

FOUNDATION

Paper 2

Fundamentals of Financial and Cost Accounting

Study Notes

SYLLABUS 2022



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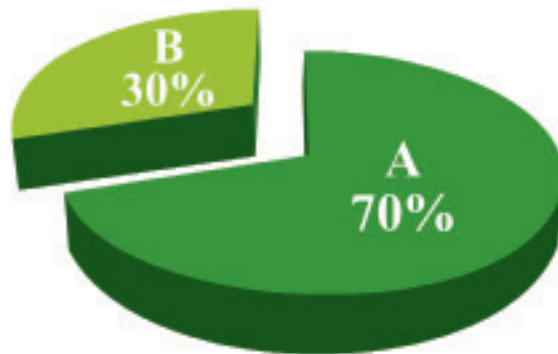
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PAPER 2: FUNDAMENTALS OF FINANCIAL AND COST ACCOUNTING

Syllabus Structure:

The syllabus in this paper comprises the following topics and study weightage:

Module No.	Module Description	Weight
Section A: Fundamentals of Financial Accounting		70%
1	Accounting Fundamentals	30%
2	Accounting for Special Transactions	15%
3	Preparation of Final Accounts	25%
Section B: Fundamentals of Cost Accounting		30%
4	Fundamentals of Cost Accounting	30%



Contents as per Syllabus

SECTION A: FUNDAMENTALS OF FINANCIAL ACCOUNTING	01 - 282
Module 1. Accounting Fundamentals	01 - 164
1.1 Understanding of Four Frameworks of Accounting (Conceptual, Legal, Institutional and Regulatory) and Forms of Organisation	
1.2 Accounting Principles, Concepts and Conventions	
1.3 Capital and Revenue Transactions - Capital and Revenue Expenditures, Capital and Revenue Receipts	
1.4 Accounting Cycle – Charts of Accounts and Codification Structure, Analysis of Transaction – Accounting Equation, Double Entry System, Books of Original Entry, Subsidiary Books and Finalisation of Accounts	
1.5 Journal (Day Books; Journal Proper – Opening, Transfer, Closing, Adjustment and Rectification Entries), Ledger	
1.6 Cash Book, Bank Book, Petty Cash Book, Bank Reconciliation Statement	
1.7 Trial Balance	
1.8 Adjustment Entries and Rectification of Errors	
1.9 Depreciation (Straight Line and Diminishing Balance methods only)	
1.10 Accounting Treatment of Bad Debts and Provision for Doubtful Debts	
Module 2. Accounting for Special Transactions	165 - 232
2.1 Consignment	
2.2 Joint Venture	
2.3 Bills of Exchange (excluding Accommodation Bill, Insolvency)	
Module 3. Preparation of Final Accounts	233 - 282
3.1 Preparation of Financial Statements of Sole Proprietorship	
3.1.1 Income Statement, Balance Sheet	
3.2 Preparation of Financial Statements of a Not-for-Profit Organisation	
3.2.1 Preparation of Receipts and Payments Account	
3.2.2 Preparation of Income and Expenditure Account	
3.2.3 Preparation of Balance Sheet	

Contents as per Syllabus

SECTION B: FUNDAMENTALS OF COST ACCOUNTING	283 - 324
Module 4. Fundamentals of Cost Accounting	285 - 324
4.1 Meaning, Definition, Significance of Cost Accounting, its Relationship with Financial Accounting	
4.2 Application of Cost Accounting for Business Decisions	
4.3 Definition of Cost, Cost Centre, Cost Unit and Cost Drivers	
4.4 Classification of Costs (with reference to Cost Accounting Standard 1)	
4.5 Ascertainment of Cost and Preparation of Statement of Cost and Profit (Cost Sheet)	

SECTION - A

**FUNDAMENTALS OF FINANCIAL
ACCOUNTING**

ACCOUNTING FUNDAMENTALS

1

This Module includes:

- 1.1 Understanding of Four Frameworks of Accounting (Conceptual, Legal, Institutional and Regulatory) and Forms of Organisation**
- 1.2 Accounting Principles, Concepts and Conventions**
- 1.3 Capital and Revenue Transactions - Capital and Revenue Expenditures, Capital and Revenue Receipts**
- 1.4 Accounting Cycle – Charts of Accounts and Codification Structure, Analysis of Transaction – Accounting Equation, Double Entry System, Books of Original Entry, Subsidiary Books and Finalisation of Accounts**
- 1.5 Journal (Day Books; Journal Proper – Opening, Transfer, Closing, Adjustment and Rectification Entries), Ledger**
- 1.6 Cash Book, Bank Book, Petty Cash Book, Bank Reconciliation Statment**
- 1.7 Trial Balance**
- 1.8 Adjustment Entries and Rectification of Errors**
- 1.9 Depreciation (Straight Line and Diminishing Balance Methods Only)**
- 1.10 Accounting Treatment of Bad Debts and Provision for Doubtful Debts**

ACCOUNTING FUNDAMENTALS

Module Learning Objectives:

After studying this Module, the students will be able to –

- ✦ Understand the four frameworks of accounting and various accounting concepts and conventions
- ✦ Understand how to distinguish Capital and Revenue Transitions
- ✦ Develop an idea about the Accounting Cycle and its various stages
- ✦ Learn about the recording of transactions in Journal and posting them to Ledgers
- ✦ Learn the preparation of Cash Book, Bank Book and Bank Reconciliation Statement
- ✦ Understand the use of Trial Balance and its preparation methodology
- ✦ Learn how adjustments and rectification entries are passed before finalization of accounts
- ✦ Learn accounting for Depreciation and Provision for Doubtful Debt

Understanding of Four Frameworks of Accounting and Forms of Organisation

1.1

● Introduction to Financial Accounting

A business is an economic activity undertaken with the objective of earning profits and to maximize the wealth of the owners. A business cannot run in isolation. Largely, the business activities are carried out by people coming together with a purpose to serve a common cause. This team is often referred to as an organization, which could be in different forms such as sole proprietorship, partnership, body corporate etc. The rules of business are based on general principles of trade, social values, and statutory framework encompassing national or international boundaries. While these variables could be different for different businesses, different countries etc., the basic purpose is to add value to a product or service in order to satisfy customer demand.

The business activities require resources (which are limited & have multiple uses) primarily in terms of material, labour, machineries, factories and other services. The success of business depends on how efficiently and effectively these resources are managed. Therefore, there is a need to ensure the businessman tracks the use of these resources. The resources are not free and thus one must be careful to keep an eye on cost of acquiring them as well. As the basic purpose of business is to make profit, one must keep an ongoing track of the activities undertaken in course of business. Two basic questions would have to be answered:

- (a) What is the result of business operations? This will be answered by finding out whether it has made profit or loss.
- (b) What is the position of the resources acquired and used for business purpose? How are these resources financed? Where the funds come from?

The answers to these questions are to be found continuously and the best way to find them is to record all the business activities. However, recording of business activities has to be done in a scientific manner so that they reveal correct outcome. The science of book-keeping and accounting provides an effective solution in this respect. It is basically a branch of social science.

● Definition of Accounting

According to the American Institute of Certified Public Accountants (Year 1961), accounting is the “art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the result thereof”.

According to the American Accounting Association (Year 1966), accounting is “the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by the users of accounting”.

● **Objectives of Accounting**

(i) **Providing Information to the Users for Rational Decision-making**

The primary objective of accounting is to provide useful information for decision-making to stakeholders such as owners, management, creditors, investors, etc. Various outcomes of business activities such as costs, prices, sales volume, value under ownership, return on investment, etc. are measured in the accounting process. All these accounting measurements are used by stakeholders (owners, investors, creditors/bankers, etc.) in course of business operation. Hence, accounting is identified as ‘language of business’.

(ii) **Systematic Recording of Transactions**

To ensure reliability and precision for the accounting measurements, it is necessary to keep a systematic record of all financial transactions of a business enterprise which is ensured by bookkeeping. These financial records are classified, summarized and reported in the form of accounting measurements to the users of accounting information i.e., stakeholders.

(iii) **Ascertainment of Results of above Transactions**

‘Profit/loss’ is the core accounting measurement. It is measured by preparing Profit and Loss Account for a particular period. Various other accounting measurements such as different types of revenue expenses and revenue incomes are considered for preparing this Profit and Loss Account. Difference between these revenue incomes and revenue expenses is known as result of business transactions identified as profit/loss. As this measure is used very frequently by stockholders for rational decision making, it has become the objective of accounting to provide such information. For example, Income Tax Act requires that every business should have an accounting system that can measure taxable income of business and also explain nature and source of every item reported in Income Tax Return.

(iv) **Ascertainment of Financial Position of Business**

‘Financial position’ is another core accounting measurement. Financial position is identified by preparing a statement of ownership i.e., Assets and Owings i.e., liabilities of the business as on a certain date. This statement is popularly known as Balance Sheet. Various other accounting measurements such as different types of assets and different types of liabilities as existed at a particular date are considered for preparing the balance sheet. This statement may be used by various stakeholders for financing and investment decision.

● **Functions of Accounting**

The functions of accounting are as follows:

- (a) Identification of monetary transactions and events;
- (b) Measurement of the identified transactions and events;
- (c) Recording of such transactions;
- (d) Classifying and summarizing of the recorded transactions;
- (e) Obtaining the results of operations and determination of financial state of affairs;
- (f) Analysing and interpreting the results and position to help in decision-making;
- (g) Communicating such information to the users (both internal and external).

- **Book Keeping**

As defined by Carter, ‘Book-keeping is a science and art of correctly recording in books of accounts all those business transactions that result in transfer of money or money’s worth’.

It is an activity concerned with recording and classifying financial data related to business operation in order of its occurrence. Its primary objective is to maintain systematic recording of transactions on a regular basis. It is a concept narrower than accounting.

- **Accountancy**

Accountancy is the discipline that incorporates certain principles or rules of accounting. It refers to the entire body of the theory and practice of accounting. It is a concept wider than accounting.

Thus, while Book-keeping is a subset of accounting, Accounting, in turn, is a part of Accountancy.



Figure 1.1: Relation between Book Keeping, Accounting and Accountancy

1.1.1 Understanding of Four Frameworks of Accounting (Conceptual, Legal, Institutional and Regulatory)

- **Framework of Accounting**

According to Collins Dictionary, the term ‘framework’ refers to ‘a structure that forms a support or frame for something’. In the context of any system, it is ‘a particular set of rules, ideas, or beliefs which you use in order to deal with problems or to decide what to do’.

In accounting, ‘framework’ provides a common set of rules and guidelines that is used to measure, recognize, present, and disclose the information appearing in an entity’s financial statements.

- **Four Frameworks of Accounting**

The framework of accounting has four pillars – Conceptual, Legal, Institutional and Legal. These are discussed below.

(a) **Conceptual Framework**

The Conceptual Framework is a body of interrelated objectives and fundamentals. The objectives identify the goals and purposes of financial reporting and the fundamentals are the underlying concepts that

help achieve those objectives. Those concepts provide guidance in selecting transactions, events and circumstances to be accounted for, how they should be recognized and measured, and how they should be summarized and reported. It states the objectives of General-Purpose Financial Reporting and the information provided by it. Conceptual Framework also guides on the qualitative characteristics that the financial statements must possess.

Conceptual Framework often plays an important role in the development of Institutional Framework and assists preparers to develop consistent accounting policies when no accounting standard applies to a particular transaction or other event, or when a standard allows a choice of accounting policy.

(b) Legal Framework

Businesses are often controlled by various statutes under which they are formed. For example, in India, partnership organisations are governed by Indian Partnership Act, 1932 or Limited Liability Partnership Act, 2008, co-operatives are controlled by the Co-operative Societies Act, 1912, companies are governed by the Companies Act, 2013. In addition, banks are controlled by Banking Regulation Act, 1949, insurance companies are under the Insurance Act, 1938, electricity companies are also governed by the Central Electricity Act, 2003. All these statutes (including various Rules framed under them) not only govern the administrative set up of these organisations, but also provide important guidelines regarding use of resources, financing and also on the maintenance of books of accounts and treatment of specified transactions. For example, the Companies Act, 2013 and Companies (Accounts) Rules, 2014 provide useful provisions on maintenance of accounting records, accounting for issue and redemption of securities, investments to be done, consolidation and even winding up of the company. Companies (Corporate Social Responsibility) Rules, 2014 provides the guidelines regarding accounting of CSR expenses as well as carry forward and set-off of excess amount spent. Thus, legal framework plays an important role in accounting. The Schedules of this Act also provide important guidelines on the form and contents of financial statements.

(c) Institutional Framework

Institutional framework refers to the guidelines issued in form of certain pronouncements by institutions entrusted by the sovereign authorities to oversee the development of the respective field. In India, the Institute of Chartered Accountants of India has been entrusted to develop standards in the field of accounting to ensure comparability and consistency in accounting information. The Indian Accounting Standard Board of ICAI thus develops quality accounting standards on different areas of accounting. Currently, there are two sets of accounting standards in India – Accounting Standards as per Companies (Accounting Standards) Rules, 2021 and Ind ASs under Companies (Indian Accounting Standards) Rules, 2015. In addition, the Cost Accounting Standards Board (CASB) of the Institute of Cost Accountants of India has, so far, developed 24 Cost Accounting Standards to facilitate cost accounting and reporting.

(d) Regulatory Framework

The activities of organisations often come under the regulatory ambit of various regulators. In India, there are different regulatory authorities in different segments of financial market, such as RBI in money market operations, SEBI in capital market operations, IRDAI in insurance sector, PFRDA in pension funds. In addition, there are Telecom Regulatory Authority of India (TRAI), Competition Commission etc. The regulations imposed by these authorities may also have important bearing on accounting of a concerned entity. For example, regulations issued by SEBI largely shape the accounting and, more importantly, reporting by a listed firm in India. Similarly, regulations framed by IRDAI affect the accounting and reporting in insurance companies. In banking, BASEL Norms and other guidelines issued by RBI largely determine the accounting of NPA (Non-Performing Assets). Central Electricity Regulatory Commission

(Terms and Conditions of Tariff) Regulations, 2009 affect the determination of tariff and accounting in an electricity company in India.

The above four frameworks provide the foundation on which accounting and more specifically corporate accounting is based in India. They help to streamline the accounting process and help to improve the quality of the reports generated and thereby contribute in the overall development of accounting.

1.1.2 Forms of Organizations

Among many other factors, the form of organisations contributes a lot in designing the accounting system and policies. Various business forms are often the result of one or more laws and the provisions stated therein governs the accounting as has been explained in the Legal Framework of Accounting. The form of an organisation determines the books to be kept, mode of maintenance of accounts, the components of financial statements and also the extent of disclosure of various information through financial statements. For example –

- (a) The sole proprietorship organisations are least regulated in India. They normally do not have any specific legislation to govern accounting requirements. However, in case their annual turnover exceeds a certain limit they may be subject to some other legislation such as the Income Tax Act, 1961.
- (b) The partnership firms are regulated by the Partnership Act, 1932 and also the Contract Act, 1872. In case, the firm does not have clear provisions in the Partnership Contract, the Partnership Act, 1932 decides on sharing profits and losses, deciding partner's claims such as remuneration and also on interest on loan.
- (c) Operations including some aspects of accounting are strictly governed by Limited Liability Partnership Act, 2008 for LLPs.
- (d) Accounting and reporting are highly regulated by the Companies Act, 2013 for Indian companies.

A common example that may be cited in this respect is the components of financial statements in different forms of business (see the following Table).

Sole Proprietorship	Partnership	LLP	Company
<ul style="list-style-type: none"> • Manufacturing/ Trading A/c • Profit and Loss A/c • Balance Sheet 	<ul style="list-style-type: none"> • Manufacturing/ Trading A/c • Profit and Loss A/c • Profit and Loss Appropriation A/c • Balance Sheet 	<ul style="list-style-type: none"> • LLP Profit & Loss A/c • LLP Balance Sheet 	<ul style="list-style-type: none"> • Statement of Profit and Loss • Balance Sheet • Cash Flow Statement • Statement Showing Changes in Other Equity

Table 1.1 Components of Financial Statements as per the business forms

Thus, it appears that forms of businesses or more specifically, the legislation forming such organisations plays a vital role in determining the form, contents of accounting reports as well as treatment of certain accounting transactions.

Accounting Principles, Concepts and Conventions

1.2

1.2.1 Introduction

One of the main objectives of accounting is to help users to take appropriate decisions by providing relevant accounting information. For this purpose, accounting maintains records of the each and every transaction in its books of accounts. The practice of this record keeping, however, may be based on diverse policies at various organisations. As a result, there is limited scope for comparing accounting information across entities over the time.

In order to ensure uniformity and consistency in record keeping and produce accounting information which is largely comparable, the accounting profession has developed rules, conventions, standards, and procedures which are generally accepted and universally practiced. This common set of rules, conventions, standards, and procedures is referred to as Generally Accepted Accounting Principles (GAAP).

The GAAPs provide the guidelines for reporting economic events and are thus, used by organisations in drafting their financial statements. These are followed by organisations so that the users of accounting information have an optimum level of consistency in the financial statements they use while comparing such information over time and across entities for decision purpose.

Such accounting principles have been developed from research, accepted accounting practices, and pronouncements of regulators.

In India, financial statements are prepared on the basis of accounting standards issued by the Institute of Chartered Accountants of India (ICAI) and the law laid down in the respective applicable statutes (like, Schedule III to Companies Act, 2013 is required to be followed by all companies). These accounting standards as well as rules prescribed under various statutes have the GGAP at their core.

1.2.2 Accounting Principles – Accounting Concepts and Accounting Conventions

Accounting principles refer to those rules of action that are universally adopted by the accountants for recording accounting transactions. They provide the guidelines for recording and reporting transactions and as such provide explanations to the current accounting practices.

Accounting principles can be further classified into (A) Accounting Concepts and (B) Accounting Conventions.

A. Accounting Concepts: Accounting concepts refer to the assumptions and conditions that define the parameters and constraints within which the accounting operates. They lay down the foundation for accounting principles, and ensure recording of financial facts on sound bases and logical considerations. The common accounting concepts include:

- (a) Entity concept

- (b) Going concern concept
- (c) Periodicity concept
- (d) Money measurement concept
- (e) Accrual concept
- (f) Dual aspect concept
- (g) Matching concept
- (h) Realisation concept
- (i) Cost concept

B. Accounting Conventions: Accounting conventions are customs and traditions associated with the practical application of accounting principles. These are widely accepted, and are the common practices which are used as guidelines when transactions are recorded. These have evolved over time out of different accounting practices. These conventions are also known as doctrine. The different accounting conventions include the following:

- (a) Convention of Conservatism
- (b) Convention of Consistency
- (c) Convention of Materiality
- (d) Convention of Full disclosure.

These accounting concepts and conventions are discussed in the following section.

1.2.2.1 Accounting Concepts

- (a) **Business Entity Concept:** This concept assumes that, for accounting purposes, the business enterprise and its owners are two separate independent entities. Thus, the business and personal transactions of its owner are separate. For example, when the owner invests money in the business, it is recorded as liability of the business to the owner. Similarly, when the owner takes away from the business cash/goods for his/her personal use, it is not treated as business expense.
- (b) **Going Concern Concept:** Accounting assumes that business will continue to operate for a longer period of time in future. In other words, it is assumed that neither there is any intention nor necessity to curtail the business operations of entity. It is on this basis that financial statements of a business entity are prepared and referring to which investors agree upon their decision to invest in the business.
- (c) **Periodicity or Accounting Period Concept:** Accounting period concepts assumes that the infinite life of an organisation can be split into smaller periods of equal duration (viz. a quarter, half-year or year). Due to this concept, the operating results are ascertained for a specific period, the financial position is reflected (through the balance sheet) at regular intervals.
- (d) **Money Measurement Concept:** A business transaction will always be recorded if it can be expressed in terms of money. The advantage of this concept is that different types of transactions could be recorded as homogenous entries with money as common denominator. A business may own ₹3 Lacs cash, 1500 kg of raw material, 10 vehicles, 3 computers etc. Unless each of these is expressed in terms of money, we cannot find out the assets owned by the business. When expressed in the common measure of money, transactions could

be added or subtracted to find out the combined effect. In the above example, we could add values of different assets to find the total assets owned.

- (e) **The Accrual Concept:** The accrual concept is based on recognition of both cash and credit transactions. In case of a cash transaction, owner's equity is instantly affected as cash either is received or paid. In a credit transaction, however, a mere obligation towards or by the business is created. When credit transactions exist (which is generally the case), revenues are not the same as cash receipts and expenses are not same as cash paid during the period.
- (f) **Dual Aspect Concept:** Dual aspect is the foundation or basic principle of accounting. It provides the very basis of recording business transactions in the books of accounts. This concept assumes that every transaction has a dual effect, i.e., it affects two accounts in their respective opposite sides. Therefore, the transaction should be recorded at two places. It means, both the aspects of the transaction must be recorded in the books of accounts. For example, goods purchased for cash has two aspects which are (i) Giving of cash (ii) Receiving of goods. These two aspects are to be recorded. Thus, the duality concept is commonly expressed in terms of fundamental accounting equation:

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

- (g) **Matching Concept:** This concept states that the revenues and expenses must be recorded at the same time at which they are incurred. In general, the revenues earned should be with the expenses incurred during the accounting period. For the application of this concept several adjustments are made for prepaid expenses, accrued incomes, etc. The operating result of an accounting period can be measured only when incomes are compared with the related expenses incurred.
- (h) **Realisation Concept:** This concept states that revenue from any business transaction should be included in the accounting records only when it is realised. The term realisation means creation of legal right to receive money. Selling goods is realisation, receiving order is not. Accordingly, revenue is said to have been realised when cash has been received or right to receive cash on the sale of goods or services or both has been created.
- (i) **Cost Concept:** Accounting cost concept states that all assets are recorded in the books of accounts at their purchase price, which includes cost of acquisition, transportation and installation and not at its market price. It means that fixed assets like building, plant and machinery, furniture, etc are recorded in the books of accounts at a price paid for them. For example, a machine was purchased by XYZ Limited for ₹5,00,000, for manufacturing shoes. An amount of ₹1,000 were spent on transporting the machine to the factory site. In addition, ₹2,000 were spent on its installation. The total amount at which the machine will be recorded in the books of accounts would be the sum of all these items i.e., ₹5,03,000. This cost is also known as historical cost. The effect of cost concept is that if the business entity does not pay anything for acquiring an asset this item would not appear in the books of accounts.

1.2.2.2 Accounting Conventions

- (a) **Convention of Conservatism:** This convention is based on the principle that "Anticipate no profit, but provide for all possible losses". It provides guidance for recording transactions in the books of accounts. It is based on the policy of playing safe in regard to showing profit. The main objective of this convention is to show minimum profit. Profit should not be overstated. If profit shows more than actual, it may lead to distribution of dividend out of capital. This is not a fair policy and it will lead to the reduction in the capital of the enterprise.
- (b) **Convention of Consistency:** The convention of consistency means that same accounting principles should be used for preparing financial statements year after year. A meaningful conclusion can be drawn from financial statements of the same enterprise when there is comparison between them over a period of time. But this can be possible only when accounting policies and practices followed by the enterprise are uniform and

consistent over a period of time. If different accounting procedures and practices are used for preparing financial statements of different years, then the result will not be comparable.

- (c) **Convention of Materiality:** The convention of materiality states that, to make financial statements meaningful, only material fact i.e., important and relevant information should be supplied to the users of accounting information. The question that arises here is what is a material fact. The materiality of a fact depends on its nature and the amount involved. Material fact means the information of which will influence the decision of its user.
- (d) **Convention of Full Disclosure:** Convention of full disclosure requires that all material and relevant facts concerning financial statements should be fully disclosed. Full disclosure means that there should be full, fair and adequate disclosure of accounting information. Adequate means sufficient set of information to be disclosed. Fair indicates an equitable treatment of users. Full refers to complete and detailed presentation of information. Thus, the convention of full disclosure suggests that every financial statement should fully disclose all relevant information.

Accounting principles - concepts and conventions – lie at the core of accounting profession as they bring about the much sought-after uniformity in the process of recording transactions. Such uniformity makes it possible to reliably compare the financial performance, financial position, and cash flows across entities and also across the reporting periods. They contribute a lot in standardising the financial reporting process.

Capital and Revenue Transactions

1.3

• Concept of Transactions

Accounting is all about recording transactions in the books of accounts of an organization in order to determine the financial performance and financial state of affairs at regular periodic interval.

A transaction is an event which can be expressed in monetary terms and brings change in the financial position of a business unit. For example, investing capital in the business, purchasing goods for resale, paying remuneration to employees etc. all are transactions as these events lead to change in the financial position of the organization. On the other hand, using a new material in production, appointment of a new manger etc. are only event as they do not change the financial position of the entity.

• Capital and Revenue Transactions – Need for Distinction

Appropriate distinction between capital and revenue transactions lies at the core of accounting and helps in achieving its objectives as stated above. The very act requires application of the accounting concepts of periodicity, accrual and matching.

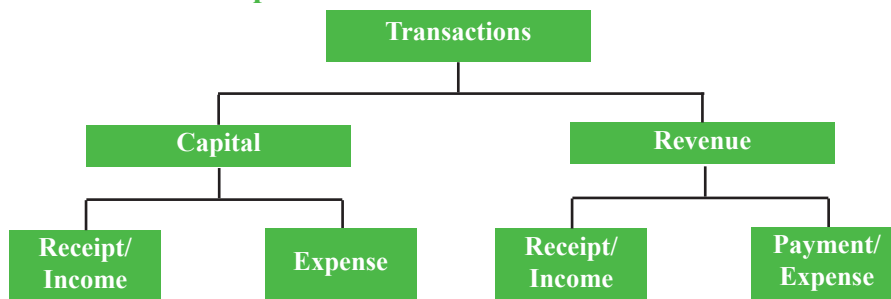
When transactions are appropriately classified into capital and revenue nature, it serves a number of purposes as follows:

- The distinction ensures proper accounting of transactions by identifying them as income or liability, and expense or asset;
- It helps determining the profitability of the operations of the entity through correct identification of income and expenses.
- It facilitates assessing the financial state of affairs through correct identification of assets and liabilities.

• Capital and Revenue Transactions

Capital Transactions are transactions having long-term effect while Revenue Transactions are transactions having short term effect. Each of these transactions can again be either a receipt or an expenditure.

1.3.1 Capital and Revenue Expenditure



Capital Expenditure refers to that expenditure benefit from which can be enjoyed by an entity over a number of accounting periods. This type of expenditure happens to be non-recurring in nature. A capital expenditure takes place when an asset or service is acquired or improvement of a fixed asset is affected. These assets resulting from such expenditure are not intended for resale in the ordinary course of business.

A capital expenditure has the following characteristics:

- (a) The amount involved in such an expenditure is generally large;
- (b) The benefit accruing from such an expenditure is consumed over more than one accounting period;
- (c) The expenditure is non-recurring in nature;
- (d) It results in an increase in value of fixed assets.

Examples of capital expenditure include purchase of machinery, construction of a plant, significant repairs to a fixed or non-current assets that significantly increases its life etc.

