000		5,000				

Less : Provision at the beginning 5,000	18,000			
		1999	By provision for doubtful debts at the beginning	15,000
			Less : Bad debts 3,000	
			Less:Provision requires 10,000 13,000	2,000

Balance sheet as on December 31, 1997

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Sundry debtors	1,00,000	
			Less : Provision for doubtful debts	5,000	95,000

Balance sheet as on December 31, 1998

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Sundry debtors	3,00,000	
			Less : Provision for doubtful debts	15,000	2,85,000

Balance sheet as on December 31, 1999

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Sundry debtors	2,00,000	
			Less : Provision for doubtful debts	10,000	1,90,000

Note: The bad debts entry will be passed whenever bad debts occur. Thus the bad debts appearing in the trial balance represent the amount already written off from the sundry debtors. Sometimes in addition to the debts given in the trial balance additional bad debts are given in the adjustments below the trial balance. This means the relevant entry for writing off the bad debts amount is required to be passed now. Thus, when the entry is passed, bad debts amount, given in the trial balance, will be increased by the additional bad debts given in the adjustments and the sum of sundry debtors given in the trial balance will stand decreased by the additional bad debts given in the adjustments. It is on this reduced balance of sundry debtors the required new provision has to be estimated.

In the illustration worked out above it was assumed that sundry debtors given is the amount after bad debts were written off. However, in order to show clearly the journal entries regarding the writing off bad debts, their transfer to provision A/c etc., the journal entries are given.

18.6. PROVISION FOR DISCOUNT ON DEBTORS :

Just as the expected bad debt losses are provided out of the year's profits, so also the estimated loss likely to arise on account of allowing of some cash discount as an incentive to encourage prompt payment to the debtors is created by having 'a Provision for discount on debtors A/c'. Broadly speaking, the treatment of provision for discount on debtors account is similar to that of provision for doubtful debts A/c. Some books usually refer to this item as 'Reserve for discount on debtors' eventhough it is appropriate to call it a provision. The point is that the provision for discount on debtors is always calculated after deducting the provision for doubtful debts from the sundry debtors. The following are the entries to be passed.

(i) When a provision for discount on debtors is created:

		Rs.	Rs.
Profit and Loss A/c....................	Dr.	xxx	
To Provision for discount on debtors			xxx
(Being the creation of a provision for discount)			

(ii) You are awre that cash discount will be allowed for prompt payment by the debtors. Whenever cash is received, the entry would be:

Cash A/c...................................	Dr.	xxx	
Discount A/c..............................	Dr.	xxx	
To Debtors A/c.			xxx
(Being the receipt of cash and discount allowed)			

(iii) The total discounts allowed during the year get posted from the cash book debit side to the debit of discount allowed account in the ledger. Now that a provision for discount on debtors account exists, the discount allowed account is transferred to the provision account by means of the following entry.

Provision for discount on debtors........	Dr.	xxx	
To Discount allowed A/c.			xxx
(Being the trasfer of discount allowed to provision A/c.)			

(iv) As explained in the context of provision for doubtful debts account the balance on provision for discount on debtors account, show either a credit balance representing excess provision or a debit balance thereby indicating that the provision is less than adequate to meet the loss. The provision required for the coming year will be estimated and the provision for discount on debtors account will have this amount appear on its debit side as 'To Balance c/d'. Now this provision account would reveal whether (a) any amount is required to be tranaferred from P & L A/c or (b) if any surplus is existing on the provision account, the amount required to be transferred to the P & L A/c.