Revenue Expenditure refers to that expenditure benefit from which can be enjoyed by an entity in the current accounting period. This type of expenditure happens to be recurring in nature. Revenue expenditures are incurred to carry on the regular course of operations by an organization.

A revenue expenditure has the following characteristics:

- (a) The amount involved in such an expenditure is generally small;
- (b) The benefit accruing from such an expenditure is consumed within one accounting period;
- (c) The expenditure is recurring in nature;
- (d) It is incurred in relation to trading activities (i.e., either for purchase or sale of goods or for providing services).

Examples of revenue expenditure include purchase of goods for resale, payment of salaries, rent, regular maintenance of fixed assets etc.

Accounting Treatment of Capital and Revenue Expenditure

An expenditure of capital nature is not written off completely (i.e., charged) against income in the accounting period in which it is acquired. Rather, it is capitalized i.e., recorded as an asset. However, over time the amount of capital expenditure is recognized as revenue expenditure i.e., it gets gradually charged against the profit in a systematic manner reflecting the benefits consumed out of it. For example, the acquisition of a machinery is a capital expenditure, but charging regular depreciation on this machinery is a revenue expenditure.

An expenditure of revenue nature charged as an expense against profit of the accounting period in which it is incurred or recognised.

Distinction between Capital and Revenue Expenditure

Following are the major differences between capital expenditure and revenue expenditure:

Capital Expenditure	Revenue Expenditure
1. The economic benefits of this expenditure are consumed over a number of accounting periods.	1. The economic benefits from revenue expenditure are consumed within one accounting period.
2. It is non-recurring in nature.	2. It is recurring in nature.
3. The amount involved in such an expenditure is generally large.	3. The amount involved in such an expenditure is generally small.
4. It is reflected in the Balance Sheet.	4. It is debited to Income Statement.

5. Capital expenditures are not matched against capital receipts.	5. Revenue expenditures are not matched against revenue receipts
6. It may be incurred before or after the commencement of operations of an entity.	6. It is always incurred after the commencement of operations of an entity.
7. It tends to increase the earning capacity or, reduce the operating expenses of an entity.	7. It helps in carrying on the activities in the current accounting period.

● Rules for Determining Capital Expenditure

An expenditure can be recognized as capital if it is incurred for the following purposes:

- An expenditure incurred for the purpose of acquiring long term assets (useful life is at least more than one accounting period) for use in business to earn profits and not meant for resale, will be treated as a capital expenditure. For example, if a second-hand motor car dealer buys a piece of furniture with a view to use it in business; it will be a capital expenditure. But if he buys second hand motor cars, for re-sale, then it will be a revenue expenditure because he deals in second hand motor cars.
- When an expenditure is incurred to improve the present condition of a machine or putting an old asset into working condition, it is recognized as a capital expenditure. The expenditure is capitalized and added to the cost of the asset. Likewise, any expenditure incurred to put an asset into working condition is also a capital expenditure.
- For example, if one buys a machine for ₹ 5,00,000 and pays ₹ 20,000 as transportation charges and ₹ 40,000 as installation charges, the total cost of the machine comes up to ₹ 5,60,000. Similarly, if a building is purchased for ₹ 1,00,000 and ₹ 5,000 is spent on registration and stamp duty, the capital expenditure on the building stands at ₹ 1,05,000.
- If an expenditure is incurred to increase earning capacity of a business, it will be considered as capital expenditure. For example, expenditure incurred for shifting the factory for easy supply of raw materials. Here, the cost of such shifting will be a capital expenditure.
- Preliminary expenses incurred before the commencement of business is considered capital expenditure. For example, legal charges paid for drafting the memorandum and articles of association of a company or brokerage paid to brokers, or commission paid to underwriters for raising capital.

Note: One useful way of recognizing expenditure as capital is to see that because of the expenditure, the business will own something which qualifies as an asset at the end of the accounting period.

Some examples of capital expenditure:

- (i) Purchase of land, building, machinery or furniture;
- (ii) Cost of leasehold land and building;
- (iii) Cost of purchased goodwill;
- (iv) Preliminary expenditures;
- (v) Cost of additions or extensions to existing assets;
- (vi) Cost of overhauling second-hand machines;
- (vii) Expenditure on putting an asset into working condition; and
- (viii) Cost incurred for increasing the earning capacity of a business.

● Rules for Determining Revenue Expenditure

Any expenditure which cannot be recognized as capital expenditure can be termed as revenue expenditure. A revenue expenditure temporarily influences only the profit earning capacity of the business. An expenditure is recognized as revenue when it is incurred for the following purposes:

Expenditure for day-to-day conduct of the business, the benefits of which last less than one year. Examples are wages of workmen, interest on borrowed capital, rent, selling expenses, and so on.

Expenditure on consumable items, on goods and services for resale either in their original or improved form. Examples are purchases of raw materials, office stationery, and the like. At the end of the year, there may be some revenue items (stock, stationery, etc.) still in hand. These are generally passed over to the next year though they were acquired in the previous year.

Expenditures incurred for maintaining fixed assets in working order. For example, repairs, renewals and depreciation.

Some examples of revenue expenditure:

- (i) Salaries and wages paid to the employees;
- (ii) Rent and rates for the factory or office premises;
- (iii) Depreciation on plant and machinery;
- (iv) Consumable stores;
- (v) Inventory of raw materials, work-in-progress and finished goods;
- (vi) Insurance premium;
- (vii) Taxes and legal expenses; and
- (viii) Miscellaneous expenses.

● Revenue Expenditure Treated as Capital Expenditure:

The following are some of the instances where an item of expenditure which is in the nature of revenue expenditure will be treated as capital expenditure.

- (a) **Repairs:** Repairs expenditure is revenue in nature, but huge amount incurred on a second-hand machinery in order to bring it to working condition can be treated as capital expenditure and should be added to the cost of Machinery.
- (b) **Wages:** Normally, wages are revenue in nature. But wages paid to the workers for the construction or installation of fixed assets, will be treated as capital expenditure and added to the cost of that asset.
- (c) **Preliminary Expenses:** All the expenses paid in the process of formation of a company should be treated as capital expenditure and recorded in the balance sheet on asset side.
- (d) **Brokerage, Government Stamp Duty and Legal Expenses:** All the expenses paid on the purchase of a property will be regarded as capital expenditure.
- (e) **Raw Materials and Stores:** These are generally revenue in nature, but if raw materials and stores are consumed in the constructing a fixed asset, the same should be treated as capital expenditure.
- (f) **Development Expenditure:** All the expenditure incurred for the development of mines and plantations should be treated as capital expenditure.

• Deferred Revenue Expenditures

Deferred Revenue Expenditure is the expenditure for which payment has been made or a liability has been incurred but which is carried forward on the presumption that will be of benefit over a subsequent period or periods. [Guidance Note on Terms used in Financial Statements issued by Institute of Chartered Accountants of India]. Deferred revenue expenditures are a combination of capital and revenue expenses whose usefulness does not expire in the year of their occurrence, but generally expires in the near future. These types of expenditures are carried forward and are written-off in future accounting periods. A portion of such expenditure is capitalised even though it is revenue in nature, and hence is also referred to as Capitalised Revenue Expenditure.

Examples of Deferred Revenue Expenditure include heavy advertisement expenditure incurred prior to launching a new product, development expenses of a product etc.

Out of the total amount of Deferred Revenue Expenditure, a part (the portion representing benefits consumed during the year) is written-off and recorded in the debit-side of the Income Statement, while the unwritten-off portion appears as an asset in the Balance Sheet.

Note: After the issuance of AS-26, the expenditures which were recognised as deferred revenue expenditure has to be treated as simple revenue expense. The accounting standard has specifically mentioned that any expenditure incurred for research, training, advertising and promotional activities should be recognised as an expense of the accounting period in which it has been incurred.

Illustration 1.

State whether the following are capital, revenue or deferred revenue expenditure.

- (i) Carriage of ₹7,500 spent on machinery purchased and installed.
- (ii) Heavy advertising costs of ₹20,000 spent on the launching of a company's new product.
- (iii) ₹200 paid for servicing the company vehicle, including ₹50 paid for changing the oil.
- (iv) Construction of basement costing ₹1,95,000 at the factory premises.

Solution:

- (i) Carriage of ₹7,500 paid for machinery purchased and installed should be treated as a Capital Expenditure.
- (ii) Advertising expenses for launching a new product of the company should be treated as a Revenue Expenditure. (As per AS-26)
- (iii) ₹200 paid for servicing and oil change should be treated as a Revenue Expenditure. As these are recurring nature
- (iv) Construction cost of basement should be treated as a Capital Expenditure.

Illustration 2.

State whether the following are capital or revenue expenditure.

- (i) Paid a bill of ₹10,000 of Mr. Kumar, who was engaged as the erection engineer to set up a new automatic machine costing ₹20,000 at the new factory site.
- (ii) Incurred ₹26,000 expenditure on varied advertisement campaigns undertaken yearly, on a regular basis, during the peak festival season.
- (iii) In accordance with the long-term plan of providing a well- equipped Labour Welfare Centre, spent ₹90,000 being the budgeted allocation for the year.

Solution:

- (i) Expenses incurred for erecting a new machine including the bill paid to the erection engineer should be treated as a Capital Expenditure.
- (ii) Advertisement expenses during peak festival season should be treated as a Revenue Expenditure.
- (iii) Expenses incurred for Labour Welfare Centre should be treated as a Capital Expenditure.

Illustration 3.

Classify the following items as capital or revenue expenditure:

- (i) An extension of railway tracks in the factory area;
- (ii) Wages paid to machine operators;
- (iii) Installation costs of new production machine;
- (iv) Materials for extension to foremen's offices in the factory;
- (v) Rent paid for the factory;
- (vi) Payment for computer time to operate a new stores control system,
- (vii) Wages paid to own employees for building the foremen's offices.

Give reasons for your classification.

Solution:

- (i) Expenses incurred for extension of railway tracks in the factory area should be treated as a Capital Expenditure because it will yield benefit for more than one accounting period and it is non-recurring in nature.
- (ii) Wages paid to machine operators should be treated as a Revenue Expenditure as it will yield benefit for the current period only and it is recurring in nature.
- (iii) Installation costs of new production machine should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period and it is incurred for acquiring long term assets.
- (iv) Materials for extension to foremen's offices in the factory should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.
- (v) Rent paid for the factory should be treated as a Revenue Expenditure because it will benefit the Company only during the current period and it is recurring in nature.
- (vi) Payment for computer time to operate a new stores control system should be treated as Revenue Expenditure because it has been incurred to carry on the normal business.
- (vii) Wages paid for building foremen's offices should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.

Illustration 4.

For each of the cases numbered below, indicate whether the income/expenditure is capital or revenue.

- (i) Payment of wages to one's own employees for building a new office extension.
- (ii) Regular hiring of computer time for the preparation of the firm's accounts.
- (iii) The purchase of a new computer for use in the business.
- (iv) The use of motor vehicle, hired for five years, but paid at every six months.

Solution:

- (i) Payment of wages for building a new office extension should be treated as a Capital Expenditure, as these has been paid for construction of fixed asset.
- (ii) Computer hire charges should be treated as a Revenue Expenditure, as it is recurring in nature.
- (iii) Purchase of computer for use in the business should be treated as a Capital Expenditure. It is a purchase of fixed assets.
- (iv) Hire charges of motor vehicle should be treated as a Revenue Expenditure.

Illustration 5.

State with reasons whether the following are capital or revenue expenditure:

- (i) Freight and cartage on the new machine ₹ 150, and erection charges ₹ 500.
- (ii) Fixtures of the book value of ₹ 2,500 sold off at ₹ 1,600 and new fixtures of the value of ₹ 4,000 were acquired. Cartage on purchase ₹ 100.
- (iii) A sum of ₹ 400 was spent on painting the factory.
- (iv) ₹ 8,200 spent on repairs before using a second hand car purchased recently, to put it in usable condition.

Solution:

- (i) Freight and cartage totaling ₹ 650 should be treated as a Capital Expenditure because it will benefit the business for more than one accounting year.
- (ii) Loss on sale of fixtures ₹ (2,500 – 1,600) = ₹ 900 should be treated as a Capital Loss. The cost of new fixtures and carriage thereon should be treated as a Capital Expenditure because the fixture will be used for a long period. So the cost of new fixture will be ₹ (4,000+100) ₹ 4,100.
- (iii) Painting of the factory should be treated as a Revenue Expenditure because it has been incurred to maintain the factory building.
- (iv) Repairing cost of second hand car should be treated as a Capital Expenditure because it will benefit the business for more than one accounting year.

Illustration 6.

State the nature (capital or revenue) of the following expenditure which were incurred by Vedanta & Co. during the year ended 30th June, 2023:

- (i) ₹ 350 was spent on repairing a second hand machine which was purchased on 8th May, 2021 and ₹ 200 was paid on carriage and freight in connection with its acquisition.
- (ii) A sum of ₹ 30,000 was paid as compensation to two employees who were retrenched.
- (iii) ₹ 150 was paid in connection with carriage on goods purchased.
- (iv) ₹ 20,000 customs duty is paid on import of a machinery for modernisation of the factory production during the current year and ₹ 6,000 is paid on import duty for purchase of raw materials.
- (v) ₹ 18,000 interest had accrued during the year on term loan obtained and utilised for the construction of factory building and purchase of machineries; however, the production has not commenced till the last date of the accounting year.

Solution:

- (i) Repairing and carriage totaling ₹550 for second hand machine should be treated as a Capital Expenditure.
- (ii) Compensation paid to employees shall be treated as a Revenue Expenditure.
- (iii) Carriage paid for goods purchased should be treated as a Revenue Expenditure.
- (iv) Customs duty paid on import of machinery to be treated as a Capital Expenditure. However, import duty paid for raw materials should be treated as a Revenue Expenditure.
- (v) Interest paid during pre-construction period to be treated as a Capital Expenditure.

Illustration 7.

State with reasons whether the following items relating to Parvati Sugar Mill Ltd. are capital or revenue:

- (i) ₹50,000 received from issue of shares including ₹10,000 by way of premium.
- (ii) Purchased agricultural land for the mill for ₹60,000 and ₹500 was paid for land revenue for period after purchase.
- (iii) ₹5,000 paid as contribution to PWD for improving roads of sugar producing area.
- (iv) ₹40,000 paid for excise duty on sugar manufactured.
- (v) ₹70,000 spent for constructing railway siding.

Solution:

- (i) ₹40,000 (50,000 – ₹10,000) received from issue of shares will be treated as a Capital Receipt. The premium of ₹10,000 should be treated as a Capital Profit.
- (ii) Cost of land ₹60,000 to be treated as Capital Expenditure and land revenue of ₹500 to be treated as Revenue Expenditure.
- (iii) Contribution paid to PWD should be treated as a Revenue Expenditure.
- (iv) Excise duty of ₹40,000 should be treated as a Revenue Expenditure.
- (v) ₹70,000 spent for constructing railway siding to be treated as a Capital Expenditure.

1.3.2 Capital and Revenue Receipts

A receipt of money may be of a capital or revenue nature. A clear distinction, therefore, should be made between capital receipts and revenue receipts in order to determine the correct result of operating performance of the entity.

Capital Receipts refer to the receipts which are obtained by an entity from operations other than the regular operations of the entity. Capital receipts do not have any effect on the profits earned or losses incurred during the course of a year. Capital receipts can take one or more of the following forms:

- (a) Additional capital introduced by the owner; and,
- (b) Proceeds from sale of long-term assets.

A receipt of money is considered as Revenue Receipt when it is obtained by an entity from its regular course of operations. Receipts of money in the revenue nature increase the profits or decrease the losses of a business and must be set against the revenue expenses in order to ascertain the profit for the period. For example, collection from customers for goods sold on credit; Fees received for services rendered etc.

Accounting Treatment of Capital and Revenue Receipts

Capital receipts are credited to the respective account of capital nature, and gets reflected in the Balance Sheet. On the other hand, revenue receipts are recognised as income and are reflected in the Income Statement.

Distinction between Capital and Revenue Receipts

Major differences between capital receipts and revenue receipts are as follows:

Sr. No.	Capital Receipt	Revenue Receipt
1.	These receipts are obtained by an entity from operations other than from the regular operations.	These receipts are obtained by an entity from regular day-to-day operations.
2.	It is non-recurring in nature.	It is recurring in nature.
3.	It is not recognised as an income.	It is recognised as an income.
4.	It gets reflected in the Balance Sheet.	It is credited to Income Statement.
5.	It does not affect the operating result of an entity.	It affects the operating result of an entity.
6.	It may result in creation of liability.	It does not create any liability.

Capital and Revenue Profit

While ascertaining the operating performance of an entity for a particular period, a proper distinction is to be made between capital and revenue profits.

If a profit arises out of an ordinary nature, being the outcome of the ordinary functions and object of the business, it is termed as 'revenue profit'. But, when a profit arises out of a non-recurring transaction, it is termed as capital profit. Generally, Capital Profits arise out of the sale of assets other than inventory at a price more than its book value or in connection with the raising of capital or at the time of purchasing an existing business.

Examples of Capital Profit include Profit prior to incorporation; Premium received on issue of shares; Profit made on re-issue of forfeited shares etc. Similarly, examples of Revenue Profit include profit on sale of goods and providing services.

Normally, Capital Profits are transferred to Capital Reserve while Revenue Profits are either distributed to owners or are credited to Reserves for future investments.

Capital and Revenue Losses

While ascertaining profit, revenue losses are differentiated from capital losses, just as revenue profits are distinguished from capital profits.

Revenue losses arise from the normal course of business by selling the merchandise at a price less than its purchase price or cost of goods sold or where there is a decline in the current value of inventories etc. Examples include discount allowed to customers for prompt payment; Bad debt loss.

Capital Loss, on the other hand, refers to a loss which does not arise to an entity in the regular course of its operations. Capital losses may result from the sale of assets, other than inventory for less than written down value or the diminution or elimination of assets other than as the result of use or sale (flood, fire, etc.) or in connection with raising capital of the business (issue of shares at a discount) or on the settlement of liabilities for a consideration more than its book value (debenture issued at par but redeemed at a premium).

Treatment of capital losses are same as that of capital profits. Capital losses arising out of sale of fixed assets generally appear in the Income Statement (being deducted from the net profit). But other capital losses are adjusted against reserves of capital in nature. Revenue losses are transferred to the Income Statement.

Accounting Cycle, Analysis of Transaction Etc.

1.4

1.4.1 Concept of Accounting Cycle

An accountant follows a sequence of activities to record and finally report transactions of an entity during an accounting period. This sequence of activities starts with identifying an event to be a transaction worthy of recording in then books to their presentation in the financial statements after proper process of summarising, classifying and finalising. To keep track of the full accounting cycle from start to finish is one of the main duties of a bookkeeper.

Thus, accounting cycle is defined as the holistic process of recording and processing all financial transactions of a company, from when the transaction occurs, to its representation on the financial statements, to closing the accounts.

Accounting cycle consists of the following sequential steps.

- (a) **Identifying the Transactions:** The first step in the accounting cycle is to analyse the events to determine if they are 'transactions'. Only events that leads to change in the financial position of the accounting unit is called transactions.
- (b) **Recording transaction in the Journal:** The second step in the accounting cycle is to record the transactions in the books of original entry i.e., Journal after identifying the Debit and the Credit element.
- (c) **Posting to Ledger:** In the next step, the transaction is posted in a summarised and classified manner to different accounts of the ledger.
- (d) **Drafting of Unadjusted Trial Balance:** At the next step, the ledger balances are compiled in the trial balance to check whether there is any error during the recording stage. This stage is, however, not mandatory.
- (e) **Passing of adjustment entries:** Identification of necessary adjustments and passing of adjusting entries make up the fifth step in the cycle.
- (f) **Drafting of Adjusted Trial Balance:** Once all adjusting entries are completed, an Adjusted Trail Balance can be prepared. This happens to be the last step before the preparation of the financial statements.
- (g) **Closing of books:** In this stage of the accounting cycle, the ledger accounts are closed and balanced (also referred to as "zeroed out") at the end of every accounting period.
- (h) **Drafting the Financial Statements:** In the last stage of the accounting cycle, the Income Statement is prepared with the closing balances of the nominal accounts, while the balances of real and personal accounts get reflected in the Balance Sheet. Financial statements are prepared in the following order: Income Statement, Statement of Retained Earnings, Balance Sheet and Statement of Cash Flows.

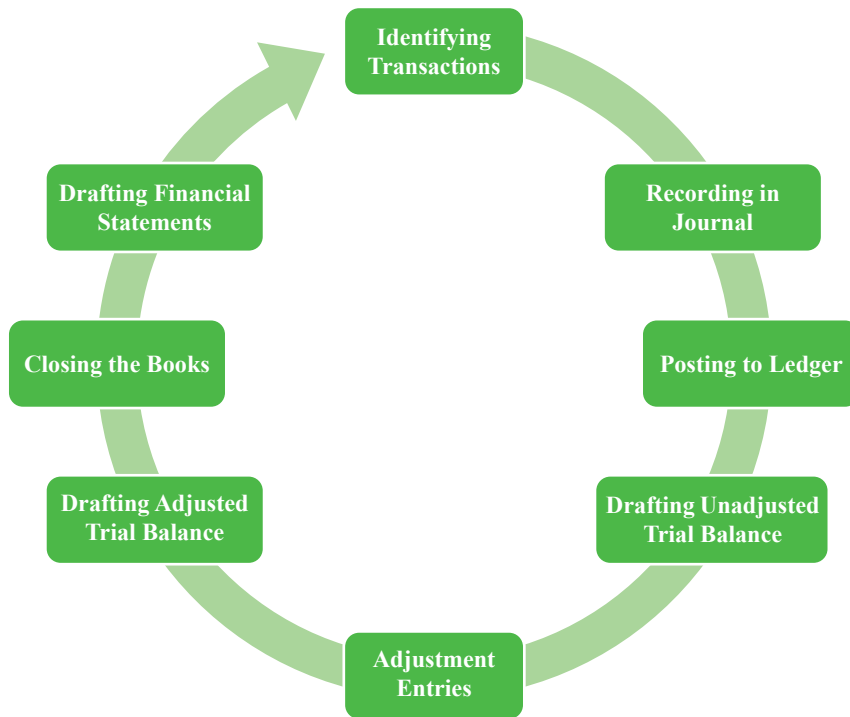


Figure 1.2: Accounting Cycle

These steps and their related components have been explained in greater detail in the following sections of this module.

☉ **Charts of Accounts and Codification Structure**

The primary purpose of financial accounting is to record the transactions entered into by an organisation during an accounting period. To achieve this, various accounts are opened and after the classification exercise the transactions get posted in the ledger (which itself is classified as personal and impersonal). These happen to be the building blocks for developing the financial statements and other management reports of the organisation.

However, with the increase in the complexity of business and flow of data, it has become quite a challenge to retrieve the information stored in the accounting records. It is for the purpose of effective management and retrieval of the already recorded accounting information, Chart of Accounts are developed.

☉ **Concept of Chart of Accounts**

A Chart of Accounts (COA) is the list of all accounts in the general ledger, each account being accompanied by a reference number. It is a financial organizational tool that provides a complete listing of every account in the general ledger of a company, broken down into subcategories. Specifically, it is an index of all the financial accounts in the general ledger of an organisation.

Chart of Accounts is the driving force behind an organisation's book-keeping and accounting systems, and is considered to be the foundation of financial reporting.

The basic purpose of such charting is to organize the accounts and group similar ones together.

This process makes it easier for the accountants and auditors to locate specific accounts. A well-structured chart of accounts is often the single best and most effective way to raise the financial reporting of an organization to the next level.

The organization of accounts within the COA varies from company to company. It usually consists of the accounts that a company has identified and made available for recording transactions in its general ledger. This can be done with accounting software.

🕒 Codification Structure

A Chart of Accounts provides the structure for the general ledger accounts of a concern. It lists specific types of accounts, describes each account, and includes account numbers. A chart of accounts typically lists asset accounts first, followed by liability and capital accounts, and then by revenue and expense accounts.

- (a) **Setting up of a Chart of Accounts:** To set up a chart of accounts, the first is to define the various accounts to be used by the organisation. Each account should have a number to identify it. Each chart of accounts typically contains a name, brief description, and an identification code.
- (b) **Ordering of Accounts:** Balance Sheet Accounts tend to follow a standard that lists the most liquid assets first. Revenue Accounts and Expense Accounts tend to follow the standard of first listing the items most closely related to the operations of the business. For example, Sales would be listed before non-operating income. In some cases, part of all the expense accounts simply may be listed in alphabetical order.
- (c) **Designing of Chart of Accounts:** The designing of a detailed chart of accounts would typically begin with an initial design which would reflect the major headings of the accounts. Thereafter, the detailed descriptions of the transaction are added, which may act as future references.

Note: While codifying the accounts, an organisation may follow a three-layer approach of providing Division Code followed by Department Code followed by Account Code.

Division Code is usually a two-digit code (but may be of three digits as well) that defines the specific company division within an organization. A company with a single division does not require division coding. The department code is usually a two- or three-digit code that defines various departments within a division. A division will usually have various departments such as accounting, production, engineering, and so on. In order to identify the departments in a division, an account manager can use these codes. Account Code is usually a three-digit code that are assigned to the accounts such as assets, supplies, expense, revenue, and so on. For instance, a multi-division company would have the chart accounts numbering in the following manner – zz-aa-123—the zz representing division, aa for the department, and 123 for accounts.

🕒 Illustration of Account Codification for a small business organisation:

For a small business, three digits code may suffice for the account number, although more digits are desirable. However, in order to allow for new accounts to be added as the business grows with more digits, new accounts can be added while maintaining the logical order. Complex businesses may have thousands of accounts, and require longer account reference numbers. As such, it is worthwhile to put thought into assigning the account numbers in a logical way and to follow any specific industry standards.

The following is an example of some of the accounts that may be included in a chart of accounts and reflecting how the digits might be coded:

Account Numbering & Description of Accounts
1000 to 1999: Asset accounts
2000 to 2999: Liability accounts
3000 to 3999: Equity accounts
4000 to 4999: Revenue accounts
5000 to 5999: Cost of goods sold accounts
6000 to 6999: Expense account
7000 to 7999: Other revenue (for example rent received, bad debt recovery etc.)
8000 to 8999: Other expenses (for example depreciation income taxes etc.)

An alternative presentation of a typical Chart of Accounts is as follows:

Balance Sheet Accounts	Income Statement Accounts
Assets (1000 – 1999)	Operating Revenues (4000 – 4999)
Liabilities (2000 – 2999)	Operating Expense (5000 – 5999)
Owner’s Equity (3000 -3999)	Overhead Costs or Expenses (6000 – 6999)
	Non-operating revenue and gains (7000 – 7999)
	Non- operating expenses and Losses (8000 – 8999)

It is to be noted that by separating each account by several numbers many new accounts can be added between any two while maintaining the logical order.

1.4.2 Analysis of Transactions

● Events and Transactions

A transaction is an event between two contracting parties, which can be expressed in terms of money and which leads to change in the financial position of a business unit. A transaction may be an exchange in which each party receives as well as sacrifices value. Examples include sale and purchase of goods, purchase of assets etc.

An event is an occurrence, happening, change or incident, which may or may not bring any change in the financial position of a business unit. Thus, appointment of a manger, launch of a new product are events but not transactions. Hence, all transactions are events but all events are not transactions.

In accounting, transactions are recorded systematically based on some source documents. Source documents include sales order, invoices and credit notes, petty cash vouchers etc.

1.4.2.1 Accounting Equation

The accounting equation is a representation of the interrelationship among three important components of accounting namely Assets, Liabilities and Equity.

In the most simplistic form, the accounting equation is presented as:

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

Assets represent the valuable resources owned and controlled by the company with the purpose of using it for generating future profits, such as cash, accounts receivable, fixed assets, inventory etc. Liabilities represent obligations of an organisation to its external stakeholders to be settled at a future date. It represents amount of money that the business owes to the other parties. Equity represents owners net claim on the assets.

The above equation can be further expanded by incorporating the various elements of the Equity component as under:

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

or, $\text{Assets} = \text{Liabilities} + [\text{Capital} + (\text{Revenue} - \text{Expenses}) - \text{Drawings}]$

or, $\text{Assets} + \text{Expenses} + \text{Drawings} = \text{Liabilities} + \text{Capital} + \text{Revenue}$

Accounting equation lies at the core of the double-entry accounting system. Whatever be the transaction to be recorded, the accounting equation before and after the entry of the transaction always remains in balance.

Consider the following illustrations.

Transaction	Assets + Expenses + Drawings	Liabilities + Capital + Revenue
Capital introduced by the owner in cash	Cash (Assets) increases	Capital increases
Purchase of goods in credit	Inventory (Asset) increases	Creditors/ Payables (Liabilities) increases
Sale of goods in credit	Debtors/ Receivables (Assets) increases; Inventory (Assets) decreases	N.A.
Wages paid	Wages (Expenses) increases; Cash/ Bank (Assets) decreases	N.A.
Commission received	Cash/ Bank (Assets) increases	Commission received (Revenue) increases
Cash withdrawn by proprietor	Cash (Assets) decreases	Capital decreases

Illustration 8.

Prepare an Accounting Equation from the following transactions in the books of Mr. X for January, 2023:

- 1 Invested Capital in the firm ₹20,000
- 2 Purchased goods on credit from Das & Co. for ₹2,000
- 4 Bought plant for cash ₹8,000
- 8 Purchased goods for cash ₹4,000
- 12 Sold goods for cash (Cost ₹4,000 + Profit ₹2,000) ₹6,000.
- 18 Paid to Das & Co. in cash ₹1,000
- 22 Received from B. Banerjee ₹300
- 25 Paid salary ₹6,000
- 30 Received interest ₹5,000
- 31 Paid wages ₹3,000

Solution:

Effect of transaction on Assets, Liabilities and Capital

Date	Transaction	Assets =	Liabilities +	Capital
2023 Jan.1	Invested Capital in the firm ₹20,000	20,000	-	20,000
2	Purchased goods on credit from Das & Co. ₹2000	+2,000	+2,000	-
	Revised Equation	22,000=	2,000+	20,000
4	Bought Plant for cash ₹8,000	+8,000 -8,000	-	-
	Revised Equation	22,000=	2,000+	20,000
8	Purchased goods for cash ₹4,000	+4,000 -4,000	--	--
	Revised Equation	22,000=	2,000+	20,000
12	Sold Goods for cash (Cost ₹4,000 + Profit ₹2,000)	+6,000 -4,000		+2,000
	Revised Equation	24,000	2,000+	22,000
18	Paid to Das & Co. for ₹1,000	-1,000	-1,000	-
	Revised Equation	23,000=	1,000+	22,000
22	Received from B. Banerjee for ₹300	+300 -300		
	Revised Equation	23,000=	1,000+	22,000
25	Paid salary for ₹6,000	-6,000		-6,000
	Revised Equation	17,000=	1,000+	16,000
30	Received Interest for ₹5,000	+5,000		+5,000
	Revised Equation	22,000=	1,000+	21,000
31	Paid Wages for ₹3,000	-3,000		-3,000
	Revised Equation	19,000=	1,000+	18,000

1.4.2.2 Double Entry System

- **Concept of Double Entry System**

Double entry system of book keeping is an accounting system which recognizes the fact that every transaction has two fold aspects - 'Debit' and 'Credit' and both aspects of the transaction are recorded in the books of accounts.

The term 'Debit' is derived from the Latin word 'debitum' which means 'what is due'. It is abbreviated by 'Dr.'

The term 'Credit' is derived from the Latin word 'credere' which means 'what is trusted. It is abbreviated by 'Cr.'

Double entry system records the transactions by understanding them as a Debit item or Credit item. A debit entry in one account gives the opposite effect in another account by a credit entry. This means that the sum of all Debit accounts must be equal to the sum of Credit accounts.

• Features of Double Entry System

- (i) Every transaction has two-fold aspects, i.e., one party giving the benefit and the other receiving the benefit.
- (ii) Every transaction is divided into two aspects, Debit and Credit. One account is to be debited and the other account is to be credited.
- (iii) Every debit must have its corresponding and equal credit.

• Advantages of Double Entry System

- (i) It ensures arithmetical accuracy of the books of accounts as, for every debit, there is a corresponding and equal credit. This is ascertained by preparing a trial balance periodically or at the end of the financial year.
- (ii) It prevents and minimizes frauds. Moreover, frauds can be detected early.
- (iii) Errors can be checked and rectified easily.

• Limitations of Double Entry System

- (i) The system does not disclose all the errors committed in the books accounts.
- (ii) The trial balance prepared under this system does not disclose certain types of errors.
- (iii) It is costly as it involves maintenance of a number of books of accounts.

• Concept of Account

An account is defined as a summarized record of transactions related to a person or a thing e.g., when the business deals with customers and suppliers, each of the customers and supplier will be a separate account. The account is also related to inanimate objects – both tangible and intangible. e.g., land, building, equipment, brand value, trademarks etc. are some of the things. When a business transaction occurs, one has to identify the ‘account’ that will be affected by it and then apply the rules to decide the accounting treatment. Only then the transactions can be recorded in accounting.

Typically, an account is expressed as a statement in form of English letter ‘T’. It has two sides. The left-hand side is called as “Debit” side and the right-hand side is called as “Credit” side. The debit side is indicated by ‘Dr’ and the credit side by ‘Cr’. Accounts are classified as follows:

- (a) **Personal Account:** As the name suggests, these are accounts related to persons. Personal Accounts can again be of three types as follows.
 - (i) **Natural Personal Account:** These represents natural persons like Suresh’s A/c, Anil’s a/c, Rani’s A/c etc.
 - (ii) **Artificial Personal Account:** The persons could also be artificial persons like companies, bodies corporate or association of persons or partnerships etc. For example, M/s ABC Ltd, M/s PQR Industries etc.
 - (iii) **Representative Personal Account:** They represent the person collectively. For example, Outstanding Rent A/c, Prepaid Insurance A/c etc.
- (b) **Real Accounts:** These are accounts related to assets or properties or possessions. Depending on their physical existence or otherwise, they are further classified as -

- (i) **Tangible Real Account** – They represent assets that have physical existence and can be seen, and touched. e.g., Machinery A/c, Stock A/c, Cash A/c, Vehicle A/c, and the like.
- (ii) **Intangible Real Account** – These represent possession of properties that have no physical existence but can be measured in terms of money and have value attached to them. e.g. Goodwill A/c, Trade mark A/c, Patents & Copy Rights A/c, Intellectual Property Rights A/c and the like.
- (c) **Nominal Account:** These accounts are related to expenses or losses and incomes or gains e.g., Salary and Wages A/c, Rent and Rates A/c, Travelling Expenses A/c, Commission received A/c, Loss by fire A/c etc.

⊙ **Analysing Debit and Credit of a Transaction**

The double entry system has specific rules for determining the Debit Account and Credit Account in any transaction. The rules can broadly be discussed as follows:

A. Golden Rule Approach or Traditional Approach

This method is based on the conventional classification of accounts. Conventionally, accounts are classified into three types – Nominal Account, Real Account and Personal Account. The rules of Debit and Credit under this approach are described below.

Nature of Account	Rule of Debit and Credit	
Nominal Account	Debit	Expenses and Losses
	Credit	Incomes and Gains
Real Account	Debit	What comes in
	Credit	What goes out
Personal Account	Debit	The receiver
	Credit	The giver

B. Accounting Equation Approach or Modern Approach

This method is based on the concept of accounting equation. The rules of debit and credit under this method are presented as follows:

Types of Account	Normal Balance of Account	To be Debited	To be Credited
Assets Account	Debit	Increase	Decrease
Liabilities Account	Credit	Decrease	Increase
Capital Account	Credit	Decrease	Increase
Revenue Account	Credit	Decrease	Increase
Expense Account	Debit	Increase	Decrease
Withdrawal Account	Debit	Increase	Decrease

Once the transactions are identified into Debit Account and Credit Account, they are recorded in the books of original entry i.e., Journal and therefrom posted to the individual accounts maintained under the Ledger.

Consider the following illustrations on analysis of transactions.

Illustration 9.

Ascertain the debit and credit from the following particulars under Modern Approach.

- (a) Started business with capital.
- (b) Bought goods for cash.
- (c) Sold goods for cash.
- (d) Paid salary.
- (e) Received Interest on Investment.
- (f) Bought goods on credit from Mr. Y
- (g) Paid Rent out of Personal cash.

Solution:

	Effect of Transaction	Account	To be debited/Credited
(a)	Increase in Cash	Cash A/c	Debit
	Increase in Capital	Capital A/c	Credit
(b)	Increase in Stock	Purchase A/c	Debit
	Decrease in Cash	Cash A/c	Credit
(c)	Increase in Cash	Cash A/c	Debit
	Decrease in Stock	Sale A/c	Credit
(d)	Increase in Expense	Salary A/c	Debit
	Decrease in Cash	Cash A/c	Credit
(e)	Increase in Cash	Cash A/c	Debit
	Increase in Income	Interest A/c	Credit
(f)	Increase in Stock	Purchase A/c	Debit
	Increase in Liability	Y A/c	Credit
(g)	Increase in Expense	Rent A/c	Debit
	Increase in Liability	Capital A/c	Credit

Illustration 10.

Ascertain the Debit Credit under Golden Rule Approach or Traditional Approach. Consider previous illustration.

Solution:

	Step-I	Step-II	Step-III	Step-IV
(a)	Cash A/c	Real	Comes in	Debit
	Capital A/c	Personal	Giver	Credit
(b)	Purchase A/c	Nominal	Expenses	Debit
	Cash A/c	Real	Goes out	Credit
(c)	Cash A/c	Real	Comes in	Debit
	Sales A/c	Nominal	Incomes	Credit

(d)	Salary A/c	Nominal	Expenses	Debit
	Cash A/c	Real	Goes out	Credit
(e)	Cash A/c	Real	Comes in	Debit
	Interest A/c	Nominal	Incomes	Credit
(f)	Purchase A/c	Nominal	Expenses	Debit
	Y' A/c	Personal	Giver	Credit
(g)	Rent A/c	Nominal	Expenses	Debit
	Capital A/c	Personal	Giver	Credit

1.4.3 Books of Original Entry

Books of original entry are referred to as the books where a business records all the business transactions initially. It is also known as Journal. These are the primary books of accounts which are used by the accountants for recording the transactions chronologically in the first place. These are also referred to as Books of Primary Entry or Books of First Entry.

Types of Books of Original Entry

The books of original entry are broadly classified into two categories as follows:

- Special Journal/ Subsidiary Books:** A Special Journal is a book of primary entry in which transactions of a specific type viz. credit purchases, credit sales, return inwards etc. Some examples include Cash Book, Bank Book, Purchase Day Book, Sales Day Book etc. These are also known as Subsidiary Books.
- General Journal:** It is the book of original entry in which miscellaneous transactions, which do not fit in any other Special Journals (as mentioned above) books, are recorded. Examples are, opening entry, closing entry adjustment entry etc.

For detail discussion, please refer to Module 1.5.

1.4.4 Posting in Ledger and Finalization of Accounts

After recording each transaction in the books of original entry, they are posted to the Ledger. Ledger contains individual accounts to which the transactions are posted. Ledger is also known as the Book of Final entry. At the end of the accounting period (viz. quarter, half-year or year), the ledger accounts are balanced and closed.

The closure of ledger accounts depends on their nature. Specifically, the nominal accounts (viz. accounts representing incomes, expenses, gains and losses) are closed by transfer to the Income Statement (namely, Trading A/c and Profit & Loss A/c for a profit-oriented organisation, and Income & Expenditure A/c for a non-profit organisation). The income statement is prepared to ascertain the operating results (viz. profit/ loss or surplus/ deficit) in relation to a specific accounting period.

The balances of the accounts of real and personal nature are carried forward to the next accounting period. Their balances are reflected in a specific financial statement called the Balance Sheet. It shows the financial position of an organisation at the end of a specific accounting period by reflecting the different assets owned, liabilities and equity of the organisation.

After identification of the transactions, the next step in Accounting Cycle is recording of transactions in the books of primary entry or Journal. This is followed by posting the transactions in respective accounts in the ledger.

1.5.1 Journal

• Concept of Journal

The word “journal” has been derived from the French word “jour”. Jour means day. So, journal means daily. Transactions are recorded daily in journal and hence it has been named so. It is a book of original entry to record transactions chronologically (i.e., in order of date) and in detail the various transactions of a trader. The process of recording transaction in a journal is called as ‘journalisation’. The entry made in this book is called a ‘journal entry’.

• Functions of Journal

- (a) **Historical Function:** It contains a chronological record of the transactions for future references.
- (b) **Analytical Function:** While recording in journal, each transaction is analysed into the debit aspect and the credit aspect. This helps to find out how each transaction will financially affect the business.
- (c) **Recording Function:** Accountancy is a business language which helps to record the transactions based on the principles. Each such recording entry is supported by a narration, which explain, the transaction in simple language.

• Advantages of Journal

The following are the advantages of journal:

- (a) Each transaction is recorded as soon as it takes place. So, there is no possibility of any transaction being omitted from the books of account.
- (b) Since the transactions are kept recorded in journal, chronologically with narration, it can be easily ascertained when and why a transaction has taken place.
- (c) Journal facilitates ledger posting.
- (d) Journal shows the complete story of a transaction in one entry.
- (e) Any mistake in ledger can be easily detected with the help of journal.

• Form of Journal

The specimen of a journal book is shown below.

Journal

Date	Particulars	Voucher number	Ledger folio	Debit (₹)	Credit (₹)
dd-mm-yy	Name of A/c to be debited Name of A/c to be credited (narration describing the transaction)	-----	Reference of page number of the A/c in ledger	-----	-----

- (i) **Date Column:** This column contains the date of the transaction.
- (ii) **Particulars:** This column contains which account is to be debited and which account is to be credited. It is also supported by an explanation called narration.
- (iii) **Voucher Number:** This Column contains the number written on the voucher of the respective transaction.
- (iv) **Ledger Folio (L.F.):** This column contains the folio (i.e., page no.) of the ledger, where the transaction is posted.
- (v) **Dr. Amount and Cr. Amount:** This column shows the financial value of each transaction. The amount is recorded in both the columns, since for every debit there is a corresponding and equal credit.

Note: All the columns are filled in at the time of entering the transaction except for the column of ledger folio. This is filled at the time of posting of the transaction to 'ledger'.

Example: As per voucher no. 31 of Roy Brothers, on 10.05.2023 goods of ₹50,000 were purchased. Cash was paid immediately. Ledger Folios of the Purchase A/c and Cash A/c are 5 and 17 respectively. Journal entry of the above transaction is given below:

Date	Particulars	Voucher No.	Ledger Folio	Debit (₹)	Credit (₹)
10.05.2023	Purchase A/c Dr.	31	5	50,000	
	To Cash A/c		17		50,000
	(Being goods purchased for cash)				

Simple vs. Compound Journal Entry

A journal entry can be either a Simple journal entry or a Compound journal entry. When in a journal entry only two accounts are affected – one account is debited and another account is credited, it is called a Simple journal entry. For example, the journal entry for the transaction 'Goods worth ₹22,000 purchased by Ramesh from Rajesh for cash' will be a simple journal entry as in this case Cash A/c will be credited by ₹22,000 and Purchase A/c will get debited with ₹22,000.

In case of a Compound journal entry, at least two debits and at least one credit or at least one debit and two or more credit items are involved. For example, the journal entry for the transaction 'Goods worth ₹22,000 purchased by Ramesh from Rajesh involving cash purchase ₹14,000 and balance on credit' will be a compound journal entry as in this case Cash A/c as-well as Creditors or Rajesh's A/c will be credited with ₹14,000 and ₹8,000 respectively, and Purchase A/c will get debited with ₹22,000.

Consider the following illustrations.

Illustration 11.

Let us illustrate the journal entries for the following transactions:

2023 April

- 1 Mr. Vikas and Mrs. Vaibhavi who are husband and wife start consulting business by bringing in their personal cash of ₹5,00,000 and ₹2,50,000 respectively.
- 10 Bought office furniture of ₹25,000 for cash. Bill No. - 2023/F/3
- 11 Opened a current account with PP National Bank by depositing ₹1,00,000
- 15 Paid office rent of ₹15,000 for the month by cheque to M/s Realtors Properties. Voucher No. 3
- 20 Bought a motor car worth ₹4,50,000 from Millennium Motors by making a down payment of ₹50,000 by cheque and the balance by taking a loan from HH Bank. Voucher No. M/23/7
- 25 Vikas and Vaibhavi carried out a consulting assignment for AA Pharmaceuticals and raised a bill for ₹10,00,000 as consultancy fees. Bill No. B23/4/1 raised. AA Pharmaceuticals have immediately settled ₹2,50,000 by way of cheque and the balance will be paid after 30 days. The cheque received is deposited into Bank.
- 30 Salary of one receptionist @ ₹5,000 per month and one officer @ ₹10,000 per month. The salary for the current month is payable to them.

Solution:

The entries for these transactions in a journal will look like:

In the Books of Vikash & Vaibhavi
Journal Entries
Journal Folio-1

Date	Particulars	Voucher number	L.F	Dr.	Cr.
				(₹)	(₹)
01-04-23	Cash A/c	Dr.	1	7,50,000	
	To Vikas's Capital A/c		2		5,00,000
	To Vaibhavi's capital A/c		3		2,50,000
	(Being capital brought in by the partners)				
10-04-23	Furniture A/c	Dr.	4	25,000	
	To Cash A/c		1		25,000
	(Being furniture purchased in cash)				
11-04-23	PP National Bank A/c	Dr.	5	1,00,000	
	To Cash A/c		1		1,00,000
	(Being current account opened with PP National Bank by depositing cash)				
15-04-23	Rent A/c	Dr.	6	15,000	
	To PP National Bank A/c		5		15,000
	(Being rent paid to M/s Realtors Properties for the month)				

20-04-23	Motor Car A/c	Dr.	M/23/7	7	4,50,000	
	To PP National Bank A/c			5		50,000
	To Loan from HH Bank A/c			8		4,00,000
	(Being car purchased from Millennium Motors by paying down payment and loan arrangement)					
25-04-23	PP National Bank A/c	Dr.	B23/4/1	5	2,50,000	
	AA Pharma A/c	Dr.		9	7,50,000	
	To Consultancy Fees A/c			10		10,00,000
	(Being amount received and revenue recognized for fees charged)					
30-04-23	Salary A/c	Dr.		11	15,000	
	To Salary payable A/c			12		15,000
	(Being the entry to record salary obligation for the month)					

Illustration 12.

Journalise the following transactions in the books of Mr. Rup

2023

April

- 1 He started business with a capital of – Plant ₹10,000, Bank ₹8,000, Stock ₹12,000
- 2 Bought furniture for resale ₹5,000
Bought furniture for Office decoration ₹3,000
- 3 Paid rent out of personal cash for ₹2,000
- 8 Sold furniture out of those for resale ₹6,000
- 12 Paid Salary to Mr. X for ₹1,200
- 15 Purchased goods from Mr. M for cash ₹3,000
- 18 Sold goods to Mr. S on credit for ₹8,000
- 20 Mr. S returned goods valued ₹1,000
- 22 Received cash from Mr. S of ₹6,500 in full settlement
- 28 Bought goods from Mr. B on credit for ₹5,000
- 30 Returned goods to Mr. B of ₹500 and paid to Mr. B ₹4,000 in full settlement.

Solution:

**In the Books of Mr. Rup
Journal Entries**

Date	Particulars	L. F.	Dr.	Cr.
			(₹)	(₹)
2023	Plant A/c	Dr.	10,000	
Aprl.1	Bank A/c	Dr.	8,000	
	Stock A/c	Dr.	12,000	
	To, Capital A/c			30,000
	[Being Plant, Bank, Stock introduced to the business]			
2	Purchase A/c	Dr.	5,000	
	To, Bank A/c			5,000
	[Being furniture purchased for resale]			
	Furniture A/c	Dr.	3,000	
	To, Bank A/c			3,000
	[Being furniture purchased for office decoration]			
3	Rent A/c	Dr.	2,000	
	To, Capital A/c			2,000
	[Being rent paid out of personal cash]			
8	Cash /Bank A/c	Dr.	6,000	
	To, Sales A/c			6,000
	[Being furniture out of those meant for resale are sold]			
12	Salary A/c	Dr.	1,200	
	To, Bank A/c			1,200
	[Being salary paid to Mr. X]			
15	Purchase A/c	Dr.	3,000	
	To, Cash A/c			3,000
	[Being goods purchased]			
18	Mr. S A/c	Dr.	8,000	
	To, Sales A/c			8,000
	[Being goods sold on credit to Mr. S]			
20	Returns Inward A/c	Dr.	1,000	
	To, Mr. S A/c			1,000
	[Being goods returned from Mr. S]			
22	Cash A/c	Dr.	6,500	
	Discount Allowed A/c	Dr.	500	
	To, Mr. S A/c			7,000
	[Being cash received from Mr. S in full settlement]			

28	Purchase A/c To, Mr. B A/c [Being goods purchased from Mr. B on credit]	Dr.		5,000	5,000
30	Mr. B A/c To, Cash A/c To, Returns Outward A/c To, Discount Received A/c [Being goods returned to Mr. B and paid cash in full settlement]	Dr.		5,000	4,000 500 500

● Rules of Journalising

While journalising a transaction, knowledge of rules to decide the 'Debit' account and 'Credit' account is essential. The rules are prescribed as per the Golden Rule depending on the nature of accounts (Personal or Real or Nominal) or as per the Accounting Equation. These are described below:

Table 1.2 Rules as per Golden Rule of Double Entry Book-keeping

Nature of Account	Rule of Debit and Credit	
Nominal Account	Debit	Expenses and Losses
	Credit	Incomes and Gains
Real Account	Debit	What comes in
	Credit	What goes out
Personal Account	Debit	The receiver
	Credit	The giver

Table 1.3 Rules as per Accounting Equation

Items	Rule of Debit and Credit	
Assets	Debit	Increase
	Credit	Decrease
Liabilities	Debit	Decrease
	Credit	Increase
Capital	Debit	Decrease
	Credit	Increase
Drawings	Debit	Increase
	Credit	Decrease
Expenses	Debit	Increase
	Credit	Decrease
Revenue	Debit	Decrease
	Credit	Increase

● Sub-division of Journal

Journal or the book of original entry is further sub-divided into two categories – Special Journal and General Journal.

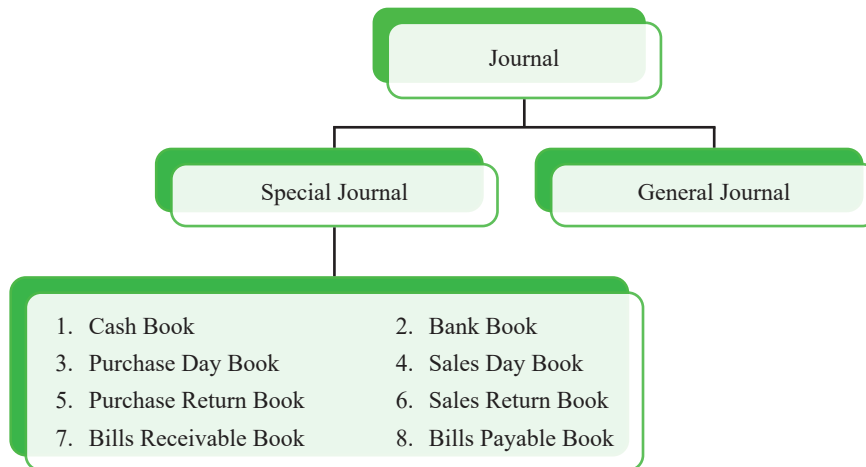


Figure 1.3: Sub-division of Journal

1. **Special Journals:** A Special Journal is a book of primary entry in which transactions of a specific type viz. credit purchases, credit sales, return inwards etc. are first recorded before being posted in the respective ledger accounts. These are also referred to as Subsidiary Books. The different special journals that are usually maintained by an organisation for primary recording of its transactions are:
 - (a) Cash Journal or Cash Book is a special journal which is maintained for recording all transactions which involve cash, whether cash inflows or cash outflows.
 - (b) Bank Book is a special journal, normally maintained in entities with huge number of transactions effected through cheques, drafts or electronic fund transfer. In small business without much bank transactions, a double/triple column Cash Book serves the purpose.
 - (c) Purchases Book or Purchases Day Book is a book of original entry maintained to record credit purchases.
 - (d) A Sales Book, also known as Sales Day Book is a book of original entry in which are recorded the details of credit sales made by an organisation. Total of Sales Book shows the total credit sales of goods during the period concerned.
 - (e) Purchases Returns Book is a book in which the goods returned to suppliers are recorded. It is also called Returns Outward Book or purchases returns day book.
 - (f) Sales Returns Book is also called Returns Inwards Book. It is used for recording goods returned to us by our customers.
 - (g) Bills Receivable Book is used to record the bills received from debtors. When a bill is received, details of it are recorded in the bills receivable book.
 - (h) Bills Payable Book is used to record bill accepted by us. When a bill drawn by our creditor is accepted particulars of the same are recorded in this book.

2. General Journal

General Journal, also known as Journal Proper is the book of original entry in which miscellaneous transactions, which do not fit in any other Special Journals (as mentioned above) books, are recorded. It is also called miscellaneous journal. The form and procedure for maintaining this journal is the same that of simple journal. The use of journal proper is confined to record transactions such as (i) Opening entries; (ii) Closing entries; (iii) Transfer entries (iv) Adjustment entries; (v) Rectification entries (vi) Entries for which there is no special journal, say, credit purchase of fixed assets etc.

The above sub-divisions have been discussed in the section that follows.