(1) When situation (a) stated above exists:

		Rs.	Rs.
Profit & Loss A/c........................	Dr.	xxx	
To Provision for discount on debtors A/c			xxx
(Being the provision of the amount required for maintaining the new reserve after adjusting the loss on account of discount)			

(2) When situation (b) stated above exists:

Provision for discount on debtors A/c.....	Dr.	xxx	
To Profit and loss A/c.			xxx
(Being the transfer of excess amount on provision account after meeting the requirements of current years loss and the new provision required)			

18.7. PROVISION FOR DISCOUNT ON CREDITORS :

When timely payments are made by the trader to his creditors, he is likely to receive some discount which will be a gain to him. Thus, the amount of sundry creditors appearing at the end of the year may represent a higher amount than he is likely to pay in the coming year. The probable gain, estimated to be obtained, is taken into account by creating a 'Provision for discount on creditors A/c'. Except for the fact that this provision account represnets a debit balance in all other respects, the treatment is similar to what is explained above in the context of provision for discount on debtors account.

The following are the entries to be passed:

(i) When a provision for discount on creditors is created:

Provision for discount on creditors.......	Dr.	xxx	
To Profit & Loss A/c			xxx
(Being the creatio of provision for discount)			

(ii) You are aware that the creditors allows cash discount to trader when the latter makes prompt payment. Whenever cash is paid the entry would be:

Creditors..	Dr.	xxx	
To Cash A/c			xxx
To Discount A/c			xxx

(Being the payment of cash and discount received)

(iii) The total discount received during the year gets posted from cash book credit side to the credit of discount received account in the ledger. As a provision for discount on creditors account exists, the discount received account is transferred by means of the following entry:

Discount received A/c..........................	Dr.	xxx	
To Provision for discount on creditors A/c			xxx

(Being the transfer of discount received to provision A/c)

(iv) As explained earlier the balance on provision for discount on creditors A/c now shows either a debit balance signifying excess provision or a credit balance suggesting that the provision was less and that the gain made was more. The provision required for the coming year will be estimated and the provision for discount on creditors account will have this amount appear on its credit side as By Balance c/d. Now the provision A/c would reveal whether any amount is required (a) to be credited to profit and loss account or (b) to be debited to profit and loss account.

(1) When situation (a) stated above exists:

Provision for discount on creditors A/c...	Dr.	xxx	
To Profit and loss A/c			xxx

(Being the transfer of amount from provision A/c after taking care of the current year gain and the new provision made)

(2) When situation (b) stated above, exists:

Profit and loss A/c.....................	Dr.	xxx	
To Provision for discount on creditors A/c			xxx

(Being the transfer of excess amount from provision account to profit and loss A/c)

The following illustration shows a situation where the accounts of both provisions are maintained.

Illustration-2:

A trader's book showed the following balances on the 1st of January, 1998.

	Rs.
Provision for discount on debtors	3,000
Provision for discount on creditors	2,000

During the year 1998 discounts allowed by him amounted to Rs.5,000 and discounts received by him Rs.4,000. He finds that on the 31st of December 1998 his sundry debtors and creditors were Rs.2,00,000 and Rs.1,20,000 respectively. He decided to provide a provision for discount on both debtors and creditors at 2%. During the year 1999, discount allowed by him amounted to Rs.1,000 and discounts received by him, Rs.800. He finds that on the 31st of December 1999 his Sundry Debtors and Creditors stood at Rs. 1,00,000 and Rs.60,000 respectively. He decided to provide a provision for discount on both debtors and creditors at 2%.

You are required to show the journal entries and the provision for discount on debtors and creditors account besides indicating how these items appear in the final accounts during the two years.

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Date	Particulars	L.f	Rs.	Rs.
1998				
Dec.31	Provision for discount on debtors A/C..Dr		5,000	
	To Discount allowed A/C			5,000
	(Being the transfer of discount allowed to the provision A/c)			
Dec.31	Discount received.............................. .Dr		4,000	
	To Provision for discount on Creditors A/C			4,000
	(Being the transfer of discount received to the provision A/c)			
Dec.31	Profit and loss A/C		6,000	
	To Provision for discount on debtors A/C			6,000
	(Being the amount required for meeting the new provision and the excess of discounts allowed over the provision)			
Dec.31	Provision for discount on Creditors A/C...Dr		4,400	
	To Profit and loss A/C			4,400
	(Being the transfer of excess amount discounts received over the provision along with the new provision)			

Dec.31	Provision for discount on debtors A/C...Dr	1,000	
	To Discount allowed A/C		1,000
	(Being the transfer of discounts allowed to the provision A/c)		
Dec.31	Discount received.............................. .Dr	800	
	To Provision for discount on Creditors A/C		800
	(Being the transfer of discount received to the provision A/c)		
Dec.31	Provision for discount on debtors A/C...Dr	1,000	
	To Profit and loss A/C		1,000
	(Being the transfer of excess provision to the profit and loss A/c)		
Dec.31	Profit and loss A/C	400	
	To Provision for discount on creditors A/C		400
	(Being the transfer of excess provision to the P&L A/c)		

Note : Journal entries required for recording the discounts allowed and received have not been passed separately as these amounts are considered to have been passed through the cash book. Thus, only the entries required to transfer these sums to the respective provisions account have been shown above.

LEDGER

Discounts Allowed Account

Dr. **Cr.**

Date	Particulars	L.F	Rs.	Date	Particulars	L.F.	Rs.
1998				1998			
	To sundrys debtors A/C		5,000	Dec.31	By provision for discount on Debtors A/c.		5,000
			5,000				5,000

Date	Particulars	L.F	Rs.	Date	Particulars	L.F.	Rs.
1999				1999			
	To sundrys debtors A/C		1,000	Dec.31	By provision for discount on Debtors A/c.		1,000
			1,000				1,000

Discount Received Account

Dr. **Cr.**

Date	Particulars	L.F	Rs.	Date	Particulars	L.F.	Rs.
1998				1998			
Dec. 31	To Provision for discount on Creditors A/c		4,000	Dec.31	By sundry Creditors A/c		4,000
			4,000				4,000
1998				1998			
Dec.31	To Provision for discount on Creditors A/c		800	Dec.31	By sundry Creditors A/c		800
			800				800

Provision for Discount on Debtors Account

Dr. **Cr.**

Date	Particulars	L.F	Rs.	Date	Particulars	L.F.	Rs.
1998				1998			
Dec. 31	To Discount allowed A/c		5,000	Dec.31	By balance b/d		3,000
Dec. 31	To Balance C/d		5,000	Dec.31	By P& L A/c		6,000
			9,000				9,000

1999				1999			
Dec. 31	To Discount allowed A/c		1,000	Dec.31	By balance b/d		4,000
Dec. 31	To P& L A/c		1,000				
Dec. 31	To Balance C/d		2,000				
			4,000				4,000
				2000			
				Jan.1	By Balance b/d		2,000

Provision for Discount on Creditors Account

Dr. Cr.

Date	Particulars	L.F	Rs.	Date	Particulars	L.F.	Rs.
1998				1998			
Jan. 1	To Balance b/d		2,000	Dec.31	By Discount received A/c		4,000
Dec. 31	To P & L A/c		4,400	Dec.31	By Balance C/d		2,400
			6,400				6,400
1999				1999			
Jan. 1	To Balance b/d		2,400	Dec.31	By Discount received A/c		800
				Dec. 31	By P & L A/c.		400
				Dec.31	By Balance C/d		1,200
			2,400				2,400
2000							
Jan.1	To Balance b/d		1,200				

Dr. Date	Particulars		L.F	Rs.	Date	Particulars		L.F.	Rs. Cr.
1998					1998				
	To Provision for discount on					By Provision for discount			
	debtors A/c					on creditors A/c			
	Discount allowed	5,000				Discount received	4,000		
	Add : New Provision	4,000				Add : New provision	2,400		
		9,000					6,400		
	Less : Old provision	3,000		6,000		Less : Old provision	2,000		4,400
1999					1999				
	To Provision for discount					By Provision for discount			
	Creditors A/c					on Debtors A/c			
	Old provision	2,400				Old provision	4,000		
	Less : Discount received 800					Less : Discount allowed	1,000		
	Less : New provision 12,00	2,000		400			3,000		
						Less: New provision	2,000		1,000