• Cash Book or Cash Journal

It is a special journal which is maintained for recording all transactions which involve cash, whether cash inflows or cash outflows. In this book of original entry, transactions of every type (whether capital natured transactions or revenue natured transactions) are entered. (Please Refer to Module 1.7 for further discussion)

• Bank Book or Bank Journal

It is a separate subsidiary book similar to cash book to record all receipts and payments made through the bank. Similar to a Single Column Cash Book, a Bank Book consists of two sides, receipts side and payment side. Receipts are debited and payments are credited in the bank book. (Please Refer to Module 1.7 for further discussion)

• Purchase Book or Purchase Day Book or Purchase Journal

The Purchase Journal is a book of original entry which is meant for recording credit purchase of goods. It records credit purchase of goods only. Credit purchase of any other assets is not recorded here. All entries in this book are made from the Purchase invoices.

The format of a Purchase Journal is as given below.

Date	Particulars	Inward Invoice No.	L.F.	(₹)

The total of the purchases made during a period is posted to Purchases Account in the General Ledger, while individual credit purchase transactions are posted in the Personal Ledger accounts of the respective suppliers (in the Creditors'/Suppliers' Ledger).

Consider the following illustration.

Illustration 13.

1. Bought 20 tables @ ₹500 per table from M.M Appliances on credit @ 12% trade discount as per invoice number 22,334 on 2nd March.
2. Purchased three dozen chairs @ ₹250 each from Metro chairs as per invoice number 1112 on 4th March on credit.
3. Second hand furniture bought from Golden Furnitures on credit as per invoice number 375 for ₹1200 on 7th March.
4. Purchased seven book racks from Mayur Furnitures for ₹4,900 paid for in cash on 6th March.
5. Purchased Machinery for ₹30,000 from Kirloskar Ltd on 9th March as per invoice number 37.

Solution:

In the Books of Furniture Shop
Purchase Day Book

Date	Name of the Suppliers and Details of goods purchased	Invoice reference	L. F.	(₹)
2nd Mar.	M.M Appliances 20 tables @ 500 and 12% trade discount (20 × 500) = 10000 less 12% discount	22334		8,800
4th Mar.	Metro Chairs (3 dozen chairs @ 250 per chair)	1112		9,000
7th Mar.	Golden Furniture	375		1,200
	Total			19,000

Please note that the transaction for purchase of book rack will not be entered in the purchase day book as it is not purchased on credit. (Where will it go then? it will go to the cash book!). Similarly purchase of machinery will not form part of purchase book. It will be entered in Journal Proper.

⊙ **Sales Book or Sales Day Book or Sales Journal**

The Sales Journal is a book of original entry which is meant for recording credit sale of goods. It records credit sale of goods only. Credit sale of any other assets is not recorded here. All entries in this book are made from the Sales invoices.

The format of a Sales Journal is as given below.

Date	Particulars	Outward Invoice No.	L.F.	(₹)

The total of the sales made during a period is posted to Sales Account in the General Ledger, while individual credit sale transactions are posted in the Personal Ledger accounts of the respective suppliers (in the Debtors'/ Customers' Ledger).

Consider the following illustration.

Illustration 14.

- 1st July Sold Tip Top clothing 50 suits of ₹2,200 each on two months credit on invoice number -2
- 11th July Sold to New Tulip Woolen 100 sweaters @ ₹250 each on invoice number 55
- 13th July Received an order from Modern clothing for 100 trousers @ ₹500 at trade discount of 10%
- 17th July Sold 50 sarees to Lunkad brothers @ ₹750 each on credit.
- 25th July Sold T-shirts at exhibition hall for cash for ₹7,500

Solution:

**In the books of Cloth Marchant
Sales Day Book**

Date	Particulars	Invoice reference	L. F.	(₹)
1st July	Tip Top Clothing (50 suits @ ₹2,200)	2		1,10,000
11th July	New India Woolen (100 sweaters @ ₹250)	55		25,000
17th July	Lunkad brother 50 sarees @ ₹750			37,500
	Total			1,72,500

Here again, cash sales at exhibition hall are not recorded. Also, merely getting an order for goods is not a transaction to be entered in sales book.

⊙ **Purchase Returns Book or Purchase Return Journal**

The Purchase Return Journal is a book of original entry which is meant for recording return of goods purchased earlier on credit. It is also known as Return Outward Book. All entries in this book are made from Debit Note issued to the supplier or Credit Note received from the supplier.

The format of a Purchase Return Journal is as given below.

Date	Particulars	Debit Note No.	L.F.	(₹)

The total of the purchase returns made during a period is posted to Purchase Returns Account in the General Ledger, while individual purchase returns transactions are posted in the Personal Ledger accounts of the respective suppliers (in the Creditors'/Suppliers' Ledger).

⊙ **Sales Return Book or Sales Return Journal**

The Sales Return Journal is a book of original entry which is meant for recording return of goods sold on credit. It is also known as Return Inward Book. All entries in this book are made from Credit Note issued by the customer.

The format of a Sales Return Journal is as given below.

Date	Particulars	Credit Note No.	L.F.	(₹)

The total of the sales return during a period is posted to Sales Return Account in the General Ledger, while individual sales return transactions are posted in the Personal Ledger accounts of the respective suppliers (in the Debtors'/ Customers' Ledger).

⊙ **Bills Receivable Journal or Bills Receivable Book**

The Bill Receivable Journal is a book of original entry which is meant for recording the bills of exchange received from the customers to whom goods have been sold on credit. All entries in this book are made from the bills of exchanges received from the customers.

The format of a Bill Receivable Journal is as given below.

Date	From whom received	Term	Due date	L.F.	(₹)

The total of the bills receivable during a period is posted to Bills Receivable Account in the General Ledger, while individual transactions are posted in the Personal Ledger accounts of the respective suppliers (in the Debtors'/ Customers' Ledger).

● Bills Payable Journal or Bills Payable Book

The Bill Payable Journal is a book of original entry which is meant for recording the bills of exchange issued to the suppliers from whom goods have been purchased on credit. All entries in this book are made from the bills of exchanges accepted against the suppliers.

The format of a Bill Receivable Journal is as given below

Date	To whom given	Term	Due date	L.F.	(₹)

The total of the bills payable during a period is posted to Bills Payable Account in the General Ledger, while individual transactions are posted in the Personal Ledger accounts of the respective suppliers (in the Creditors'/ Suppliers' Ledger).

● General Journal or Journal Proper

As mentioned earlier, General Journal is the book of original entry in which those transactions for which no special journal is maintained, are recorded. Accordingly, it records credit purchases, credit sales, purchase returns, sales return etc. (for which specific subsidiary books are maintained). In addition, it also records certain specified transactions. These are discussed below.

- (a) **Opening Entries:** Opening entry is referred to as the first entry that is recorded or which is brought forward from a previous accounting period to the new accounting period. The balances which are brought forward are assets, liabilities and equity accounts appearing in the Balance Sheet of the preceding accounting period.

Example: Suppose a businessman opens a new set of books on January 1, 2023 with cash in hand ₹1,000, debtors ₹2,000, stock in trade ₹3,200, machinery ₹7,000, furniture ₹2,000, Sundry Creditor ₹1,500, bank loan ₹3,000, capital ₹10,700 the respective opening entry in the journal will be:

Journal				Dr.	Cr.
Date	Particulars	V. N	L. F	(₹)	(₹)
	Cash A/c	Dr.		1,000	
	Sundry Debtors A/c	Dr.		2,000	
	Stock in trade A/c	Dr.		3,200	
	Machinery A/c	Dr.		7,000	
	Furniture & Fitting A/c	Dr.		2,000	
	To Sundry creditors A/c				1,500
	To Bank loan A/c				3,000
	To Capital A/c				10,700
	(Being opening entry)				

Illustration: 15

Following Balances appeared in the books of Mr. P on 31st March, 2023. Pass the necessary opening entry for 2023-24:

Credit balances: Capital ₹30,000; Bills Payable ₹5,000; Creditors ₹10,000

Debit balances: Furniture ₹4,000; Machinery ₹18,000; Debtors ₹12,000; B/R ₹9,000; Cash ₹2,000

Solution:**OPENING ENTRY IN THE BOOKS OF MR. P**

Date	Particulars	L.F.	Dr.	Cr.
			(₹)	(₹)
2024 Apr. 1	Furniture A/c	Dr.	4,000	
	Machinery A/c	Dr.	18,000	
	Debtors A/c	Dr.	12,000	
	Bills Receivable A/c	Dr.	9,000	
	Cash A/c	Dr.	2,000	
	To Capital A/c			30,000
	To Bills Payable A/c			5,000
	To Creditors A/c			10,000
	(Being opening entry)			

Illustration 16.

Consider the following balances in the Balance Sheet as on 31st March 2023. Pass the opening entry on 1st April 2024.

	(₹)
Subodh's Capital A/c	2,75,000
Loan from HH bank	4,25,000
Plant and machinery	3,30,000
Cash in hand	20,000
Balance at CC bank	1,75,000
Trade Debtors	3,55,000
Closing stock	1,35,000
Trade Payables	2,95,000
Outstanding Expenses	40,000
Prepaid Insurance	20,000

Solution:

The opening entry will be as follows:

Particulars		Dr. (₹)	Cr. (₹)
Plant and machinery A/c	Dr.	3,30,000	
Cash in hand A/c	Dr.	20,000	
Balance at CC bank A/c	Dr.	1,75,000	
Trade Debtors A/c	Dr.	3,55,000	
Closing stock A/c	Dr.	1,35,000	
Prepaid Insurance	Dr.	20,000	
To Subodh's Capital A/c			2,75,000
To Loan from HH bank A/c			4,25,000
To Trade Payables A/c			2,95,000
To Outstanding Expenses A/c (Being Opening entry)			40,000

- (b) **Closing Entries:** When the books are balanced at the close of the accounting period with a view to prepare final accounts it is necessary that balance of all the income and expenses accounts must be transferred to Trading and Profit and Loss Account. The process of transferring balances to the Trading and Profit and Loss Account at the end of year is called closing the books and entries passed at that time are called closing entries.

Example: On 31st December, 2023, the balances in expenses accounts are: Salary ₹500; Rent ₹200; Stationary ₹50; Legal Charges ₹100; and income accounts are: Commission received ₹70. These balances will be recorded in Profit and Loss Account through the following closing entry:

Journal				Dr. (₹)	Cr. (₹)
Date	Particulars	V. N	L. F		
	Profit and Loss A/c Dr.			850	
	To Salary A/c				500
	To Rent A/c				200
	To Stationery A/c				50
	To Legal Charges A/c				100
	(Being closing entry)				
	Commission Received A/c Dr.			70	
	To Profit and Loss A/c				70
	(Being closing entry)				

Illustration 17.

Pass closing entries for the following particulars as on 31st March 2023 presented by X Ltd.

Particulars	₹
Opening stock	10,000
Purchases	50,000
Wages	5,000
Returns outward	5,000
Sales	1,00,000
Returns inward	10,000
Salaries	8,000
Insurance	1,000
Bad debts	3,000
Interest received	3,000
Discount allowed	4,000
Discount received	3,000
Closing stock	15,000

Solution:

**In the Books of X Ltd.
Journal**

Date 2023 March 31st	Particulars	L F	Dr.	Cr.
			(₹)	(₹)
	Trading A/c	Dr.	75,000	
	To, Opening Stock A/c			10,000
	To, Purchases A/c			50,000
	To, Wages A/c			5,000
	To, Returns inward A/c			10,000
	(Transfer to balances for closing the latter accounts)			
	Sales A/c	Dr.	1,00,000	
	Returns outward A/c	Dr.	5,000	
	Closing Stock A/c	Dr.	15,000	
	To, Trading A/c			1,20,000
	(Transfer of balances for closing the former accounts)			
	Trading A/c	Dr.	45,000	
	To, Profit and Loss A/c			45,000
	(Gross profit transferred)			
	Profit and Loss A/c	Dr.	16,000	
	To, Salaries A/c			8,000
	To, Insurance A/c			1,000

	To, Bad Debts A/c			3,000
	To, Discount allowed A/c			4,000
	(Transfer of balances for closing the latter accounts)			
	Interest received A/c	Dr.	3,000	
	Discount received A/c	Dr.	3,000	
	To, Profit and Loss A/c			6,000
	(Transfer of balances for closing the former accounts)			
	Profit and Loss A/c	Dr.	35,000	
	To, Capital A/c			35,000
	(Net profit transferred to Capital A/c)			

- (c) **Transfer Entry:** In accounting, it is sometimes necessary to transfer an amount or balance of one account to some other account. The journal entries through which the amount of an account are transferred to another account, are referred to as Transfer entries.

Example: Drawings ₹500 is transferred from the drawings account to the capital account to find out the net capital. The transfer entry will be passed as follows:

Journal				Dr.	Cr.
Date	Particulars	V. N	L. F	(₹)	(₹)
	Capital A/c Dr.			500	
	To Drawing A/c				500
	(Being closing entry)				

- (d) **Adjusting Entries:** These entries are passed at the time of finalization of accounts for honouring the different generally accepted accounting principles i.e., accounting concepts and accounting conventions. Please refer to Module 1.8 for detail discussion.

Example: Wages outstanding ₹2,000.

Journal				Dr.	Cr.
Date	Particulars	V. N	L. F	(₹)	(₹)
	Wages A/c Dr.			500	
	To Outstanding Wages A/c				500
	(Being outstanding wages recorded)				

- (e) **Rectification Entries:** These entries are passed for correcting the different errors that get committed while recording, posting, casting, balancing etc. in the books of accounts. Please refer to Module 1.8 for detail discussion.

1.5.2 Ledger

● Concept of Ledger

After recording each transaction in the books of original entry i.e., Journal, the next thing is to classify them according to the accounts affected. All similar transactions must be brought together. For instance, all transactions relating to credit purchase must be put in one place. Similarly, all transactions with a customer or a supplier must be gathered at one place. The book in which this classification is done is called the ledger.

A ledger is a book which contains a condensed and classified record of all the pecuniary transactions of the business posted from the books of original entry i.e., Journal. It is the final destination of all the accounts, and hence, it is also called the Book of Final Entry.

Note: It should be noted that journal contains a chronological detail record while ledger contains a classified record of all transactions.

● Ledger Account

An 'Account' is the structural unit of a ledger. A ledger contains numerous accounts depending upon the number of transactions and the parties involved therein.

Following is the format of a ledger account.

Dr.			 Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				

- (i) Date Column: This column contains the date of the transaction.
- (ii) Particulars: This column contains which account is to be credited and which account is to be debited.
- (iii) Journal Folio (J.F.): This column contains the folio (i.e., page no.) of the Journal, where the transaction is recorded.
- (iv) Dr. Amount and Cr. Amount: These columns show the financial value of each transaction.

● Functions of Ledger

- (a) It acts as a permanent store-house of all the transactions of a concern arranged for ready reference.
- (b) It summarizes the effects of business transactions in terms of the individual accounts, so that a conclusion concerning the status of each account may be drawn periodically.

● Advantages of Ledger

The following are the advantages derived from a ledger:

- (a) It is the ledger through which successful application of double entry system of bookkeeping is ensured.
- (b) Transactions relating to different persons or concerns are recorded in the account of each person or concern separately. As a result, complete and reliable information is available in respect of each and every account.
- (c) Different types of income and expenses are recorded in different accounts separately. So, it is possible to ascertain the amount of income and expenditure under each head which facilitates assessment of financial performance.

- (d) Separate account is opened for each item of assets and liabilities. It is, therefore, possible to ascertain the value of different assets and liabilities which facilitates assessment of financial position.
- (e) Transactions being recorded primarily in journal and thereafter finally in ledger, the possibility of errors and defalcations is remote.
- (f) Valuable information and statistics are collected from ledger and supplied to the management to enable them to run the concern efficiently.

⊙ **Process of Ledger Posting**

After the transactions are recorded in the journal, it is then posted in the principal book called as 'Ledger'. The process of transferring the entries from journal to respective ledger accounts is called ledger posting. Balancing of ledgers is carried to find out differences at the end of the year.

Ledger posting is entering information in the ledger, in respective accounts from the journal for individual records. The account debited is posted on the debit side and the account credited is posted on the credit side of the same account.

This process is carried throughout the year and at the end of the financial year the ledger accounts are closed and are totalled and balanced. This process is called the balancing of the ledger accounts.

The rules for posting of entries:

- (a) A separate account is opened for each item of income or expenses or assets or liabilities and entries from the journal are posted in respective ledger account accordingly.
- (b) The words like 'To' and 'By' are used while posting the entries in the ledger accounts. 'To' is used when accounts are posted in the debit side column of a particular account. 'By' is used when accounts are posted in the credit side column of a particular account.
- (c) The account which is debited in the journal should also be debited in the ledger book but the reference should be of respective credit account.

⊙ **Balancing of Ledger Account**

At the end of every accounting year, all the accounts which are operated in the ledger book are closed, totalled and balanced. Balancing of ledgers means finding the difference between the debit and credit amounts of a particular account.

The steps for balancing a Ledger Account are as follows:

- (a) Calculate the totals of debit and credit columns separately and find out their difference. The difference is called a Balance amount.
- (b) If the total of the debit side is higher than that of the credit side, the balance is called as "Debit Balance" and is written on the credit side (the side with lower amount) of that particular account as "By Balance c/d" or "By Balance c/f". Here, c/d means carried down and c/f means carried forward.
- (c) Similarly, if the total of the credit side is more than that of debit side total, the balance is called "Credit Balance". The difference amount is written on the debit side of the account as "To balance c/d" or "To balance c/f"
- (d) Last year's closing balance is the opening balance of the current year. So, if there is debit it should be shown on the debit side of a particular account as "To Balance b/d" or "To Balance b/f". Here, b/d means brought down and b/f means brought forward.

Note: Nominal accounts are not balanced; the balances are transferred to profit and loss account.

Please remember the balances of personal and real accounts only are carried down to the next accounting period as they represent resources and obligations of the business which will continue to be used and settled respectively in future. Balances of nominal accounts (which represent incomes or gains and expenses or losses) are not carried down to the next period. These balances are taken to the Profit and Loss account (or Income statement) prepared for the period. The net result of the P & L Account will show either net income or net loss which will increase or decrease the owner’s equity.

Posting to Ledger Accounts from Subsidiary books

In the above section, we explained posting to ledger accounts directly on the basis of journal entries. In practice, however, we know that use of subsidiary books is in vogue. Let us see how the posting to ledger accounts is done based on these records. For each of the subsidiary books, there is a ledger account e.g. for purchase book, there is Purchase Account, for sales book there’s Sales A/c, for cash book there will be Cash A/c as well as Bank A/c and so on.

⊙ **Sub-division of Ledger**

Practically, the Ledger may be divided into two groups –

- (a) Personal Ledger; and
- (b) Impersonal Ledger.

They are again sub-divided as follows:

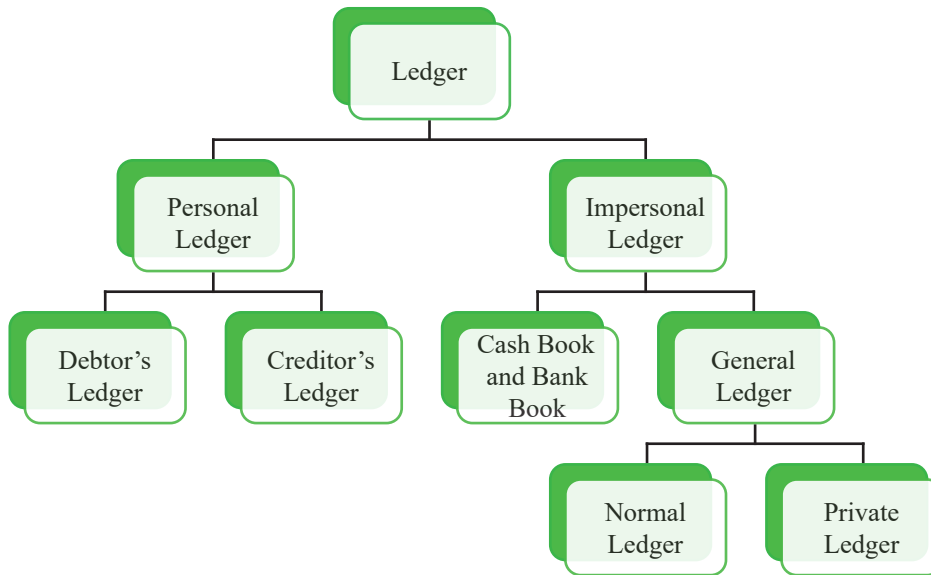


Figure 1.4: Sub-division of Ledger

- (a) **Personal Ledger:** The ledger where the details of all transactions about the persons who are related to the accounting unit, are recorded, is called the Personal Ledger.

Again, Personal Ledger may be divided into two groups:

- (i) **Debtors’ Ledger:** The ledger where the details of transactions about the persons to whom goods are sold, cash is received, etc. are recorded, is called Debtors’ Ledger.

(ii) **Creditors' Ledger:** The ledger where the details of transactions about the persons from whom goods are purchased on credit, cash is paid etc. are recorded, is called Creditors' Ledger.

(b) **Impersonal Ledger:** The Ledger where details of all transactions about assets, incomes & expenses etc. are recorded, is called Impersonal Ledger.

Impersonal Ledger may, again be divided into two group.

(i) **Cash Book and Bank Book:** The Books where all cash & bank transactions are recorded, is called Cash Book and Bank Book respectively.

(ii) **General Ledger:** The ledger where all transactions relating to real accounts, nominal accounts, and personal account (other than Trade Debtors and Trade Creditors) are recorded, is called General Ledger.

General Ledger may, again, be divided into two groups. viz, Nominal Ledger; & Private Ledger.

1. **Nominal Ledger:** The ledger where all transactions relating to incomes and expenses are recorded is called Nominal Ledger.

2. **Private Ledger:** The Ledger where all transactions relating to assets and liabilities are recorded is called Private Ledger.

• Advantages of Sub-division of Ledger

The above sub-division of ledger provides important benefits, such as:

- As a result of sub-division, the division of work is possible and records can be maintained efficiently by the concerned employee.
- As a result of sub-division, the size and volume of ledger is reduced.
- From the different classes of ledger, a particular type of transactions can easily be found out.
- As a result of sub-division chances of mistakes are minimized.
- As a result of sub-division, the accounting work may be computed quickly which is very helpful to the management.
- Due to sub-division, allotment of different types of work to different employees is done for which concerned employee will be responsible.

Consider the following Illustrations.

Illustration 18.

Let us now see how we can create ledger account for the seven journal entries that we passed for Illustration No. 11.

Folio No. 1

Cash Account

Dr.

Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
1.4.2023	To Vikas's capital	1	5,00,000	10.4.2023	By Furniture	1	25,000
1.4.2023	To Vaibhavi's capital	1	2,50,000	11.4.2023	By Punjab National Bank	1	1,00,000
				30.4.2023	By Balance c/d		6,25,000
			7,50,000				7,50,000
1.5.2023	To balance b/d		6,25,000				

Mr. Vikas's Capital Account

Dr.

Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
30.4.2023	To balance c/d		5,00,000	1.4.2023	By Cash	1	5,00,000
			5,00,000				5,00,000
				1.5.2023	By Balance b/d		5,00,000

Folio No. 3

Mrs. Vaibhavis's Capital Account

Dr.

Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
30.4.2023	To balance c/d		2,50,000	1.4.2023	By Cash	1	2,50,000
			250,000				2,50,000
				1.5.2023	By Balance b/d		2,50,000

Folio No. 4

Furniture Account

Dr.

Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
10.4.2023	To Cash		25,000	30.4.2023	By Balance c/d		25,000
			25,000				25,000
1.5.2023	To Balance b/d		25,000				

Folio No. 5

Punjab National Bank Account

Dr.

Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
11.4.2023	To Cash	1	1,00,000	15.4.2023	By Rent	1	15,000
25.4.2023	To Consultancy Fees	1	2,50,000	20.4.2023	By Motor Car	1	50,000
					By Balance c/d		2,85,000
			3,50,000				3,50,000
1.05.2023	To balance b/d		2,85,000				

Folio No. 6

Rent Account

Dr.

Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
15.4.2023	To Punjab National Bank	1	15,000				

Folio No. 7

Motor Car Account

Dr.

Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
20.4.2023	To Punjab National Bank	1	50,000				
20.4.2023	To Loan from HDFC Account	1	4,00,000				

Folio No. 8

Loan from HDFC Account

Dr.

Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
				20.4.2023	By Motor Car	1	4,00,000

Folio No. 9

Avon Pharmaceuticals Account

Dr.

Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
25.4.2023	To Consultancy Fees	1	7,50,000				

Folio No. 10

Consultancy Fees Account

Dr.

Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
				25.4.2023	By Punjab National Bank	1	2,50,000
				25.4.2023	By Avon Pharma	1	7,50,000

Folio No. 11

Salary Account

Dr.

Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
30.4.2023	To Salary Payable	1	15,000				

Folio No. 12

Salary Payable Account

Dr.

Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
				30.4.2023	By Salary	1	15,000

Illustration 19.

Record following transactions in the Personal Account of Raman.

Date	Particulars	₹
2023 Sept. 1	Sold goods to Raman	5,420
4	Received from Raman cash	5,150
	And allowed him discount	270
15	Raman bought goods	6,000
28	Received cash from Raman on account	2,000
Oct.1	Balance from last month b/d	4,000
13	Sold goods to Raman	10,000
20	Received from Raman cash	3,960
	And allowed him discount	40
31	Received cash in full settlement of Raman's account	9,800

Solution:

Raman Account

Dr.

Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
Sept.1	To Sales A/c	5,420	Sept.4	By Cash A/c	5,150
15	To Sales	6,000	4	By Discount	270
			28	By Cash	2,000
			30	By Balance c/d	4,000
		11,420			11,420
Oct.1	To Balance b/d	4,000	Oct.20	By Cash	3,960
13	To Sales	10,000	20	By Discount	40
			31	Cash	9,800
			31	Discount (Balancing figure)	200
		14,000			14,000

Cash Book, Bank Book, Petty Cash Book, Bank Reconciliation Statement

1.6

1.6.1 Cash Book

☉ Concept of Cash Book

A vast majority of transactions undertaken by an entity actually get settled (either received or paid) through cash, whether liquid cash, cheques or draft or through electronic fund transfer. Due to this high volume of cash transactions, a separate book to record only cash transactions is indispensable.

A Cash Book is a special journal which is used for recording all cash receipts and all cash payments. The receipts are entered on the debit side, while the payments are recorded in the credit side of the cash book.

☉ Cash Book – A Journal or a Ledger Account

Basically, a Cash Book is both a journal as well as a ledger account. It is a journal or book of original entry since transactions are recorded in it for the first time from the source documents. The Cash Book is also a ledger account in the sense that it is designed in the form of a Cash Account and records cash receipts on the debit side and cash payments on the credit side. Thus, the Cash Book is both a journal and a ledger.

☉ Features of Cash Book

Following are the features of Cash Book.

- a) Cash Book records only cash transactions.
- b) It records all cash payments and cash receipts.
- c) It records transactions in chronological order.
- d) The proforma of the cash book is similar to that of a ledger account. It has two sides – Debit side and Credit side.
- e) Cash Book simultaneously performs functions as the book of primary entry as well as a ledger account. It is also called journalised ledger.
- f) Cash Book balance reflects the total amount of cash available to the entity.

☉ Types of Cash Book

Depending upon the nature of cash transactions, Cash book is broadly classified into Regular Cash Book and Petty Cash Book. Regular Cash Book is further customized to record bank transactions and discount allowed and received from customers and suppliers respectively. The following diagram demonstrates the classification in detail.

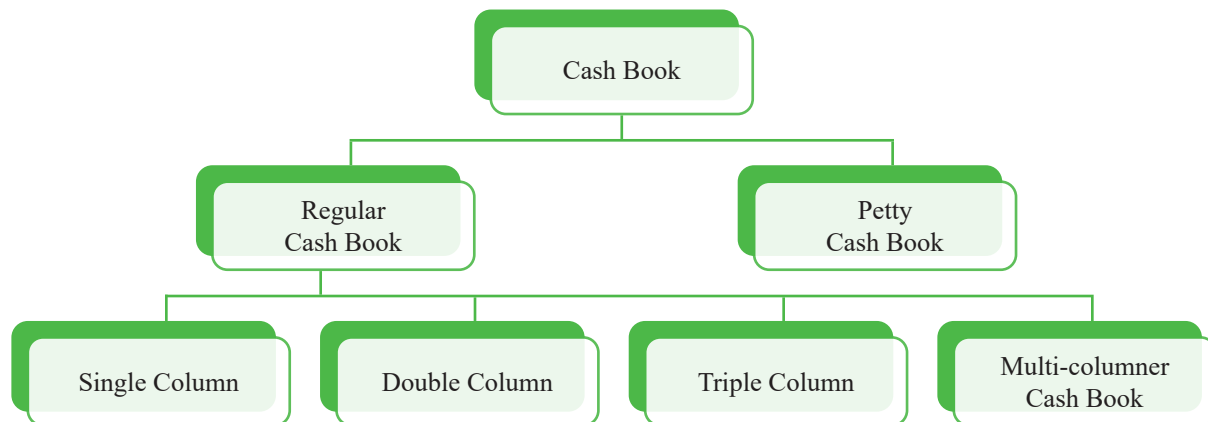


Figure 1.5: Types of Cash Book

These are discussed below.

A. Regular Cash Book: The cash book that records all the usual cash and bank transactions is called a Regular or General Cash Book. These can be further classified based on the number of columns they incorporate on either side to record transactions of specified nature.

a) Single Column Cash Book: In this cash book only one amount column is maintained on each side to record transactions settled in liquid cash only. It is usually maintained by the small organisations without the access to any bank account. In addition, when an organization keeps a separate Bank A/c in its ledger, it also keeps a single column cash book. Single Column Cash Book is equivalent to the cash account of the entity. Its balance represents cash-in-hand at a particular point of time. The proforma of the single column cash book is as under:

Dr.				Cr.			
Cash Book (Single Column)							
Date	Particulars	L.F.	Cash (₹)	Date	Particulars	L.F.	Cash (₹)

b) Double Column Cash Book: A double column cash book, also known as a two-column cash book, consists of two columns on each side to record cash and bank transactions. Rather than separating cash and bank accounts, a double column cash book enables accountants to maintain the two accounts side by side. The balance of this cash book reflects the amounts of Cash-in-hand as-well-as Cash-at-bank at a particular point of time. An entity without any bank transaction may also keep a double column cash book by considering discount column instead of bank column. The proforma of the double column cash book with bank column is as under:

Dr.					Cr.				
Cash Book (Double Column)									
Date	Particulars	L.F.	Cash (₹)	Bank (₹)	Date	Particulars	L.F.	Cash (₹)	Bank (₹)

Note: Double column cash book with cash and bank account columns side by side, gives rise to a unique type of entry referred to as the Contra Entry. When any transaction takes place involving Bank A/c and Cash A/c, the posting will happen on both side of the same account (here, the Double Column Cash Book). Examples of such transactions are: Deposit of cash into bank, Withdrawal of cash from bank etc. For recording such a transaction, the letter 'C' is written on both sides in the Ledger Folio (L.F.) column.

- c) **Triple Column Cash Book:** This type of cash book has three columns (namely Cash, Bank and Discount). The discount column on each side, however, indicate two different types of discounts—Discount Allowed on debit side and Discount Received on credit side. This is why Discount columns in a triple column cash book is never balanced but their aggregate figures are directly posted to respective ledger account.

The proforma of the double column cash book is a under:

Dr.						Cr.					
Cash Book (Triple Column)											
Date	Particulars	L.F.	Cash (₹)	Bank (₹)	Discount (₹)	Date	Particulars	L.F.	Cash (₹)	Bank (₹)	Discount (₹)

- d) **Multi-columnar Cash Book:** This is a customized form of cash book that is maintained by organisations where huge cash transactions take place under certain fixed heads. Generally, organisations like clubs, schools, colleges etc. maintain this type of cash book. The proforma of the multi-columnar cash book is a under

Dr.						Cr.					
Multi-columnar Cash Book											
Date	Particulars	Subscription (₹)	Donation (₹)	Interest Received (₹)	Misc. Income (₹)	Date	Particulars	Salaries & wages (₹)	Rent & Taxes (₹)	Communication charges (₹)	Misc. Expenses (₹)

(I) Contra Transactions

Transactions which relates to allowing discount or receiving discount in cash after the settlement of the dues are known as Contra Transactions.

Example:

- Received ₹500 as discount from Mr. Ghosh whose account was previously settle in full.

Cash A/c	Dr.	₹500
To Discount Received A/c		₹500

(Being cash received as discount from Mr. Ghosh whose account was previous settled in full)

- Paid ₹ 400 as discount to Mr. Ghosh Dastidar who settled his account in full previously.

Discount Allowed A/c	Dr.	₹400
To Cash A/c		₹400

(Being discount allowed in cash to Mr. Ghosh Dastidar who settled his account in full)

the petty cashier from the chief cashier are entered. The credit side consists of several columns including a total column. Every payment made by the petty cashier is entered on this side twice - once in the total column and then to the appropriate expense column. The difference between the total of the debit items and that of the "total column" on the credit side at any time will represent the balance of the petty cash in hand and this should tally with the petty cashier's actual holding of cash.

The posting from the petty cash book to the respective accounts in the ledger are made directly in total at the end of every month or any other fixed period.

The amount of petty cash is provided to the petty cashier either on Ordinary System or on Imprest System. Under the Ordinary System, a pre-decided amount of cash is given in lump sum by the chief cashier to the petty cashier. When the entire amount of petty cash gets spent, the petty cashier submits the details of petty expenditures to the chief cashier for review, and reimbursement.

Under the Imprest System, the total amount of petty expenses for a particular period is estimated beforehand. This amount is referred to as Imprest Cash or Imprest Float. The imprest cash is advanced by the principal cashier to the petty cashier out of which the later meets all the petty expenses incurred during the period. At the end of the fixed period, petty cashier prepares a State of Petty Cash reflecting the petty expenses incurred and submits the same to the chief cashier. The chief cashier after examination of the petty transactions remit an amount equal to the total petty expenses incurred to the petty cashier. Thus, at the beginning of the next accounting period, the petty cashier will have the same amount of imprest cash to meet the petty expenses of the period.

The following is a simple format of a petty cash book:

Dr.		Petty Cash Book								Cr.
Amount Received (₹)	Date	Particulars	V.N.	Total (₹)	Postage (₹)	Printing and Stationary (₹)	Cartage (₹)	Traveling Expenses (₹)	Misc. (₹)	

Consider the following illustrations.

Illustration 20.

Let us see an illustration for the following cash and bank transactions in the books of Mr. Abhishek

January 1 Opening cash balance was ₹3,800 and bank balance was ₹27,500

January 4 Wages paid in cash ₹1,500

January 5 received cheque of ₹19,800 from KBK enterprises after allowing discount of ₹200

January 7 Paid to consultancy charges by cheque for ₹7,500

January 10 Cash of ₹2,500 withdrawn from bank

January 12 Received a cheque for ₹4,500 in full settlement of the account of Mr. X at a discount of 10% and deposited the same into the Bank.

January 15 X's cheque returned dishonoured by the Bank

Solution:**In the Books of Abhishek
Cash Book****Dr.****Cr.**

Date	Particulars	L. F.	Cash (₹)	Bank (₹)	Discount Allowed (₹)	Date	Particulars	L. F.	Cash (₹)	Bank (₹)	Discount received (₹)
1-Jan	Opening Balance		3,800	27,500		4-Jan	Wages paid		1,500		
5-Jan	Recd from KBK			19,800	200	7-Jan	Consultancy fees			7,500	
10-Jan	Cash withdrawn		2,500			10-Jan	Cash withdrawn			2,500	
12-Jan	Mr. X			4,500	500	15-Jan	Mr. X			4,500	500
							Closing balance		4,800	37,300	
			6,300	51,800	700				6,300	51,800	500

Illustration 21.

Enter the following transactions in the columnar petty cash book of a cashier who was given ₹ 10,000 on 1st March, 2023 on the imprest system:

2023	Particulars	₹
March 2	Paid for postage stamps	800
2	Paid for stationary	1000
3	Paid for cartage	400
3	Paid for postage stamps	600
8	Paid for paper	100
12	Paid for cartage	600
18	Paid tips for trips to office staff	200
23	Paid for ink and nibs	400
25	Paid for Tiffin to office staff	600
26	Paid for train fair	500
28	Paid for bus fair	400
29	Envelops and letter heads	600
30	Printing address on above	400
31	Cab fare to manager	1000

Solution:

Amount Received (₹)	Date	Particulars	V. N.	Total (₹)	Postage (₹)	Printing and Stationary (₹)	Cartage (₹)	Traveling Expenses (₹)	Misc. (₹)
10,000	2023 March 1	To Cash							
	2	By Postage		800	800				
	2	By Stationary		1,000		1,000			
	3	By Cartage		400			400		
	3	By Postage		600	600				
	8	By Paper		100		100			
	12	By Cartage		600			600		
		By Tips to staff		200					200

		By Ink and Nibs	400		400			
		By Tiffin	600					600
		By Train Fare	500				500	
		By Bus Fare	400				400	
		By Envelops etc.	600		600			
		By Printing	400		400			
		By Cab Fare	1,000				1,000	
		By balance c/d	2,400					
10,000			10,000	1,400	2,500	1,000	1,900	800
2,400	April 1	To balance b/d						

1.6.2 Bank Reconciliation Statement

☉ Concept of Bank Reconciliation Statement

Since transactions effected in cheques, drafts and other electronic fund transfer are recorded in Bank Book (or Double Column Cash Book in case of a small organisation) by the organisation and in Pass Book/ Bank Statement by the bank, at any point of time, the balances as per Bank Book and Pass Book/Bank Statement should be equal in amount. However, this happens rarely in practice due to a number of reasons. A statement which is prepared to reconcile the above two balances is known as Bank Reconciliation Statement.

☉ Features of Bank Reconciliation Statement

Following are the features of a Bank Reconciliation Statement.

- It is just a statement and not an account.
- It is not a part of double entry book keeping system.
- It is prepared for a particular day, not for a period.
- It is prepared at regular intervals, say every month, three-month, 6-month etc according to the requirement of the company.
- It is prepared by an entity who has an account with a bank, a bank does not prepare it.
- It explains the causes of disagreement between bank statement and Bank Book.

☉ Causes of Disagreement Between Bank Statement and Bank Book (or Bank Column of Cash Book)

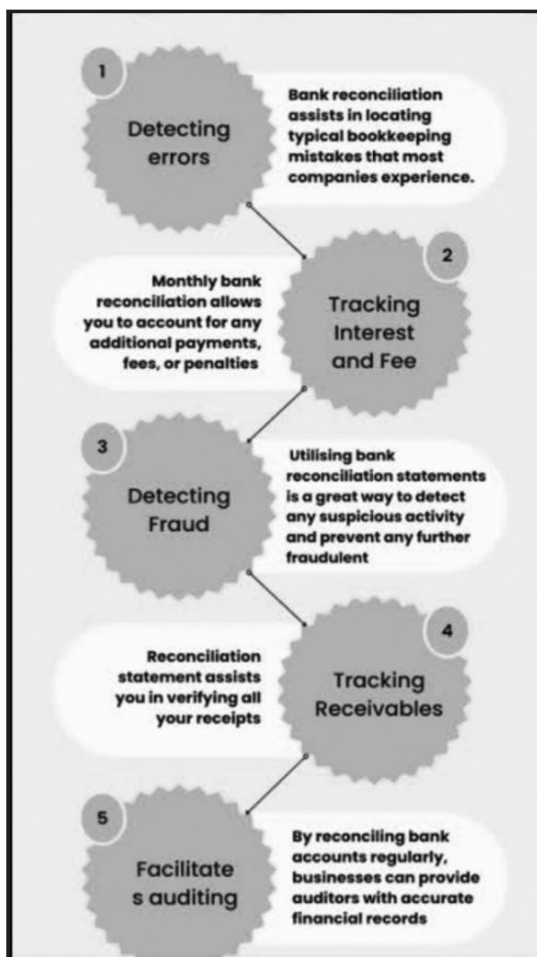
A. Items not appearing in Bank Pass Book

- Cheques issued by business entity not debited by the bank:** This may be due to the reason that the cheques have not been banked by the payee or it may still be under clearance. As a result, Bank Pass Book will show higher balance than cash book balance. This is also termed as unpresented cheques.
- Cheques deposited but not credited by the bank:** This may be due to the reason that the cheques are deposited for collection but are still in clearance. Here, balance as per Cash Book will be more than the balance as per Bank Passbook. This is also called as outstanding cheques.
- Errors in Bank Pass Book:** The Bank may by mistake miss out entering the debit or credit transactions which results in the difference.
- Standing Instructions:** The entity may give standing instruction to the Bank for certain regular payments like loan repayment instalment, transfer of funds etc. This may get entered in the Pass Book immediately, but Cash Book entry may be delayed leading to the difference.

B. Items not appearing in the Cash Book

- a) **Bank interest, Bank charges etc.:** The Bank will charge interest on overdraft or service fees for issue of demand draft, pay orders etc. Here, being the source of transaction, the Bank will record the transactions in the Pass Book immediately and send the debit advices to the business entity. The entry in the Cash Book may be delayed. Similarly, the Bank could credit interest on fixed deposits, which may get entered in business books at a later date.
- b) **Direct deposits in Bank account:** Sometimes customers or others may directly deposit an amount in the Bank for goods or services rendered. The Bank will enter it immediately, but entry in Cash Book will appear later.
- c) **Bills for collection:** The Business Entity may send bills of exchange for collection. The Bank will collect the payment and credit the same in the Passbook. The entry in Cash Book will be made only after receipt of information from the Bank.
- d) **Errors in Cash Book:** The records may be missed out by the book-keeper of the Business Entity.

Benefits of Preparing Bank Reconciliation Statement



⦿ Steps in Preparation of Bank Reconciliation Statement

The preparation of Bank Reconciliation Statement can start with any of the available balances viz. balance of Bank Book (alternatively, bank column of Cash Book) or balance of Bank Statement. After this, relevant adjustments must be made of the transactions that has caused the disagreement – either by making addition or subtraction of the relevant items. Once all the items of disagreement get adjusted, the two balances should get tallied.

The sequential steps may be listed as follows:

- Identify the balances and the character thereof. Remember, a debit balance in Cash Book means asset where as a credit balance means a Bank overdraft. In Bank passbook, it's reverse. A debit balance in Pass Book means overdraft and a credit balance is a favourable balance. This must be carefully understood.
- Based on the above, start with the balance (or overdraft) as per one book and arrive at the balance (or overdraft) as per the other book. The items of differences will be added to or deducted from the balance (or overdraft) with which the reconciliation is started.
- The end result should be the balance (or overdraft) as per the other book e.g. if you start with balance as per Cash Book, then after adding or deducting items of differences, you should arrive at the balance as per the Pass Book.
- One has to make sure that all the items of differences from Cash Book as well as Bank book are taken into account in the reconciliation statement.
- Whether the items of differences should be added or deducted will depend on the sequence you follow.

This is shown in following table.

When reconciliation is started with	Bal. as per CB	OD as per CB	Bal. as per PB	OD as per PB
Cheques deposited in Bank, but not cleared	Less	Add	Add	Less
Cheques issued, but not presented in Bank	Add	Less	Less	Add
Interest debited in PB only	Less	Add	Less	Add
Payments by Bank debited in PB only	Less	Add	Add	less
Direct payment by customer in PB only	Add	Less	Less	add
Bills discounted & dishonoured in PB only	Less	Add	Add	Less
Cheques deposited, dishonoured in PB only	Less	Add	Add	Less
Interest, Dividend, Commission collected by Bank not recorded in the Cash Book	Add	Less	Less	Add
Overcasting of payment side of Cash Book or Under casting of Receipt side of Cash Book	Add	Less	Less	Add
Undercasting of Payment side of Cash Book or overcasting of Receipts side of Cash Book	Less	Add	Add	Less
Deposits recorded twice in the Cash Book or excess amount recorded in the Cash Book	Less	Add	Add	Less
Undercasting of credit side of the Pass Book or overcasting of the debit side of the Pass Book	Less	Add	Add	Less

Cheques deposited into Bank and credited with out recording in the Cash Book	Add	Less	Less	Add
Wrong debit in the Pass Book for issue of cheque, Bank charges, etc.	Less	Add	Add	Less
Wrong credit in the Pass Book for deposit of cheque, interest, etc.	Add	Less	less	add
Cheques drawn but not actually issued to the suppliers/creditors	Add	Less	Less	Add
Bank charges recorded twice in the Cash Book	Add	LESS	LESS	Add
Amount withdrawn from Bank not recorded in the Cash Book	Less	Add	Add	less

Note: The abbreviation CB - Cash Book, PB - Pass Book and OD - Over Draft.

Consider the following illustrations.

Illustration 22.

From the following particulars of M/s Ramesh enterprises, prepare a Bank Reconciliation Statement:

- Bank overdraft as per Pass Book as on 31st March 2023 was ₹88,000.
- Cheques deposited in Bank for ₹58,000 but only ₹20,000 were cleared till 31st March 2023.
- Cheques issued were ₹25,000, ₹38,000 and ₹20,000 during the month. The cheque of ₹58,000 is still with the supplier.
- Dividend collected by Bank ₹12,500 was wrongly entered as ₹15,200 in the Bank Column of Cash Book.
- Amount transferred from FD A/c into the Current A/c ₹20,000 appeared only in Pass Book.
- Interest on overdraft ₹9,300 was debited by Bank in Pass Book and the information was received only on 3rd April 2023.
- Direct deposit by M/s Nabin Traders ₹4,000 not entered in Bank Column of Cash Book.
- Corporation tax ₹12,000 paid by Bank as per standing instruction appears in Pass Book only.

Solution:

Bank Reconciliation Statement as on 31st March 2023

Particulars	(₹)	(₹)
Overdraft as per Pass Book		88,000
Add:		
(i) Cheques issued but not presented till 31st March	58,000	
(ii) Transfer from fixed deposit	20,000	
(iii) Direct deposit by M/s Nabin Traders	4,000	82,000
		1,70,000
Less:		
(i) Cheques deposited but not cleared ₹ (58,000 - 20,000)	38,000	
(ii) Dividend collected excess recorded in Bank Column of Cash Book ₹(15,200 - 12,500)	2,700	
(iii) Interest on overdraft debited in Pass Book only	9,300	
(iv) Corporation tax paid appeared in Pass Book only	12,000	62,000
Overdraft as per Cash Book		1,08,000

Note: Bank Column of Cash Book may be construed as Bank Book.

Illustration 23.

On 31.12.2023, P. Roy's Bank Balance as shown by the Cash Book was ₹75,000. On receipt of Bank Statement it was found that:

- i) Three cheques of ₹3,000, ₹4,000 and ₹1,500 drawn in favour of suppliers respectively on 28th, 29th and 30th December, 2023 had been debited in the Bank Statement on 2nd January 2024.
- ii) The Bank had credited ₹8,000 on 30th December, 2023, in respect of collection made by Bank directly from a customer, the intimation not having yet been received.
- iii) Two cheques of ₹5,000 and ₹6,000 were deposited into Bank on 30th December, 2023 had been credited in the Bank statement on 4th January, 2024.
- iv) The Bank had debited ₹30 as incidental charges on 30th December, 2023 but not entered in the Cash Book.

Show the reconciliation of the Bank Balance as per Cash Book with the Bank Balance as per Bank Statement as on 31st December, 2023.

Solution:**Bank Reconciliation Statement of Mr. P. Roy as on 31st December, 2023**

Particulars	(₹)	(₹)
Bank Balance as per Cash Book (Dr.)		75,000
Add:		
(i) Cheques issued but not presented for payment ₹3,000, ₹4,000 & ₹1500 respectively.	8,500	
(ii) Collection by Bank from a Customer not recorded in the Cash Book	8,000	16,500
		91,500
Less:		
(i) Cheques deposited but not credited in the Pass Book on 31.12.21 ₹5,000 + ₹6,000 respectively.	11,000	
(ii) Bank charges not recorded in the C.B.	30	11,030
Balance as per Pass Book (Cr.)		80,470

Illustration 24.

On 31.12.2023 your pass book showed a credit balance of ₹5,000. Before that date you had issued cheques worth ₹1,000 of which cheques worth ₹300 were not yet cashed. On 26th December, you deposited a cheque for ₹150 in the bank but you did not enter it in cash book. The pass book showed a credit of ₹40 for interest and a debit of ₹10 for bank charges and the cash book had not corresponding entries for them. A cheque for ₹1,200 deposited in your account No. 2 was wrongly credited by the bank to this account. Dishonoured bill was debited in the pass book only ₹500. Cheques for ₹700 paid in to the bank were not yet credited in the pass book.

A wrong debit of ₹100 appears in the pass book. A cheque of ₹150 received from a customer was entered in the cash book in December, 2023 but the same was omitted to be paid in to the bank.

Determine the balance as per cash book as on that date.

Solution:**Bank reconciliation statement as on 31.12.2023**

Particulars	(₹)	(₹)
Credit Balance as per pass book		5,000
Add:		
(1) Bank charges not recorded in cash book	10	
(2) Dishonoured bill debited only in pass book	500	
(3) Cheques paid in to bank but not yet credited in pass book	700	
(4) Wrong debit in the pass book	100	
(5) Cheque received but not presented with the bank	150	1,460
		6,460
Less:		
(1) Cheques issued but not yet encashed (₹1,000 - ₹700)	300	
(2) Cheque deposited but not recorded in cash book	150	
(3) Interest not recorded in cash book	40	
(4) A wrong credit appears only in pass book	1,200	
		1,690
Balance as per Cash Book (Dr.)		4,770

Illustration 25.

The Bank Pass Book of Mr. Anil showed an overdraft of ₹6,000 on 31.12.2023. Prepare the Bank Reconciliation Statement based on the following details:

- (1) Cheques issued but not presented upto 31.12.2023, ₹5,500
- (2) Cheques deposited but not credited upto 31.12.2023, ₹9,000
- (3) Bank commission ₹30 was entered only in the Pass Book.
- (4) A cheque for ₹6,500 issued in settlement of a debt was encashed on 28.12.2023 but entered in the Cash Book as ₹8,500.

Solution:**Mr. Anil Bank Reconciliation Statement as on 31st December, 2023**

Particulars	(₹)	(₹)
Overdraft as per Pass Book		6,000
Add:		
(i) Cheques issued but not presented for payment	5,500	
(ii) Cheque for ₹6,500 issued and encashed but entered in the Cash Book at ₹8,500 (8,500 - 6,500)	2,000	7,500
		13,500

Less:		
(i) Cheques deposited but not credited	9,000	
(ii) Bank commission entered in the Pass Book only	30	9,030
Over Draft as per Cash Book (Cr.)		4,470

⊙ Amendment in Cash Book Before Preparing BRS

Sometimes, in order to find out the correct balance at bank, one needs to amend the Cash Book (i.e., bank column of Cash Book or Bank Book) before the preparation of Bank Reconciliation Statement. In short, Bank Reconciliation Statement should be prepared by taking the balance shown by the Amended Cash Book. The students should remember that usually two types of transactions are recorded in amended Cash Book -

- i) Items which were not at all recorded in Cash Book.
- ii) Any error made by Cash Book.

The transactions which are already recorded in Cash Book i.e., the rest of the transactions will go to Bank reconciliation statement.

Note: It must be remembered that preparation of Amended Cash Book is possible only when the balance as per Cash Book is given in the problem.

Steps to be followed for preparation:

- a) Open the Amended Cash Book with the Balance as per Cash Book, whether favourable or unfavourable,
- b) Adjust the items (i.e., which are not recorded in Cash Book and any other error made by Cash Book.)
- c) Close the Cash Book and find out the balance,
- d) Prepare Bank Reconciliation Statement by taking the Cash Book balance and rest of the transaction which are not adjusted against amended Cash Book.

Consider the following illustrations.

Illustration 26.

The Bank Column of the Cash Book showed an Overdraft of ₹5,000 on 31.3.2023, whereas per Bank Statement the overdraft is ₹4,200. The following differences were noticed between the two records:

- a) Cheques of ₹2,400 issued but not encashed by customers
- b) Cheques deposited but not cleared ₹1,200
- c) Collection charges debited by Bank not recorded in CB ₹100
- d) Bank interest charged by the Bank not recorded in CB ₹300
- e) Cheques dishonoured debited by Bank not in CB ₹400
- f) Interest directly received by Bank not entered in CB ₹400

Prepare Bank Reconciliation Statement after amending the CB.

Solution:

Here, please note that amended CB is asked. What it actually means is to record all revenue (expense or income) items of differences and those items that are recorded in PB only must first be recorded in the CB and then the reconciliation statement should be prepared by taking the revised balance as per CB. Here is the amended CB.

Dr.	Cash Book (Bank column only)		Cr.
Particulars	(₹)	Particulars	(₹)
To, Interest received	400	By, Balance b/d (OD)	5,000
		By, Colloection charges	100
		By, Bank interest	300
To, Balance c/d (OD)	5,400	By, Customer (chq dishonoured)	400
	5,800		5,800

Bank Reconciliation Statement as on 31-03-2023

Particulars	(₹)
Bank OD as per CB	5,400
Add: Cheques deposited, but not cleared	1,200
Less: cheques issued but not encashed	(2,400)
Bank OD as per PB	4,200

Illustration 27.

The following is a summary from Cash Book of M/s Adarsh Trading for the month of Sept 2023.

	(₹)		(₹)
Balance b/d	1,407	Payments	15,520
Receipts	15,073	Balance c/d	960
	16,480		16,480

On investigation it was found that

- a) Bank charges of ₹35 were not entered in the Cash Book
- b) A cheque of ₹47 issued to supplier was entered by mistake as a receipt in the Cash Book.
- c) A cheque of ₹18 was returned by the Bank marked as 'refer to drawer' but it's not entered in Cash Book.
- d) The balance brought forward in Sept 2023 should have been ₹1,470.
- e) Cheques paid to suppliers ₹214, ₹370 and ₹30 have not been presented for payment.
- f) Deposits of ₹1542 on 30th Sept were cleared by the Bank on 2nd October.
- g) The Bank charged a cheque wrongly to Adarsh trading ₹72.
- h) Bank statement shows overdraft of ₹124 as on 30th Sept 2023.