Balance sheet as on December 31, 1998

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry debtors	1,20,000		Sundry debtors	2,00,000	
Less : Provision for discount on debts	2,400	1,17,600	Less : Provision for discount on debtors	4,000	1,96,000

Balance sheet as on December 31, 1999

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry Creditors	60,000		Sundry debtors	1,00,000	
Less : Provision for discount on Creditors	1,200	58,500	Less : Provision for discount on debts	2,000	98,000

18.8. QUESTIONS :

I. Short Answer Type

1. Explain the following :
   (a) Reserve Vs Provision
   (b) Secret reserve-statutory reserve
   (c) Define reserve state different types of reserves

II. Essay Type

1. Define reserve. Explain the purpose of creating different types of reserves.
2. What is reserve? Distinguish between a reserve and provision.
3. What is a secret reserve? How is it created? What are its advantages and limitations?
4. Distinguish between secret reserves and specific reserves.
5. Distinguish between general reserves and specific reserves.
6. Explain the accounting treatment concerning the maintenance of a provision for doubtful debts.

18.9 EXERCISES :

1. A businessman's books showed sundry debtors at Rs.10,00,000 as on the 31st December 1997, on which date he decided to maintain a provision for doubtful debts A/c at 5% on the debtors.

During the year 1998 his bad debts amounted to Rs.1,00,000. His sundry debtors stood at Rs.25,00,000 as on the 31st December, 1998. He desired to continue the provision for doubtful debts A/c at the same rate of 5% on debtors. During the year 1999 his debtors amounted to Rs.25,000. On the 31st December, 1999 his debtors stood at Rs.18,00,000. He desired to continue the provision A/c at 5%.

Give the journal entries and show the necessary ledger accounts, besides indicating how the relevent accounts would appear in the final accounts during the three year period.

(**Ans:** Amount debited to the profit and loss A/c in 1997 Rs.50,000; 1998 Rs.1,75,000) (Amount credited to P & L A/c in 1999 Rs.10,000)]

2. In the year 1997 the books of M/s. B.R. Ltd. showed bad debts to the true of Rs.30,000. The provisions for doubtful debts at the commencement of the year stood at Rs.40,000; The debtors stood at Rs.2,90,000. The firm adopts a policy of maintaining a provision for doubtful debts A/c at 5%.

   During the year 1998 bad debts amounted to Rs.40,000 and on 31st of December of the year debtors amounted to Rs.5,00,000.

   During the year 1999 bad debts were Rs.10,000 and the sundry debtors at the end of the year stood at Rs.1,00,000. The policy of maintaining a provision A/c was continued.

   Show the provision for doubtful debts A/c for all the three years and also show how this account appears in the profit and loss A/c and in the balance sheet.

   [Ans: Amount debited to P & L A/c in 1997 Rs.4,500 in 1998 Rs.50,500; Amount credited to P & L A/c in 1999 Rs.10,000]

3. The following is an extract of the trial balance of Grandlay Plastic Ltd.

Trial Balance	**Dr.** **Rs.**	**Cr.** **Rs.**
Sundry debtors	3,20,000	
Bad debts	8,000	
Provision for doubtful debts		9,000

Outside the trial balance, adjustments are given as under:

1. Write off further bad debts Rs.3,000
2. Maintain a provision for doubtful debts @5% on debtors.
3. Create a provision for discount on debtors at 2%

Write up necessary ledger accounts and show their position the profit and loss account and in the balance sheet.

[Ans: Amount debitd to P & L A/c towards provision for doubtful debts; Rs.17,850; Provisions for discount on debtors Rs.6,023)]

4. The following figures appear in the books of RRR and Bros.

1998		
Jan.1	Provision for discount on debtors	1,200
Dec.31	Discount allowed during the year	3,000
Dec.31	Debtors	80,000

It was desired to maintain a provision for discount on debtors at 2%.

Show the provision A/c and also indicate how it appears in the final accounts.