Show what adjustments will you make in the Cash Book and prepare a Bank reconciliation statement as on 30-09-2023.

Solution:

As we know, the errors in the Cash Book must first be corrected and entries that have been missed out in the CB should be recorded.

Dr.		Cash Book for Sept 2023		Cr.	
Particulars	(₹)	Particulars	(₹)		
To, Original balance b/d	960	By, Bank charges not recorded earlier	35		
To, Error in balance carried (1,470 - 1,407)	63	By, Cheques issued recorded as receipt Now corrected (2×47)	94		
		By, Cheque returned	18		
		By, Revised balance c/d	876		
	1,023			1,023	

Now we can prepare the Bank reconciliation statement.

Bank Reconciliation from member as on 30.9.2023

Particulars	(₹)	(₹)
Balance as per Cash Book		876
Add: Cheques issued but not presented (214 + 370 + 30)		614
		1,490
Less: i) Deposits not cleared	1,542	
ii) Cheques charged by mistake	72	1,614
Overdraft as per Pass Book		124

In the process of accounting, transactions are initially recorded in the primary books wherefrom they are posted to respective accounts in the ledgers. On the reporting date, the ledger accounts are balanced for the purpose of drafting the financial statements. At this juncture, a statement is generally prepared by summarizing the account balances with a view to check the arithmetical accuracy of accounting. This statement is known as Trial Balance.

⊙ Definition of Trial Balance

Trial balance may be defined as a statement or a list of all ledger account balances taken from various ledgers on a particular date to check the arithmetical accuracy.

According to the Dictionary for Accountants by Eric. L. Kohler, Trial Balance is defined as “a list or abstract of the balances or of total debits and total credits of the accounts in a ledger, the purpose being to determine the equality of posted debits and credits and to establish a basic summary for financial statements”.

According to Rolland, Trial Balance is defined as “The final list of balances, totalled and combined, is called Trial Balance”.

Trial Balance is merely a listing of balances on a particular date. Further it must be understood that Trial Balance does not form part of books of account, but it is a report prepared by extracting balances of accounts maintained in the books of accounts. Although it is supposed to be prepared at the end of accounting period, computerized accounting packages are capable of providing instant Trial Balance reports even on daily basis.

⊙ Features of a Trial Balance

Following are the features of Trial Balance:

- a) It is a list of debit and credit balances which are extracted from various ledger accounts.
- b) It is not an account. It is only a statement of debit and credit balances of account.
- c) The purpose is to establish arithmetical accuracy of the transactions recorded in the Books of Accounts.
- d) It does not prove accounting accuracy which can be determined by audit.
- e) It is not a part of the final statements.
- f) It is usually prepared at the end of the accounting year, but it can also be prepared anytime as and when required.
- g) It is a link between books of accounts and the Profit and Loss Account and Balance Sheet.

⊙ Purpose of a Trial Balance

Trial Balance serves the following purposes:

- a) **Bird's Eye View:** The trial balance gives the summary of all the ledgers. Since the net amount gets displayed, one can save time by not viewing the concerned ledger again.

- b) **Pointing out Error:** The trial balance aids in pointing out errors. It is also used to check the arithmetical accuracy of books of accounts. If the trial balance does not tally, the errors can be found out, rectified and then financial statements can be prepared.
- c) **Basis for Preparation of Financial Statements:** It forms the basis for preparation of financial statements i.e., Profit and Loss Account and Balance Sheet.
- d) **Quick Reference:** It acts as a quick reference. One can easily find out the balance in any ledger account without actually referring to the ledger.
- e) **Helps in Analyses:** If the listing of ledger accounts is systematically done in the trial balance, one can do a quick trend analysis. Hence, listing is usually done in the sequence of Asset accounts, Liability accounts, Capital accounts, Owner's equity accounts, Income or gain accounts and Expenses or losses accounts in that order. One can draw some quick inferences from trial balance by interpreting the same. If one plots monthly trial balances side by side, one can analyse the movement of balances in various accounts e.g., one can see how expenses are increasing or decreasing or showing a trend of movements. By comparing the owner's equity balances as on two dates, one can interpret the business result e.g., if the equity has gone up, one can interpret that business has earned net profit and vice versa.

Preparation of Trial Balance is not indispensable as it is not a part of financial statements. It is a mere statement prepared by the accountants for his own convenience and if it agrees, it is assumed that at least arithmetical accuracy has been confirmed although there may be a lot of errors undetected.

☉ Method of Preparation of Trial Balance

Trial Balance can be prepared under any of the following two methods:

- a) Total Method or Gross Trial Balance:
- b) Balance Method or Net Trial Balance.
- c) Compound Method.

These are explained as under:

- a) **Total Method or Gross Trial Balance:** Under this method, two sides of the accounts are totalled. The total of the debit side is called the "debit total" and the total of the credit side is called the "credit total". Debit totals are entered on the debit side of the Trial Balance while the credit total is entered on the credit side of the Trial Balance.

If a particular account has total in one side, it will be entered either in the debit column or the credit column as the case may be.

Advantages:

- a) It checks arithmetical accuracy of the accounts.
- b) Extraction of ledger balances is not required at the time of preparation of Trial Balance.

Disadvantages: Preparation of final accounts is not facilitated.

- b) **Balance Method or Net Trial Balance:** Under this method, all the ledger accounts are balanced. The balances may be either "debit-balance" or "credit balance".

Advantages:

- a) It helps in the easy preparation of final accounts.

b) It saves time and effort in constructing a Trial Balance.

Disadvantages:

Errors may remain undisclosed irrespective of the agreement of Trial Balance.

c) **Compound Method** : Under this method, totals of both the sides of the accounts are written in the separate columns. Along with this, the balances are also written in the separate columns. Debit balances are written in the debit column and credit balances are written in the credit column of the Trial Balance.

Advantages : It offers the advantage of both the methods.

Disadvantages : Lengthy process and more time consumed in the preparation of a Trial Balance.

Note: In the trial balance, all assets, drawings, debtors, expenses and losses are included in the debit balances column and all liabilities, capital, creditors, gains and incomes are included in credit balances column.

⊙ **Pro-forma of Trial Balance**

Generally, the following pro-forma is used in preparation of a Trial Balance.

Trial Balance of as on

Sl. No.	Ledger Accounts	L.F.	Dr.	Cr.
			₹	₹

Note: However, in some cases, in order to minimize the space utilised, Debit. and Credit balances are shown on the left and right sides of the trial balance respectively.

⊙ **Treatment of Various Items in the Trial Balance**

The following table gives the treatment of various items in the trial balance.

Heads of Accounts	Side of Trial Balance	Reasons
Cash in hand	Debit	Assets
Cash at Bank	Debit	Assets
Cash at Bank (overdrawn)	Credit	Liability
Bank Overdraft	Credit	Liability
Capital	Credit	Liability
Opening stock	Debit	Assets
Wages	Debit	Expenses
Purchase	Debit	Expense/Increase in stock
Carriage Inwards	Debit	Expenses
Freight	Debit	Expenses
Royalty on production	Debit	Expenses
Gas, Water, Fuel	Debit	Expenses

Motive Power	Debit	Expenses
Import Duty	Debit	Expenses
Sales	Credit	Income/Decrease in stock
Discount Allowed	Debit	Losses
Discount Received	Credit	Gains
Bad Debts	Debit	Losses
Reserve /Provision for Bad & Doubtful Debt (Opening)	Credit	Gains (It is a part of retained earning)
Commission Received	Credit	Incomes
Salaries	Debit	Expenses
Commission paid	Debit	Expenses
Rent, rates, and taxes	Debit	Expenses
Repairs and maintenance	Debit	Expenses
Insurance	Debit	Expenses
Carriage outward	Debit	Expenses
Trade charges	Debit	Expenses
Royalty on sales	Debit	Expenses
Interest paid	Debit	Expenses
Interest received	Credit	Income
Advertisement	Debit	Expenses
Sundry expenses	Debit	Expenses
Miscellaneous expenses	Debit	Expenses
Miscellaneous receipts	Credit	Incomes
Income tax	Debit	Drawings
L.I.C. Premium	Debit	Drawings
Office expenses	Debit	Expenses
Export duty	Debit	Expenses
Allowances	Debit	Losses
Rebates	Debit	Losses
Sales tax	Debit	Expenses
Horses and Carts	Debit	Assets
Watch Dog Squad	Debit	Assets
Loan Secured	Credit	Liability
Loans Advanced	Debit	Assets
Reserve Funds	Credit	Liability (It is a part of retained earning)
Sinking Fund	Credit	Liability
Sinking Fund Investments	Debit	Assets

Ecology Fund	Credit	Liability
Ecology Fund Investments	Debit	Assets
Building Fund	Credit	Liability
Building	Debit	Assets
Land	Debit	Assets
Plant	Debit	Assets
Machinery	Debit	Assets
Furniture & fittings	Debit	Assets
Motor vehicles	Debit	Assets
Computer	Debit	Assets
Office equipment	Debit	Assets
Goodwill	Debit	Assets
Patent rights	Debit	Assets
Copyrights	Debit	Assets
Trade marks	Debit	Assets
Investments	Debit	Assets
Shares & Securities (as investment)	Debit	Assets
G. P. Notes	Debit	Assets
Sundry debtors	Debit	Assets
Sundry creditors	Credit	Liability
General Reserve	Credit	Liability
Bill Receivable	Debit	Assets
Bills Payable	Credit	Liability
Provision for Discount on Debtors	Credit	Liability
Provision for Discount on Creditors	Debit	Assets
Lighting and Heating	Debit	Expense
Drawings	Debit	Assets
Contribution to Provident Fund	Debit	Assets
Prize Fund	Credit	Liability
Depreciation	Debit	Losses (Non cash expenses)
Provision for Depreciation	Credit	Liability
Returns Inwards	Debit	Losses
Returns Outwards	Credit	Gains
Freehold Property	Debit	Assets
Premises	Debit	Assets
Leasehold Property	Debit	Assets
Loose Tools	Debit	Assets
Petty Cash	Debit	Assets

Provident Fund	Credit	Liability
Debentures Purchased	Debit	Assets
Debentures (from Public)	Credit	Liability
Loan on Mortgage	Credit	Liability
Prepaid Expenses	Debit	Assets
Outstanding Expenses	Credit	Liability
Bad Debts Recovered	Credit	Gains
Accrued Incomes	Debit	Assets
Apprenticeship Premium received	Credit	Income
Books	Debit	Assets
Newspaper and Magazine	Debit	Expenses
Profit and Loss A/c (Dr.)	Debit	Losses
Profit and Loss A/c (Cr.)	Credit	Gains
Accumulated Depreciation	Credit	Liability
Postage and Telegram	Debit	Expense
Travelling & Conveyance	Debit	Expenses

Consider the following illustration.

Illustration 28.

From the following ledger account balances, prepare a Trial Balance of Mr. Sen for the year ended 31st March, 2024. Capital ₹80,000; Sales ₹10,00,000; Adjusted Purchase ₹8,00,000; Current A/c (cr) ₹10,000; Petty Cash ₹10,000; Sales Ledger Balance ₹1,20,000; Purchase Ledger Balance ₹60,000; Salaries ₹24,000; Carriage Inwards ₹4,000; Carriage Outward ₹6,000; Discount Allowed ₹10,000; Building ₹80,000; Outstanding Expenses ₹10,000; Prepaid Insurance ₹2,000; Depreciation ₹4,000; Cash at Bank ₹80,000; Loan A/c (cr) ₹66,000; Profit & Loss A/c(cr) ₹20,000; Bad Debts Recovered ₹2,000; Stock at 31.03.2024 ₹1,20,000; Interest Received ₹10,000; Accrued Interest ₹4,000; Investment ₹20,000; Provision for Bad Debts (01.04.2023) ₹6,000; General Reserve ₹20,000.

Solution.

Trial Balance of Mr. Sen

Dr. Cr.
as on 31st March, 2024

Heads of Accounts	₹	Heads of Accounts	₹
Adjusted Purchase	8,00,000	Capital	80,000
Petty Cash	10,000	Sales	10,00,000
Sales Ledger Balance	1,20,000	Current A/c	10,000
Salaries	24,000	Purchase Ledger Balance	60,000
Carriage Inward	4,000	Outstanding Expenses	10,000
Discount Allowed	10,000	Loan A/c	66,000
Building	80,000	Profit & Loss A/c(cr)	20,000
Prepaid Insurance	2,000	Bad Debts Recovered	2,000

Depreciation	4,000	Interest Received	10,000
Cash at Bank	80,000	Provision for Bad debts	6,000
Stock (31.03.2024)	1,20,000	General Reserve	20,000
Accrued Interest	4,000		
Investment	20,000		
Carriage outward	6,000		
Total	12,84,000	Total	12,84,000

Illustration 29.

Journalize the following transactions in the books of Gaurav, post them into ledger and prepare trial balance for June 2023:

June 1: Gaurav started business with ₹10,00,000 of which 25% amount was borrowed from wife.

June 4: Purchased goods from Aniket worth ₹40,000 at 20% TD and 1/5th amount paid in cash.

June 7: Cash purchases ₹25,000.

June 10: Sold goods to Vishakha ₹30,000 at 30% TD and received 30% amount in cash.

June 12: Deposited cash into bank ₹20,000.

June 15: Uninsured goods destroyed by fire ₹5,500.

June 19: Received commission ₹3,500.

June 22: Paid to Aniket ₹25,500 in full settlement of Account.

June 25: Cash stolen from cash box ₹1,000.

June 27: Received from Vishakha ₹14,500 and discount allowed ₹200.

June 30: Interest received ₹2,400 directly added in our bank account.

Solution:

In the books of Gaurav

Journal

Date 2023	Particulars	L.F.	Dr.	Cr.
			(₹)	(₹)
1-Jun	Cash A/c Dr. To Capital A/c To Loan from Wife A/c (Being capital brought into business)		10,00,000	7,50,000 2,50,000
4-Jun	Purchases A/c Dr. To Cash A/c To Aniket's A/c (Being goods purchased at 20% TD & 1/5th amount paid in cash)		32,000	6,400 25,600
7-Jun	Purchases A/c Dr. To Cash A/c (Being cash purchases)		25,000	25,000

10-Jun	Cash A/c Vishakha's A/c To Sales A/c (Being goods sold at 30% TD & 30% amount received in cash)	Dr. Dr.	6,300 14,700	21,000
12-Jun	Bank A/c To Cash A/c (Being cash deposited in bank)	Dr.	20,000	20,000
15-Jun	Loss by Fire A/c To Purchases A/c (Being uninsured goods lost by fire)	Dr.	5,500	5,500
19-Jun	Cash A/c To Commission A/c (Being commission received)	Dr.	3,500	3,500
22-Jun	Aniket's A/c To Cash A/c To Discount A/c (Being paid to Aniket in full settlement & discount received)	Dr.	25,600	25,500 100
25-Jun	Loss by Theft A/c To Cash A/c (Being cash stolen)	Dr.	1,000	1,000
27-Jun	Cash A/c Discount A/c To Vishakha's A/c (Being amount received from Vishakha & discount allowed)	Dr. Dr.	14,500 200	14,700
30-Jun	Bank A/c To Interest A/c (Being interest received directly added into bank account)	Dr.	2,400	2,400

Dr.

Cash Account

Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
1/6/23	To Capital A/c		7,50,000	4/6/23	By Purchases A/c		6,400
1/6/23	To Loan from Wife A/c		2,50,000	7/6/23	By Purchases A/c		25,000
10/6/23	To Sales A/c		6,300	12/6/23	By Bank A/c		20,000
19/6/23	To Commission A/c		3,500	22/6/23	By Aniket's A/c		25,500
27/6/23	To Vishakha's A/c		14,500	25/6/23	By Loss by Theft A/c		1,000
				30/6/23	By Balance c/d		9,46,400
			10,24,300				10,24,300
1/7/23	To Balance b/d		9,46,400				

Dr.				Capital Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
30/6/23	To Balance c/d		7,50,000	1/6/23	By Cash A/c		7,50,000				
			7,50,000				7,50,000				
				1/7/23	By Balance b/d		7,50,000				

Dr.				Loan from Wife Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
30/6/23	To Balance c/d		2,50,000	1/6/23	By Cash A/c		2,50,000				
			2,50,000				2,50,000				
				1/7/23	By Balance b/d		2,50,000				

Dr.				Purchases Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
4/6/23	To Cash A/c		6,400	15/6/23	By Loss by fire A/c		5,500				
4/6/23	To Aniket's A/c		25,600	30/6/23	By Bal c/d		51,500				
7/6/23	To Cash A/c		25,000								
			57,000				57,000				
1/7/23	To Balance b/d		51,500								

Dr.				Aniket's Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
22/6/23	To Cash A/c		25,500	4/6/23	By Purchases A/c		25,600				
22/6/23	To Discount A/c		100								
			25,600				25,600				

Dr.				Vishakha's Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
10/6/23	To Sales A/c		14,700	27/6/23	By Cash A/c		14,500				
				27/6/23	By Discount A/c		200				
			14,700				14,700				

Dr.				Sales Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
30/6/23	To Balance c/d		21,000	10/6/23	By Cash A/c		6,300				
				10/6/23	By Vishakha's A/c		14,700				
			21,000				21,000				
				1/7/23	By Balance b/d		21,000				

Dr. Bank Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
12/6/23	To Cash A/c		20,000	30/6/23	By Balance c/d		22,400
30/6/23	To Interest A/c		2,400				
			22,400				22,400
1/7/23	To Balance b/d		22,400				

Dr. Loss by Fire Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
15/6/23	To Purchases A/c		5,500	30/6/23	By Balance c/d		5,500
			5,500				5,500
1/7/23	To Balance b/d		5,500				

Dr. Commission Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
30/6/23	To Balance c/d		3,500	19/6/23	By Cash A/c		3,500
			3,500				3,500
				1/7/23	By Balance b/d		3,500

Dr. Discount Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
27/6/23	To Vishakha's A/c		200	22/6/23	By Aniket's A/c		100
				30/6/23	By Balance c/d		100
			200				200
1/7/23	To Balance b/d		100				

Dr. Loss by Theft Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
25/6/23	To Cash A/c		1,000	30/6/23	By Balance c/d		1,000
			1,000				1,000
1/7/23	To Balance b/d		1,000				

Dr. Interest Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
30/6/23	To Balance c/d		2,400	30/6/23	By Bank A/c		2,400
			2,400				2,400
				1/7/23	By Balance b/d		2,400

Trial Balance as on 30.7.23

Name of Account	Dr.	Cr.
	(₹)	(₹)
Cash A/c	9,46,400	-----
Capital A/c	-----	7,50,000
Loan from Wife A/c	-----	2,50,000
Purchases A/c	51,500	-----
Aniket's A/c	-----	-----
Vishakha's A/c	-----	-----
Sales A/c	-----	21000
Bank A/c	22,400	-----
Loss by Fire A/c	5,500	-----
Commission A/c	-----	3500
Discount A/c	100	-----
Loss by Theft A/c	1,000	-----
Interest A/c	-----	2,400
Total	10,26,900	10,26,900

Illustration 30.

Journalize the following transactions in the books of M/s R & Sons, post them into ledger and prepare trial balance for April 2023:

- Apr. 1: Commenced business with ₹40,000.
 Apr. 4: Bought goods for cash ₹4,000
 Apr. 7: Sold goods ₹700
 Apr. 10: Bought goods from M/s B Bros. ₹3,000 at 10% trade discount.
 Apr. 14: Purchased machinery of ₹5,000 from M/s R Bros.
 Apr. 16: Paid for transportation of machinery ₹500 & installation charges ₹300 on it.
 Apr. 20: Paid quarterly interest on borrowed amount of ₹5,000 at 12% p.a.
 Apr. 24: Supplied goods to M/s M & Sons ₹3,500.
 Apr. 27: Paid to M/s B Bros. ₹2,600 in full settlement of account.
 Apr. 28: M/s M & Sons returned goods worth ₹300 & paid for ₹1,200 on account.
 Apr. 29: Received commission ₹250.
 Apr. 30: Paid conveyance to manager ₹450.

Solution:

**In the books of M/s R and Sons
Journal**

Date 2023	Particulars	L.F.	Dr.	Cr.
			(₹)	(₹)
1-Apr	Cash A/c To Capital A/c (Being cash introduced as capital)	Dr.	40,000	40,000
4-Apr	Purchases A/c To Cash A/c (Being bought goods for cash)	Dr.	4,000	4,000
7-Apr	Cash A/c To Sales A/c (Being sold goods for cash)	Dr.	700	700
10-Apr	Purchases A/c To M/s B Bros. A/c (Being purchased goods at 10% TD)	Dr.	2,700	2,700
14-Apr	Machinery A/c To M/s R Bros. A/c (Being purchased machinery on credit)	Dr.	5,000	5,000
16-Apr	Machinery A/c To Cash A/c (Being transportation & installation charges on machinery paid)	Dr.	800	800
20-Apr	Interest A/c To Cash A/c (Being paid quarterly interest on borrowed amt. of ₹5,000 at 12% p.a.)	Dr.	150	150
24-Apr	M/s M & Sons A/c To Sales A/c (Being goods sold on credit)	Dr.	3,500	3,500
27-Apr	M/s B Bros. A/c To Cash A/c To Discount A/c (Being paid in full settlement & discount received)	Dr.	2,700	2,600 100
28-Apr	Return Inwards A/c Cash A/c To M/s M & Sons A/c (Being goods returned & received on account)	Dr. Dr.	300 1,200	1,500
29-Apr	Cash A/c To Commission A/c (Being commission received)	Dr.	250	250
30-Apr	Conveyance A/c To Cash A/c (Being conveyance paid to manager)	Dr.	450	450

Ledger

Dr. **Cash Account** Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
1.4.23	To Capital A/c		40,000	4.4.23	By Purchases A/c		4,000
7.4.23	To Sales A/c		700	16.4.23	By Machinery A/c		800
28.4.23	To M/s M & Sons A/c		1,200	20.4.23	By Interest A/c		150
29.4.23	To Commission A/c		250	27.4.23	By M/s B Bros. A/c 2,600		
				30.4.23	By Conveyance A/c		450
				30.4.23	By Balance c/d		34,150
			42,150				42,150
1.5.23	To Balance b/d		34,150				

Dr. **Capital Account** Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
30.4.23	To Balance c/d		40,000	1.4.23	By Cash A/c		40,000
			40,000				40,000
				1.5.23	By Balance b/d		40,000

Dr. **Purchases Account** Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
4.4.23	To Cash A/c		4,000	30.4.23	By Balance c/d		6700
10.4.23	To M/s B Bros. A/c		2,700				
			6,700				6,700
1.5.23	To Balance b/d		6,700				

Dr. **Sales Account** Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
30.4.23	To Balance c/d		4,200	7.4.23	By Cash A/c		700
				24.4.23	By M/s M & Sons A/c		3,500
			4,200				4,200
				1.5.23	By Balance b/d		4,200

Dr. **M/s B Bros. Account** Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
27.4.23	To Cash A/c		2,600	10.4.23	By Purchases A/c		2,700
27.4.23	To Discount A/c		100				
			2,700				2,700

Dr. Machinery Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
14.4.23	To M/s R Bros. A/c		5,000	30.4.23	By Balance c/d		5,800
16.4.23	To Cash A/c		800				
			5,800				5,800
1.5.23	To Balance b/d		5,800				

Dr. M/s R Bros. Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
30.4.23	To Balance c/d		5,000	14.4.23	By Machinery A/C		5,000
			5,000				5,000
				1.5.23	By Balance b/d		5,000

Dr. Interest Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
20.4.23	To Cash A/c		150	30.4.23	By Balance c/d		150
			150				
1.5.23	To Balance b/d		150				

Dr. M/S M & Sons Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
24.4.23	To Sales A/c		3,500	28.4.23	By Return Inwards A/c		300
				28.4.23	By Cash A/c		1,200
				30.4.23	By Balance c/d		2,000
			3,500				3,500
1.5.23	To Balance b/d		2,000				

Dr. Discount Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
30.4.23	To Balance c/d		100	27.4.23	By M/s Bhandari Bros. A/c		100
			100				100
				1.5.23	By Balance b/d		100

Dr. Return Inwards Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
28.4.23	To M/s Kunal & Sons A/c		300	30.4.23	By Balance c/d		300
			300				300
1.5.23	To Balance b/d		300				

Dr. Commission Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
30.4.23	To Balance c/d		250	29.4.23	By Cash A/c		250
			250				250
				1.5.23	By Balance b/d		250

Dr. Conveyance Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
30.4.23	To Cash A/c		450	30.4.23	By Balance c/d		450
			450				450
1.5.23	To Balance b/d		450				

Trial Balance as on 30.4.23

Dr. Cr.

Name of Account	(₹)	(₹)
Cash A/c	34,150	-----
Capital A/c	-----	40,000
Purchases A/c	6700	-----
Sales A/c	-----	4,200
M/s B Bros. A/c	-----	-----
Machinery A/c	5,800	-----
M/s R Bros. A/c	-----	5,000
Interest A/c	150	-----
M/s M & Sons A/c	2,000	-----
Discount A/c	-----	100
Return Inwards A/c	300	-----
Commission A/c	-----	250
Conveyance A/c	450	-----
Total	49,550	49,550

Illustration: 31.

Enter the following transactions in the proper subsidiary books and post them to ledger accounts. Also prepare Trial Balance:

2023

Jan. 1: Purchased goods worth ₹6,000 from M/s A. Kumar & Sons on credit.

Jan. 5: Sold goods to M/s Vinay Kumar ₹2,000 on credit.

Jan. 7: Purchased goods from M/s Vinod Bros. ₹4,000 at 5% TD.

Jan. 9: Sold goods to P. Kumar on cash ₹500.

Jan. 12: Bought goods from Jayant Kumar ₹3,500 at 10% TD.

Jan. 17: Supplied goods to M/s Ramakanta ₹2,500 at 5% TD.

Jan. 20: Sold furniture to M/s N. Kumar worth ₹1,200.

Jan. 22: Returned goods to M/s Vinod Bros. ₹500 gross.

Jan. 25: M/s Vinay Kumar returned goods worth ₹500.

Jan. 27: Sent debit note to M/s A. Kumar for ₹200.

Jan. 30: Sold goods to N. Kumar worth ₹9,000 and received half amount on the spot.

Solution:

Purchases Book

Date	Name of Supplier	Inward Invoice No.	L.F	(₹)
1.1.23	M/s A. Kumar			6,000
7.1.23	M/s Vinod Bros. (4000 - 5% TD)			3,800
12.1.23	Jayant Kumar (3500 - 10% TD)			3,150
				12,950

Sales Book

Date	Name of Supplier	Outward Invoice No.	L.F	(₹)
5.1.23	M/s Vinay Kumar			2,000
17.1.23	M/s Ramakant (2500 - 5% TD)			2,375
30.1.23	M/s N. Kumar			4,500
				8,875

Return Inwards Book

Date	Name of Supplier	Credit Note No.	L.F	(₹)
25.1.23	M/s Vinay Kumar			500
				500

Return Outwards Book

Date	Name of Supplier	Debit Note No.	L.F	(₹)
22.1.23	M/s Vinod Bros. (500 - 5% TD)			475
27.1.23	M/s A. Kumar			200
				675

Dr.

Cash Book

Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
9.1.23	To Sales A/c (Being cash sales)		500	31.1.23	By Balance c/d		5,000
30.1.23	To Sales A/c (Being cash sales)		4,500				
			5,000				5,000
1.2..23	To Balance b/d		5,000				

Dr.				Purchases Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
31.1.23	To Sundries as per purchases book		12,950								
				31.1.23	By Balance c/d		12,950				
1.2.23	To Balance b/d		12,950				12,950				

Dr.				Sales Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
31.1.23	To Balance c/d		13,875	9.1.23	By Cash A/c		500				
				30.1.23	By Cash A/c		4,500				
				31.1.23	By Sundries as per Sales Book		8,875				
			13,875				13,875				
				1.2.23	By Balance b/d		13,875				

Dr.				Return Inwards Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
31.1.23	To Sundries as per return inwards book		500	31.1.23	By Balance c/d		500				
			500				500				
1.2.23	To Balance b/d		500								

Dr.				Return Outwards Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
31.1.23	To Balance c/d		675	31.1.23	By Sundries as per return outwards book		675				
			675				675				
				1.2.23	By Balance b/d		675				

Dr.				M/s A. Kumar Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
27/1/23	To Return Outwards A/c		200	1/1/23	By Purchases A/c		6000				
31/1/23	To Balance c/d		5,800								
			6,000				6,000				
				1/2/23	By Balance b/d		5,800				

Dr.				M/s Vinod Bros Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
22.1.23	To Return Outwards A/c		475	7.1.23	By Purchases A/c		3,800				
31.1.23	To Balance c/d		3,325								
			3,800				3,800				
				1.2.23	By Balance b/d		3,325				

Dr. Jayant Kumar Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
31.1.23	To Balance c/d		3,150	12.1.23	By Purchases A/c		3,150
				1.2.23	By Balance b/d		3,150

Dr. M/s Vinay Kumar Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
5.1.23	To Sales A/c		2,000	25.1.23	By Return Inwards A/c		500
				31.1.23	By Balance c/d		1,500
			2,000				
1.2.23	To Balance b/d		1,500				

Dr. M/s Ramakant Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
17.1.23	To Sales A/c		2,375	31.1.23	By Balance c/d		2,375
1.2.23	To Balance b/d		2,375				

Dr. M/s N. Kumar Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
20.1.23	To Furniture A/c		1,200	31.1.23	By Balance c/d		5,700
30.1.23	To Sales A/c		4,500				
			5,700				5,700
1.2.23	To Balance b/d		5,700				

Dr. Furniture Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
31.1.23	To Balance c/d		1,200	20.1.23	By M/s N. Kumar A/c		1,200
				1.2.23	By Balance b/d		1,200

Dr. Trial Balance as on 31.1.2023 Cr.

Name of Account	(₹)	(₹)
Cash A/c	5,000	-----
Purchases A/c	12,950	-----
Sales A/c	-----	13,875
Return Inwards A/c	500	-----
Return Outwards A/c	-----	675
M/s A. Kumar A/c	-----	5,800

M/s Vinod Bros. A/c	----	3,325
Jayant Kumar A/c	----	3,150
M/s Vinay Kumar A/c	1,500	----
M/s Ramakant A/c	2,375	----
M/s N. Kumar A/c	5,700	----
Furniture A/c	----	1,200
Total	28,025	28,025

Illustration 32.

The total of debit side of Trial Balance of a larger boot and shoe repairing firm as on 31.12.2023 is ₹1,66,590 and that of the credit side is ₹42,470. After several checking and re-checking the mistakes are discovered:

Items of Account	Correct Figure (as it would be) ₹	Figures as it appears in the Trial Balance ₹	
Opening Stock	14,900	14,800	
Repairs (outstanding)	61,780	61,780	(appear in the Debit side)
Rent & Taxes	2,160	2,400	
Sundry Creditors	6,070	5,900	
Sundry Debtors	8,060	8,310	

Ascertain the correct total of the Trial Balance.

Solution:

Particulars	Debit (₹)	Credit (₹)
Total as per Trail Balance	1,66,590	42,470
Opening Stock understated (14,900-14,800)	+100	-
Repairs being credit balance, but shown as debit balance	-61,780	+61,780
Rent & Taxes overstated (2,400-2,160)	-240	-
Sundry Creditors understated (6,070-5,900)	-	+170
Sundry Debtors overstated (8,310-8,060)	-250	-
Total	1,04,420	1,04,420

Adjustment Entries and Rectification of Errors

1.8

1.8.1 Adjustment Entries

⦿ Concept of Adjustment Entries

At the end of the reporting period, entities prepare the financial statements on the basis of the ledger balances appearing as on that date. However, in many cases the balances reflected by the ledger accounts are not final and certain adjustments may be required to convert into the true figures. The entries which are required to adjust the ledger balances to reflect the true figure are known as adjustment entries.

The passing of adjusting entry(s) is a fundamental bookkeeping and accounting process. The primary purpose for the adjusting process is to reflect true essence of the transactions and the proper situation of the entity as on the date of passing of such entries. It happens to be a necessary part of the accounting cycle and has to be built into the accounting system.

The adjustment entries are passed at the end of an accounting period, and these entries usually have reflections in the income statement as-well-as the balance sheet. These entries are not passed on the basis of source documents like invoice, bill etc. However, the documents may indicate the amount to be adjusted.

After the ledger balances are adjusted by the adjusting entries, accountant has to prepare an adjusted trial balance based on all account balances, now adjusted. These adjusted balances are finally used to prepare the financial statements.

⦿ Features of Adjustment Entries

The features of adjustment entries are:

- (a) These are a special type of journal entries.
- (b) There are no source documents like vouchers for the transactions.
- (c) These entries are recorded on the Journal Proper.
- (d) These are passed to reflect the final balance of an account that would appear in the financial statements.
- (e) These entries are passed to comply with the accounting principles.
- (f) Adjustment entries are passed at the end of an accounting period.

⦿ Different Categories of Adjustment Entries

Adjustment entries are broadly classified into the following three types:

A. Prepaid and Pre-received: The transactions under this category involve – Prepaid expenses and Unearned revenues. The former refers to money paid in advance for expenses not yet incurred, while the later are money received in advance but yet to be earned.

For example, suppose, M/S X & Co. paid insurance premium of ₹12,000 on car insurance for one year effective from 01.07.2023. Out of the total amount paid, ₹9,000 (01.07.23 to 31.03.24) will be considered for the financial year 2023-24 and the remaining 3 months' premium will be considered as Prepaid Insurance.

Similarly, suppose, Youngsters' Club received subscription of ₹18,000 from a member for 18 months effective from 01.07.2023. Out of the total amount, ₹9,000 (01.07.23 to 31.03.24) will be considered for the financial year 2023-24 and the remaining 9 months' subscription will be considered as Subscription Received in Advanced.

The above two adjustments are required to be done by performing an adjustment entry in each case.

B. Accruals: The accrual transactions can be either accrued expenses or accrued incomes. Accrued expenses, also referred to as outstanding expenses, are expenses which have actually taken place, but for which no payment has yet been made up to the end of the accounting period. As such, they are not accounted for in the books. On the other hand, accrued incomes are incomes earned, but not yet recorded nor money received.

For example, suppose, M/s Y & Co. has not yet paid the electricity bill for March 2023 ₹20,000 till 31.03.2023. This represents outstanding electricity expenses to be adjusted.

Again, rent for the month of March is not yet recovered from the tenant till 31.03.23. This will be treated as Accrued Rent.

C. Estimates and Non-cash Expenses:

Expenses such as depreciation and provisions are transactions which are of non-cash in nature (i.e., no cash goes out for the same). They are required to be estimated. Similarly closing stock also requires valuation.

The items which require the passing of adjustment entries are practically called 'Adjustments'. Some of the usual adjustment items that emerge at the time of finalization of accounts are as follows:

Adjustments	Type of Adjustment Entry to be passed
a) Closing stock	Adjustments regarding Estimated Items
b) Outstanding expenses	Adjustments regarding Accrual
c) Prepaid expenses	Adjustments regarding Prepaid
d) Accrued incomes	Adjustments regarding Accrual
e) Pre-received incomes	Adjustments regarding Pre-received
f) Depreciation on Fixed Assets	Adjustments regarding Estimated Items
g) Provision for doubtful debts and discount on debtors	Adjustments regarding Estimated Items

Some typical adjustment entries:

Adjustment	Journal Entry
A. Income Statement Related Items	
a) Relating to Income	
Pre-received Incomes	Income A/c Dr. To Pre-received Income A/c
Accrued Incomes	Accrued Income A/c Dr. To Income A/c
b) Relating to Expenses	
Outstanding expenses	Expenses A/c Dr. To Outstanding Expenses A/c

Prepaid expenses	Prepaid Expenses A/c To Expenses A/c	Dr.
B. Balance Sheet Related Items		
a) Stock		
Closing stock	Stock-in-trade A/c To Purchases/ Trading A/c	Dr.
Goods withdrawn by owner for personal use	Drawing A/c To Purchases A/c	Dr.
Goods distributed as free samples to public	Advertisement A/c To Purchases A/c	Dr.
Goods distributed as free samples to employees	Wages/ Salaries A/c To Purchases A/c	Dr.
Goods-in-Transit	Goods-in-transit A/c To Purchases/ Trading A/c	Dr.
Abnormal loss of stock	Abnormal Loss A/c To Purchase/ Trading A/c	Dr.
Stock used as stationary	Stationery A/c To Purchases/ Stock A/c	Dr.
Materials used for constructing Fixed Assets	Fixed Assets A/c To Purchases/ Stock A/c	Dr.
Goods sent on approval basis, pending approval on Balance Sheet date	Sales A/c To Debtors A/c	Dr.
	Stock on Sale or Return A/c To Trading A/c	Dr.
Goods sent on Consignment	Goods sent on Consignment A/c To Purchases A/c	Dr.
Goods sent to Branch	Goods sent on Branch A/c To Purchases A/c	Dr.
Goods sent on Hire Purchase basis	Goods sent on Hire Purchase A/c To Purchases A/c	Dr.
b) Receivables		
Provision for Bad Debts	P/L A/c To Provision for Bad Debts A/c	Dr.
Provision for Discount on Debtors	P/L A/c To Provision for Discount on Debtors A/c	Dr.
Mutual Set-off between debtors and creditors	Creditors A/c Dr. To Debtors A/c	
c) Fixed Assets		
Depreciation on tangible fixed assets	Depreciation A/c To Fixed Assets A/c	Dr.
Amortisation on intangible fixed assets	Amortisation A/c To Fixed Assets A/c	Dr.

Illustration 33.

Pass the necessary entries to make the following adjustment as on 31st Dec. 2023

1. Stock on 31st Dec. 2023 was ₹12,000.
2. Depreciation at 10% on furniture valued at ₹4,500 and machinery valued at ₹50,000.
3. Interest accrued on securities ₹650.
4. Bad debts during the year amounted to ₹450.
5. Unexpired insurance as on 31st Dec. 2023 was ₹290.
6. Salaries outstanding on 31st Dec., 2023 were ₹600.
7. Make provision for discount on debtors and creditors @ 2.5%. The debtors and creditors at the end of the year were ₹35,000 and ₹24,000.

Solution:

Journal Entries		Dr.	Cr.
Sl. No.	Particular	₹	₹
1	Stock Account Dr. To Trading Account (being the value of closing stock)	12,000	12,000
2	Depreciation Account Dr. To Furniture Account To Machinery Account (Being depreciation at 10% on furniture and machinery for the year)	5,450	450 5,000
3	Interest Accrued Account Dr. To Interest Account (being interest accrued on securities brought in to account)	650	650
4	Bad debts Account Dr. To Debtors Account (being loss on account of non-recovery of debts debited to bad debts account)	450	450
5	Unexpired or prepaid Insurance Account Dr. To Insurance Account (Being the amount of the unexpired insurance as on the date of the balance sheet)	290	290
6	Salaries Account Dr. To Salaries outstanding Account (Being the amount of outstanding salaries brought into account)	600	600
7(a)	Profit and Loss Account Dr. To Provision for discount on debtors Account (Being provision made for discount on debtors @ 2.5%)	875	875
7(b)	Provision for discount of creditors Account Dr. To Profit and Loss Account (Being provision made for discount on creditors @ 2.5)	600	600

Note: The above list is not exhaustive but indicative only.

1.8.2 Rectification of Errors

⊙ Concept

Every concern is interested in ascertaining its true profit and financial position at the close of the financial year. But in spite of the best efforts of the book-keeper and the accountant, certain errors are committed in the recording of the transactions which affect the financial statements of the concern. It, therefore, becomes utmost important for the book-keeper and the accountant to locate such errors and rectify them so that correct profit and financial position of the concern may be ascertained. So, whenever errors in accounting records come to notice, they should be rectified without waiting till the end of the accounting year when Trial Balance is to be prepared. Such rectification essentially requires passing a journal entry in the Journal Proper.

⊙ Adjustment Entry vs. Rectification Entry

The purpose of adjustment entries is to determine the correct profit and for finalization of accounts keeping in mind certain accounting concepts and conventions including matching concept.

On the contrary, the purpose of rectification entries is to rectify any error occurred during the recording, casting, posting of transactions.

⊙ Stages of Errors

Errors may occur at any of the following stages of the accounting process:

A) At the Stage of Recording the Transactions in Journal

Following types of errors may happen at this stage:

- i) Errors of principle,
- ii) Errors of omission,
- ii) Errors of commission.

B) At The Stage of Posting the Entries in Ledger

- i) Errors of omission:
 - a) Partial omission,
 - b) Complete omission.
- ii) Errors of commission:
 - a) Posting to wrong account,
 - b) Posting on the wrong side,
 - c) Posting of wrong amount.

C) At the Stage of Balancing the Ledger Accounts

- a) Wrong totaling of accounts,
- b) Wrong balancing of accounts.

D) At the Stage of Preparing the Trial Balance

- a) Errors of omission,
- b) Errors of commission:
 1. Taking wrong account,
 2. Taking wrong amount,
 3. Taking to the wrong side.

On the above basis, we can classify the errors in four broad categories:

1. Errors of Principle,
2. Errors of Omission,
3. Errors of Commission,
4. Compensating Errors

⊙ **Types of Errors**

Basically, errors are of two types:

- a) Errors of principle: When a transaction is recorded in contravention of accounting principles, like treating the purchase of an asset as an expense, it is an error of principle. In this case there is no effect on the trial balance since the amounts are placed on the correct side, though in a wrong account. Suppose on the purchase of a typewriter, the office expenses account is debited; the trial balance will still agree.
- b) Clerical errors: These errors arise because of mistake committed in the ordinary course of the accounting work. Clerical errors are again of three types:
 - i) Errors of Omission: If a transaction is completely or partially omitted from the books of account, it will be a case of omission. Examples would be: not recording a credit purchase of furniture or not posting an entry into the ledger.
 - ii) Errors of Commission: If an amount is posted in the wrong account or it is written on the wrong side or the totals are wrong or a wrong balance is struck, it will be a case of “errors of commission”.
 - iii) Compensating Errors: If the effect of errors committed cancel out, the errors will be called compensating errors. The trial balance will agree. Suppose an amount of ₹ 10 received from A is not credited to his account and the total of the sales book is ₹ 10 excess. The omission of credit to A’s account will be made up by the increased credit to the Sales Account.

⊙ **Effect of Errors on Trial Balance**

Errors	Effect on Trial Balance
Errors of Principle	Trial balance will tally
Errors of partial omission	Trial balance will not tally
Errors of full omission	Trial balance will tally
Errors of commission	Normally Trial Balance does not tally
Compensating Errors	Trial balance will tally

The following chart clarifies the issue further.

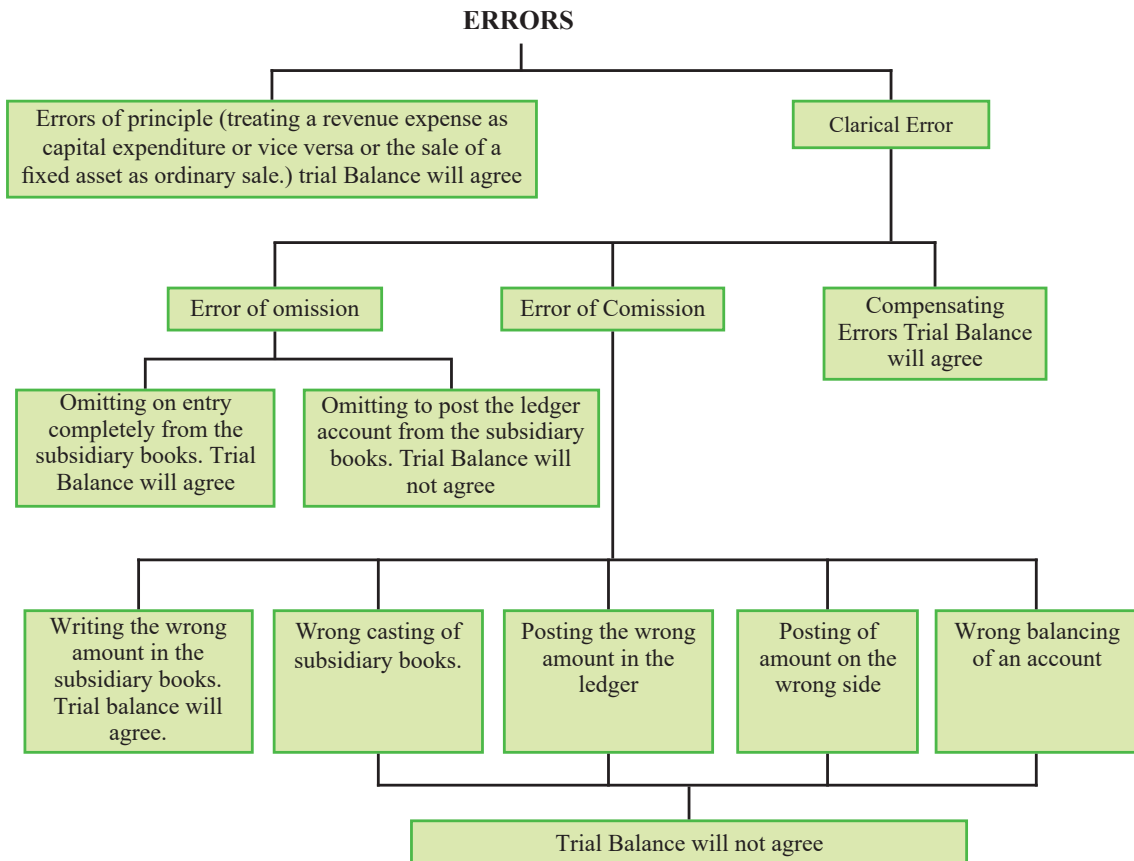


Figure 1.6: Types of Errors and Their Effect on Trial Balance

⦿ Process of Rectification of Errors

Errors should never be corrected by overwriting. If immediately after making an entry it is clear that an error has been committed, it may be corrected by neatly crossing out the wrong entry and making the correct entry. If, however, the errors are located after some time, the correction should be made by making another suitable entry, called rectification entry. In fact, the rectification of an error depends on at which stage it is detected and whether the error is single sided or double sided. An error can be detected at any one of the following stages:

- a) Before preparation of Trial Balance
- b) After Trial Balance but before the Final Accounts are drawn.
- c) After Final Accounts, i.e., in the next accounting period

Accordingly, the following are the possibilities:

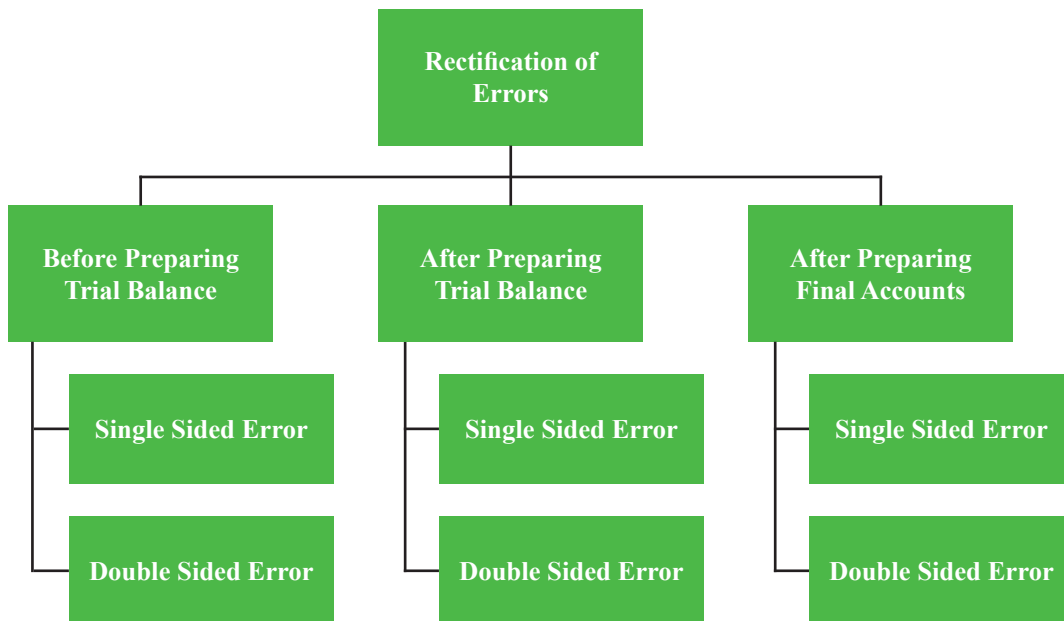


Figure 1.7: Rectification of Errors at Different Stages

Here single sided errors mean the errors that affect only one aspect of account i.e., either debit or credit and double-sided errors mean the errors that affect both aspects i.e., debit as well as credit.

Certain examples of single sided errors are:

1. Wrong casting (e.g., under casting of purchase day book)
2. Wrong carry forward (Total of a page of sales day book of ₹2,000 carried to the next page as ₹200)
3. Wrong posting (sales posted to the credit side of the customer account)
4. Balancing (Plant account debit balance shows short debit by ₹150)

Stage 1: Before Preparation of Trial Balance

- a) **Single Sided Errors:** Only a rectification statement is required to be passed. No double entry is required.
For example: For under-casting of purchase day book ₹2,000, Purchase A/c is to be debited by ₹2,000 only.
- b) **Double Sided Errors:** For rectifying a double-sided error at this stage, a rectification entry is required to be passed. The approach has been clarified as follows.
For example: Purchase of a Building for ₹3,00,000 was wrongly passed through Purchase A/c.

Correct Entry		Wrong Entry		Rectification Entry	
Building A/c	Dr. ₹3,00,000	Purchase A/c	Dr. ₹3,00,000	Building A/c	Dr. ₹3,00,000
To Cash A/c	₹3,00,000	To Cash A/c	₹3,00,000	To Purchase A/c	₹3,00,000

Stage 2: After Preparation of Trial Balance

At this stage, Trial Balance is already drafted with the ledger balances. Hence, any difference in the aggregate Debit and Credit balances of Trial Balance is transferred to Suspense A/c. It is also kept for unsure accounting treatment.

At this stage, any error is rectified by passing a rectification entry.

- a) **Single Sided Errors:** Rectification entry to be passed involving Suspense Account.

For example, for Purchased Day Book under-casted by ₹2,000, the rectification entry will be as follows:

Purchase A/c	Dr.	₹2,000	
	To Suspense A/c		₹2,000

- b) **Double Sided Errors:** These errors are rectified by passing rectification entries without involving the Suspense Account. The approach has been clarified as follows.

For example: Purchase of a Building for ₹3,00,000 was wrongly passed through the Purchase A/c.

Correct Entry		Wrong Entry		Rectification Entry	
Building A/c	Dr. ₹3,00,000	Purchase A/c	Dr. ₹3,00,000	Building A/c	Dr. ₹3,00,000
To Cash A/c	₹3,00,000	To Cash A/c	₹3,00,000	To Purchase A/c	₹3,00,000

Stage 3: After Preparation of Final Accounts

At this stage, the Final Accounts are also prepared. Thus, apart from Suspense Account, preparation of a Profit and Loss Adjustment Account is mandatory here to reflect the rectifications in any nominal account.

- a) **Single Sided Errors:** Rectification entry to be passed involving Suspense Account. In addition, nominal accounts are to be replaced by Profit and Loss Adjustment Account.

For example, for Purchased Day Book under-casted by ₹2000, the rectification entry will be as follows:

Profit and Loss Adjustment A/c.....	Dr.	₹2,000	
	To Suspense A/c		₹2,000

- b) **Double Sided Errors:** These errors are rectified by passing rectification entries without involving the Suspense Account. In addition, nominal accounts are to be replaced by Profit and Loss Adjustment Account. The approach is explained below.

For example: Purchase of a Building for ₹3,00,000 wrongly passed through Purchase A/c.

Correct Entry		Wrong Entry		Rectification Entry	
Building A/c	Dr. ₹3,00,000	Purchase A/c	Dr. ₹3,00,000	Building A/c	Dr. ₹3,00,000
To Cash A/c	₹3,00,000	To Cash A/c	₹3,00,000	To Purchase A/c	₹3,00,000

The net balance of Profit and Loss Adjustment Account represents the net impact of all rectifications on the profit and loss for the year. This balance is transferred to Capital Account.

Note: In the rectification entry, if the nominal account is debited, the profit will decline while, if the nominal account is credited, the profit will increase.

Now, consider the following illustrations.

Illustration 34.

Correct the following errors located before preparation of Trial Balance.

- The Sales Book has been totaled ₹100 short.
- Goods worth ₹150 returned by Green & Co. have not been recorded anywhere.

- c) Furniture purchased from Gulab & Bros., ₹1,000 has been entered in Purchases Day Book.
- d) Discount allowed to G. Mohan & Co. ₹18 has not been entered in the Discount Column of the Cash Book. The account of G. Mohan & Co. has, however, been correctly posted.

Solution:

In the books of

Journal

		Dr.	Cr.
Date	Particulars	L.F.	(₹)
2024			
(a)	Since sales book has been cast ₹100 short, the Sales Account has been similarly credited ₹100 short. The correcting entry is to credit the Sales Account by ₹100 as "By wrong totaling of the Sales Book ₹100".		
(b)	Returns Inward Account To Green & Co. Account (Being Goods returned by the firm, previously omitted from the Returns Inward Book)	Dr.	150
			150
(c)	Furniture A/c	Dr.	1,000
	To Purchase A/c		1,000
	(Being correction of the mistake, by which purchases Account was debited instead of the Furniture Account)		
(d)	In this case the account of the customer has been correctly posted; the discount account has been debited ₹18 short since it has been omitted from the discount column on the debit side of the cash book. The discount account should now be debited by the entry. "To Omission of entry in the Cash Book ₹18".	Dr.	