[Amount debited to P & L A/c Rs.3,400]

5. Provision for discount on creditors appears at Rs.1,000 on 1.1.98 inthe books of a trader. During the year 1998 he receives discounts to the extent of Rs.900. On Dec. 31, 1998 his creditors amounted to Rs.2,00,000. He desired to maintain a provision for discount A/c at 2% on the creditors.

Give the necessary journal entries and show how the provision A/c appears in the ledger and also in final A/cs.

[Ans: Amount credited to P & L A/c Rs.3,900]

6. The following balance were extracted from the books of a trader:

1998		
Jan.1	Provision for doubtful debts	10,000
Jan.1	Provision for discount on debtors	3,000
Jan.1	Provision for discount on creditors	2,000
Dec.31	Bad debts during the year	16,000
Dec.31	Discounts allowed during the year	5,000
Dec.31	Discounts received during the year	2,800
Dec.31	Sundry debtors	5,06,000
Dec.31	Sundry creditors	2,00,000

You are required to (i) write off further bad debts amounting to Rs.6,000; (ii) Maintain the provision for discount on debtors at 2% and (iii) maintain the provision for discount on creditors A/c at 1% (iv) maintain the provision for doubtful debts at 5% on sundry debtors.

Give journal entries and ledger accounts and show how these items appear in the final accounts.

[Ans: Amount to be debited to P & L A/c towards the provison for DD: Rs.37,000; provision for discount on drs: Rs.11,500; Provision for discounts on crs: Rs.2,800]

7. Atlas industries Ltd., maintains a provision for bad debts at 5% and provision for discout at 2% debtors. It also maintains a provision for discount on creditors at 2%. From the following particulars write up the provision A/c for all the three years. The floowing were the balances as on the 1st of January 1998.

	Rs.
Provision for bad debts	9,000
Provision for discount on debtors	8,000
Provision for discount on creditors	6,000

Other particulars are as follows:

Year	**Debtors** Rs.	**Creditors** Rs.	**Bad debts written off** Rs.	**Discount allowed** Rs.	**Discount received** Rs.
1998	2,00,000	2,00,000	5,000	6,000	5,000
1999	1,40,000	1,78,000	21,000	3,500	2,000
2000	1,70,000	1,52,000	6,000	7,000	4,600

Show also how the items would appear in the final accounts.

Ans.

	1998 P&L A/c		**1999 P&L A/c**		**2000 P&L A/c**	
	Debited	**Credited**	**Debited**	**Credited**	**Debited**	**Credited**
	Rs.	**Rs.**	**Rs.**	**Rs.**	**Rs.**	**Rs.**
Towards Prov. for DD	6,000	---	18,000	---	7,500	---
Towards Provision for discount on Debtors	1,800	---	2,360	---	7,570	---
Towards Provision for discount on Creditors	---	3,000	---	1,560	---	4,080

8. The provision for doubtful debts A/c in the books of M/s. Nirman Erectors Ltd., appeared at Rs.4,000 on the 1st of January 1997. The company dicided to maintain a provision of 5% on debtors towards doubtful debts end provisions for discount on debtors and creditors at 2% respectively. The following further information is available.

	1997 **Rs.**	**1998** **Rs.**	**1999** **Rs.**
Bad debts written off	500	2,000	4,000
Debtors at the end	60,000	80,000	1,00,000
Creditors at the end	50,000	75,000	80,000
Discount allowed	600	1,000	1,800
Discount received	5,000	1,100	1,600

You are required show the provision accounts for doubtful debts, discount of debtors, discount on creditors and also indicate how the items will appear in the profit and loss accounts and balane sheets of all the three years.

Ans.

	1997 P&L A/c Debited Rs.	Credited Rs.	1998 P&L A/c Debited Rs.	Credited Rs.	1999 P&L A/c Debited Rs.	Credited Rs.	
Towards Prov. for DD		---	500	3,000	---	5,000	---
Towards Provision for discount on Debtors		1,740	---	1,380	---	2,180	---
Towards Provision for discount on Creditors		---	6,000	---	1,600	---	1,700

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