Illustration 35.

Mr. A closed his books of account on September 30, 2023 in spite of a difference in the Trial Balance. The difference was ₹830 the credits being short; it was carried forward in a Suspense Account. In 2023 following errors were located:

- i) A sale of ₹2,300 to Mr. Lala was posted to the credit of Mr. Mala.
- ii) The total of the Returns Inward Book for July, 2023 ₹1,240 was not posted in the ledger.
- iii) Freight paid on a machine ₹5,600 was posted to the Freight account as ₹6,500.
- iv) While carrying forward the total in the Purchase Account to the next page, ₹65,590 was written instead of ₹56,950.
- v) A sale of machine on credit to Mr. Mehta for ₹9,000 was not entered in the books at all. The book value of machine was ₹7,500. The firm has the practice of writing off depreciation @10% on the balance at the end of the year.

Pass journal entries to rectify the errors. Have you any comments to make?

Solution:**Journal of Mr. A**

		Dr.	Cr.	
Date	Particulars	L.F.	(₹)	(₹)
2023	Mr. Mala A/c	Dr.	2,300	
(i)	Mr. Lala A/c	Dr.	2,300	
	To Suspense A/c			4,600
	(Correction of error by which a sale of ₹2,300 to Mr. Lala was posted to the Credit of Mrs. Mala)			
(ii)	Profit and Loss Adjustment A/c	Dr.	1,240	
	To Suspense A/c			1,240
	(Rectification of omission to post the total of Returns Inward Book for July, 2023)			
iii)	a) Machinery A/c	Dr.	5,600	
	Suspense A/c	Dr.	900	
	To Profit & Loss Adjustment A/c			6,500
	(Correction of error by which freight paid for a machine ₹5,600 was posted to Freight Account at ₹6,500 instead of capitalizing it)			
	b) Profit & Loss Adjustment A/c	Dr.	560	
	To Plant and Machinery A/c			560
	(Depreciation @ 10% charged on freight paid on a machine capitalized)			
iv)	Suspense A/c	Dr.	8,640	
	To Profit & Loss Adjustment A/c			8,640
	(Correction of wrong carry forward of total in the purchase Account to the next page ₹65,590 instead of ₹56,950)			
v)	Mr. Mehta	Dr.	9,000	
	To Plant & Machinery A/c			6,750
	To Profit & Loss Adjustment A/c			2,250
	(Correction of omission of sale of machine on credit to Mr. Mehta for ₹9,000 with a book value of ₹7,500 on which depreciation @10% has been charged in 2023)			

Comments:

The Suspense Account will not appear as shown below:

Suspense Account**Dr.****Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
2023	To Profit and Loss Adjustment A/c	900	2023	By Balance b/d	830
	To Profit and Loss Adjustment A/c	8,640		By Sundries:	
				Mr. Mala	2,300
				Mr. Lala	2,300
				By Profit and Loss Adjustment A/c	1,240
				By balance c/d	2,870
		9,540			9,540

Since the suspense Account still shows a balance, it is obvious that there are still some errors left in the books.

Profit & Loss Adjustment Account**(For Prior Period Items)****Dr.****Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
2023	To Suspense A/c	1,240	2023	By Machinery A/c	5,600
	To Plant & Machinery A/c	560		By Suspense A/c	900
	To Balance c/d	15,590		By Suspense A/c	8,640
				By Mr. Mehta	2,250
		17,390			17,390

Illustration 36.

Rectify the following errors assuming that the errors were detected

- a) Before the Preparation of Trial Balance;
- b) After the preparation of Trial Balance and
- c) After the preparation of Final Accounts.
 - i) Purchase Plant for ₹10,000 wrongly passed through Purchase Account.
 - ii) Sales Day Book was cast short by ₹1,000.
 - iii) Cash paid to Mr. X for ₹1,000 was posted to his account as ₹100.
 - iv) Purchase of goods from Mr. T for ₹3,500 was entered in the Purchase Day Book as ₹500.
 - v) Paid salary for ₹3,000 wrongly passed through wages account.

Solution:

In the Books of

Journal (without narration)

Date	Before preparation of Trial Balance		After preparation of Trial Balance		After preparation of Final Accounts	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
i)	Plant A/c	₹ 10,000	Plant A/c	₹ 10,000	Plant A/c	₹ 10,000
	To Purchase A/c.	₹ 10,000	To Purchase A/c.	₹ 10,000	To P&L Adjustment A/c	₹ 10,000
ii)	Sales account will be credited with ₹ 1,000		Suspense A/c Dr.	₹ 1,000	Suspense A/c Dr.	₹ 1,000
			To Sales A/c.	₹ 1,000	To P&L Adjustment A/c	₹ 1,000
iii)	X Account will be debited when ₹ 900		X A/c Dr.	₹ 900	X A/c Dr.	₹ 900
			To Suspense A/c.	₹ 900	To Suspense A/c	₹ 900
iv)	Purchase A/c Dr.	₹ 3,000	Purchase A/c Dr.	₹ 3,000	P&L Adjustment A/c Dr.	₹ 3,000
	To T A/c	3,000	To T A/c	₹ 3,000	To T's A/c.	₹ 3,000
v)	Salary A/c Dr.	₹ 3,000	Salary A/c Dr.	₹ 3,000	P&L Adjustment A/c. Dr.	3,000
	To Wages A/c	₹ 3,000	To Wages A/c.	₹ 3,000	To P&L Adjustment A/c	₹ 3,000

Illustration 37.

A merchant, while balancing his books of accounts notices that the T.B. did not tally. It showed excess credit of ₹ 1,700. He placed the difference to Suspense A/c. Subsequently he noticed the following errors:

- Goods brought from Narayan for ₹ 5,000 were posted to the credit of Narayan's A/c as ₹ 5,500
- An item of ₹ 750 entered in Purchase returns book was posted to the credit of Pandey to whom the goods had been returned.
- Sundry items of furniture sold for ₹ 26,000 were entered in the sales book.
- Discount of ₹ 300 from creditors had been duly entered in creditor's A/c but was not posted to discount A/c. Pass necessary journal entries to rectify these errors. Also show the Suspense A/c

Solution:

- Goods bought from Narayan are posted to credit of his A/c as ₹ 5,500 instead of ₹ 5,000. Here, it is correct to credit Narayan's A/c. But the mistake is extra credit of ₹ 500. This is one sided error, as posting to purchases A/c is correctly made. So the rectification entry will affect the Suspense A/c. This needs to be reversed by the rectification entry:

Narayan's A/c	Dr.	₹ 500	
To Suspense A/c			₹ 500

- b) Goods bought from Pandey were returned back to him. It should have appeared on the debit side of his A/c. For rectifying we will need to debit his A/c with double the amount i.e. ₹ 1500 (₹ 750 to cancel the wrong credit and another ₹ 750 to give effect for correct debit) and the effect will go to Suspense A/c. The correction entry is:

Pandey A/c	Dr.	₹ 1,500	
	To Suspense A/c		₹ 1,500

- c) Sale of furniture was recorded in sales book. What's wrong here? Remember that sales book records sale of goods only and nothing else. Sale of furniture will appear in either cash book (if sold for cash) or journal proper (if sold on credit). Hence, wrong credit to Sales A/c must be removed and credit should be given to Furniture A/c. It's important to note that this rectification entry will not affect the Suspense A/c. The correction entry is:

Sales A/c	Dr.	₹ 26,000	
	To Furniture A/c		₹ 26,000

- d) The discount received from creditor is not entered in discount A/c but was correctly recorded in creditors' A/c. This is one sided error and will therefore be routed through suspense for correction. A discount is received; it must be credited being an income.

Suspense A/c	Dr.	₹ 300	
	To Discount received A/c		₹ 300

Let us now see how Suspense A/c will Look like. Excess credit of ₹ 1,700 in Trial Balance will be shown on the debit side of Suspense A/c. This will bring in total debit equal to total credit.

Dr.				Suspense Account				Cr.			
Date	Particulars	J. F.	(₹)	Date	Particulars	J. F.	(₹)				
	To Balance b/d		1,700		By Narayan		500				
	To Discount received		300		By Pandey		1,500				
			2,000				2,000				

Please observe that after correcting passing all rectification entries, the Suspense A/c tallies automatically.

Illustration 38.

Pass necessary journal entries to rectify the following errors:

- An amount of ₹ 200 withdrawn by owner for personal use was debited to trade expenses.
- Purchase of goods of ₹ 300 from Nathan was wrongly entered in sales book.
- A credit sale of ₹ 100 to Santhanam was wrongly passed through purchase book.
- ₹ 150 received from Malhotra was credited to Mehrotra.
- ₹ 375 paid as salary to cashier Dhawan was debited to his personal A/c.
- A bill of ₹ 2,750 for extension of building was debited to building repairs A/c
- Goods of ₹ 500 returned by Akashdeep were taken into stock, but returns were not posted.
- Old furniture sold for ₹ 200 to Sethi was recorded in sales book
- The period end total of sales book was under cast by ₹ 100
- Amount of ₹ 80 received as interest was credited to commission.

Solution:

Sl. No.		Particulars		Dr.	Cr.
				(₹)	(₹)
(a)	Wrong Entry	Trade Expenses A/c	Dr.	200	
		To Cash A/c			200
	Correct entry	Drawings A/c	Dr.	200	
		To Cash A/c			200
	Rectification entry	Drawings A/c	Dr.	200	
		To Trade Expenses A/c			200
(b)	Wrong Entry	Nathan A/c	Dr.	300	
		To Sales A/c			300
	Correct entry	Purchases A/c	Dr.	300	
		To Nathan A/c			300
	Rectification entry	Purchases A/c	Dr.	300	
		Sales A/c	Dr.	300	
		To Nathan A/c			600
(c)	Wrong Entry	Purchases A/c	Dr.	100	
		To Santhanam A/c			100
	Correct entry	Santhanam A/c	Dr.	100	
		To Sales A/c			100
	Rectification entry	Santhanam A/c	Dr.	200	
		To Sales A/c			100
		To Purchases A/c			100
(d)	Wrong Entry	Cash A/c	Dr.	150	
		To Mehrotra A/c			150
	Correct entry	Cash A/c	Dr.	150	
		To Malhotra A/c			150
	Rectification entry	Mehrotra A/c	Dr.	150	
		To Malhotra A/c			150
(e)	Wrong Entry	Dhawan A/c	Dr.	375	
		To Cash A/c			375
	Correct entry	Salary A/c	Dr.	375	
		To Cash A/c			375
	Rectification entry	Salary A/c	Dr.	375	
		To Dhawan A/c			375

(f)	Wrong Entry	Building Repairs A/c	Dr.	2,750	
		To Cash A/c			2,750
	Correct entry	Buildings A/c	Dr.	2,750	
		To Cash A/c			2,750
	Rectification entry	Buildings A/c	Dr.	2,750	
		To Building Repairs A/c			2,750
(g)	Wrong Entry	No entry passed A/c			
	Correct entry	Sales Returns A/c	Dr.	500	
		To Akashdeep A/c			500
	Rectification entry	Sales Returns A/c	Dr.	500	
		To Asashdeep A/c			500
(h)	Wrong Entry	Sethi A/c	Dr.	200	
		To Sales A/c			200
	Correct entry	Sethi A/c	Dr.	200	
		To Furniture A/c			200
	Rectification entry	Sales A/c	Dr.	200	
		To Furniture A/c			200
(i)	Wrong Entry	No entry passed A/c			
	Correct entry	Suspense A/c	Dr.	100	
		To Sales A/c			100
	Rectification entry	Suspense A/c	Dr.	100	
		To Sales A/c			100
(j)	Wrong Entry	Cash A/c	Dr.	80	
		To Commission A/c			80
	Correct entry	Cash A/c	Dr.	80	
		To Interest A/c			80
	Rectification entry	Commission A/c	Dr.	80	
		To Interest A/c			80

Illustration 39.

Rectify the following error:

- i) Purchases of ₹300 from Raman passed through Sales Book.
- ii) Bill received from Ramu for ₹500 passed through Bills Payable Book.
- iii) An item of ₹150 relating to Prepaid Rent was omitted to be brought forward from last year.
- iv) ₹400 paid to B Mehta, against our acceptance was debited to N Mehta.
- v) Received ₹300 from Ajit whose account was written off for ₹300 earlier and posted to the credit of Amit.
- vi) Transistor sold to Karun for ₹750 passed through Sales Book twice.

Solution:**Rectification Entries**

			Dr.	Cr.
	Particulars	L.F.	(₹)	(₹)
(i)	Purchase A/c Dr. Sales A/c Dr. To Raman A/c (Being the amount passed through sales book cancelled and debited to purchases account)		300 300	600
(ii)	Bills Receivable A/c Dr. Bills Payable A/c Dr. To Ramu's A/c (Being Bills Receivable was wrongly entered as Bills Payable, now rectified)		500 500	1,000
(iii)	Prepaid Rent A/c Dr. To Suspence A/c (Being prepaid Rent omitted to brought forward in books of accounts earlier, now rectified)		150	150
(iv)	Bills Payable A/c Dr. To N. Mehta A/c (Being the amount wrongly debited to N. Mehta, now rectified)		400	400
(v)	Amrit A/c Dr. To Bad Debts Recovered A/c (Being the amount credited to Ajit account cancelled and credited to bad debts recovered)		300	300
(vi)	Sales A/c Dr. To Karun A/c (Being wrong credit given to sales account cancelled)		750	750

Illustration 40.

Following errors were detected in the Accounts of AA Ram and Sons for the year ended 30th June, 2023:

- A builder's bill for ₹2,700 for the erection of a small shed was debited to repairs account.
- A cheque for ₹300 received from Rahim Bux and Co. was dishonoured and debited to allowances account.
- Goods to the value of ₹150 returned by Chandmal Bros. were included in stock, but no entry was made in the books.
- Repairs to plant amounting to ₹567 had been charged to plant and machinery account
- Wages paid to the firm's own workmen for making certain additions to machinery amounting to ₹550 were posted to wages account.
- A cheque for ₹75 received from Lala Ram was credited to the account of Tika Ram and debited incorrectly to cash account.
- A sum of ₹100 drawn by the proprietor for personal use was debited to travelling expenses account.

Give journal entries to correct these errors.

Solution:**Journal Entries**

			Dr.	Cr.
	Particulars	L.F.	(₹)	(₹)
(i)	Building A/c To Repairs A/c (Being a builder's bill for the erection of a small shed wrongly debited to Repairs Account, now corrected)	Dr.	2,700	2,700
(ii)	Rahim Bux & Co.A/c To Allowances A/c (Being a cheque received from Rahim Bux & Co. dishonoured was wrongly debited to Allowances Account, now rectified)	Dr.	300	300
iii)	Returns Inwards A/c To Chandmal Bros.A/c (Being goods returned by Chandmal Bros. omitted to be recorded, now recorded)	Dr.	150	150
iv)	Repairs A/c To Plant and Machinery A/c (Being repairs to plant and machinery wrongly debited to Plant and Machinery Account, now corrected)	Dr.	567	567
v)	Plant & Machinery A/c To Wages A/c (Being wages paid for making certain additions to machinery wrongly debited to Wages Account, now rectified)	Dr.	550	550
vi)	a) Tika Ram A/c To Lala RamA/c (Being cheque received from Lala Ram wrongly credited to Tika Ram instead of to Lala Ram, now corrected)	Dr.	75	75
	b) Bank A/c To Cash A/c (Being cheque received from Lala Ram wrongly debited to Cash Account instead of to Bank A/c, now rectified)	Dr.	75	75
vii)	Drawings A/c To Travelling Expenses A/c (Being amount drawn by the proprietor wrongly debited to Travelling Expenses account, now corrected)	Dr.	100	100

Illustration 41.

On going through the Trial balance of A Ltd. You find that the debit is in excess by ₹ 150. This was credited to “Suspense Account”. On a close scrutiny of the books the following mistakes were noticed:

1. The totals of debit side of “Expenses Account” have been cast in excess by ₹ 50.
2. The “Sales Account” has been totaled in short by ₹ 100.
3. One item of purchase of ₹ 25 has been posted from the day book to supplier ledger as ₹ 250.
4. The sale return of ₹ 100 from a party has not been posted to that account though the Party’s account has been credited.
5. A cheque of ₹ 500 issued to the Suppliers’ account (shown under Trade payables) towards his dues, has been wrongly debited to the purchases.
6. A credit sale of ₹ 50 has been credited to the Sales and also to the Trade receivables Account.
 - i) Pass necessary journal entries for correcting the above;
 - ii) Show how they affect the Profits; and
 - iii) Prepare the “Suspense Account” as it would appear in the ledger.

Solution:**Journal Entries**

Particulars	L.F.	Dr.	Cr.
		(₹)	(₹)
Suspense A/c	Dr.	50	
To Expenses A/c			50
(Being the mistake in totaling of Expenses A/c, rectified)			
Suspense A/c	Dr.	100	
To Sales A/c			100
(Being the mistake in totaling of Sales A/c, rectified)			
Supplier A/c	Dr.	225	
To Suspense A/c			225
(Being the mistake in posting from Day Book to Ledger rectified)			
Sales Returns A/c	Dr.	100	
To Suspense A/c			100
(Being the sales return from a party not posted to “Sales Returns” now rectified)			
Trade Payable A/c	Dr.	500	
To Purchases A/c			500
(Being the payments made to supplier wrongly posted to purchases now rectified)			
Trade Receivables A/c	Dr.	100	
To Suspense A/c			100
(Being the sales wrongly credited to Customer’s Account now rectified)			

Dr.	Suspense Account		Cr.
Particulars	(₹)	Particulars	(₹)
To Expenses A/c	50	By Difference in Trial balance	150
To Sales A/c	100	By Suppliers A/c	225
To Balance c/d	425	By Sales Returns A/c	100
		By Trade Receivables A/c	100
	575		575
		By Balance b/d	425

Since the Suspense Account does not balance, it is clear that all the errors have not been traced. As a result of the above corrections the Net Profit will be:

Particulars	₹	₹
Mistake in totaling in "Expenses"	50	
Mistake in totaling in "Sales"	100	
Mistake in posting from day book to Ledger under "Supplier's"	225	
Mistake in wrongly debiting the Purchase A/c	500	
Omission in positing under "Sales Returns"		100
	650	100
Net Increase	550	

As a result of these adjustments, the Profits will be increased by ₹550 in The books of accounts of A Ltd. for the year.

Illustration 42.

The books of accounts of A Co. Ltd. for the year ending 31.3.2023 were closed with a difference in books carried forward. The following errors were detected subsequently:

- Return outward book was under cast by ₹100.
- ₹1,500 being the total of discount column on the credit side of the cash book was not posted.
- ₹6,000 being the cost of purchase of office furniture was debited to Purchase A/c.
- A credit sale of ₹760 was wrongly posted as ₹670 to the customers A/c. in the sales ledger.
- The Sales A/c. was under casted by ₹10,000 being the carry over mistakes in the sales day book.
- Closing stock was over casted by ₹10,000 being casting error in the schedule or inventory. Pass rectification entries in the next year.

Prepare suspense account and state effect of the errors in determination of net profit of last year.

Solution:

In the Books of A Co. Ltd. Journal

Date 2023	Particulars	L.F.	(₹)	(₹)
(a) Apr1	Suspense A/c	Dr.	100	
	To Profit & Loss Adjustment A/c			100
	(Returns outward book was under cast now rectified).			

(b)	Suspense A/c	Dr.	1,500	
	To Profit & Loss Adjustment A/c			1,500
	(Discount received was not recorded, now rectified.)			
(c)	Office Furniture A/c	Dr.	6,000	
	To Profit & Loss Adjustment A/c			6,000
	(Office furniture purchased wrongly debited to Purchase A/c. not rectified.)			
(d)	Debtors' A/c	Dr.	90	
	To Suspense A/c.			90
	(Debtors account was posted ₹ 670 in place of ₹ 760, now rectified.)			
(e)	Suspense A/c.	Dr.	10,000	
	To Profit & Loss Adjustment A/c.			10,000
	(Sales account was under casted, now rectified)			
(f)	Profit & Loss Adjustment A/c.	Dr.	10,000	
	To Suspense A/c.			10,000
	(Closing Stock was overcastted, now rectified.)			

Dr. Suspense Account Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
2023	To Profit & Loss Adj. A/c	100	2023	By Difference in Trial Balance	21,510
Apr.1	To Profit & Loss Adj. A/c	1,500	Apr.1	By Debtors A/c.	90
	To Profit & Loss Adj. A/c	10,000			
	To Profit & Loss Adj. A/c	10,000			
		21,600			21,600

Particulars	Decrease (-) (₹)	Increase (+) (₹)
Item (a).....	-	100
(b).....	-	1,500
(c).....	-	6,000
(d) No effect	-	-
(e).....	-	10,000
(f).....	10,000	-
	10,000	17,600
Profit will increase by	7,600	-
	17,600	17,600

Depreciation (Straight Line and Diminishing Balance Methods Only)

1.9

1.9.1 Concept of Depreciation

An entity requires various types of assets for conducting its operations. These assets can broadly be classified into Fixed Assets and Current Assets.

Fixed Assets are those assets which provide benefit to an entity over multiple accounting periods, instead of one accounting period. So, the cost of the Fixed Asset should not be charged to the accounting period in which it is acquired but should be allocated over the periods during which benefits will be derived from such assets. This allocation of the total cost of a fixed asset over several accounting periods leads to the concept of Depreciation.

Depreciation is derived from the Latin word 'Depretium', where 'De' – decline 'Pretium' – Price. This decline in price is due to constant use, wear and tear. Thus, the term 'Depreciation' means a gradual and permanent decline in the value of a tangible fixed asset due to its use, wear and tear, obsolescence, effluxion of time, expiration of legal rights or similar other causes.

Characteristics of Depreciation:

- (i) It is a charge against profit.
- (ii) It indicates diminution in service potential.
- (iii) It is an estimated loss of the value of an asset. It is not an actual loss.
- (iv) It depends upon different assumptions, like effective life and residual value of an asset.
- (v) It is a process of allocation and not of valuation.
- (vi) Depreciation on any particular asset is restricted to the working life of the asset.

According to Accounting Standard 10, Property, Plant and Equipment, depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Objective of and Necessity for Providing Depreciation

- Correct calculation of Cost of Production.
- Correct calculation of Profits.
- Correct disclosure of fixed assets at reasonable value.
- Provision of Replacement Cost.

- Maintenance of Capital .
- Compliance with Technical and legal requirement

1.9.2 Depreciation and Other Losses of Value of a Fixed Asset

a) Amortization

Amortization refers to the deterioration in the value of an intangible Fixed Assets due to effluxion of time or expiration of legal right. In other words, it is the process of allocating an amount against the profits over the period of beneficial life of the intangible asset. Assets such as Copyright, Patent Right etc. are subject to amortization.

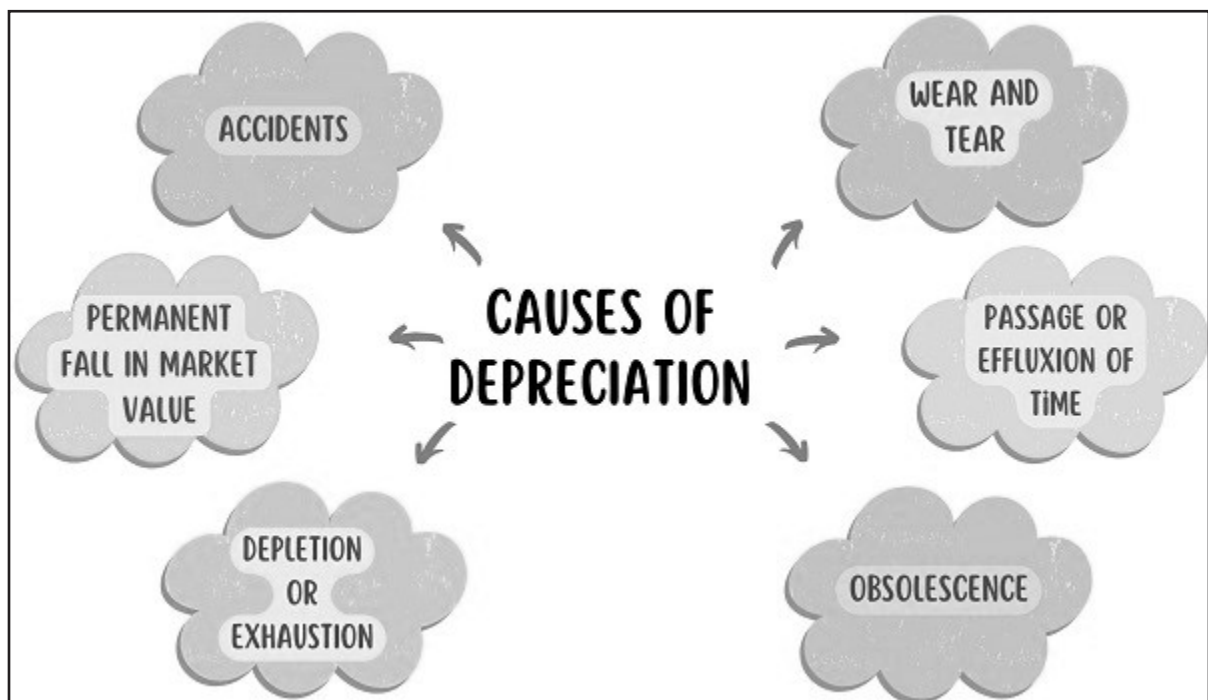
b) Obsolescence

Obsolescence refers to the fall in the value of a fixed asset due to new technology, introduction of better processes/ techniques or change in taste, fashion, etc. It is a sudden loss in the value of an asset difficult to predict.

c) Depletion

Depletion refers to fall in value of a tangible fixed assets (being a non-renewable natural resource) arising due to its exhaustion. It occurs only for wasting assets (viz. Mines, quarries, oil wells, timber stands, etc.)

1.9.3 Causes of Depreciation



The factors which cause depreciation of fixed assets can be broadly divided into two categories as follows:

A. Internal Factors

- a) Wear and Tear: Regular usage of the asset results in its wear and tear. Accordingly, its value falls.
- b) Physical deterioration: Deterioration of the physical capacities of an asset due to non-use or improper use of the asset results in fall in the value of the asset.
- c) Exhaustion: Wasting assets lose value when they get exhausted due to resources being extracted out of such assets.

B. External Factors

- a. Effluxion/Passage of time: If it is not put to regular use, value of an asset may fall with the passage of time.
- b. Expiry of the legal life of an asset: Certain intangible assets are acquired for a pre-determined specified time period. On expiry of such period, they will not be usable for the purpose of regular operations.
- c. Obsolescence: Invention of new technologies, processes/techniques or change in taste, fashion, etc. may cause a sudden loss in the value of an asset which may be in good physical and operating condition.
- d. Abnormal reasons: Certain abnormal occurrences, viz. destruction of an asset on any natural calamity, fire, and other accidents may result in fall in the value of an asset.

1.9.4 Methods of Providing Depreciation

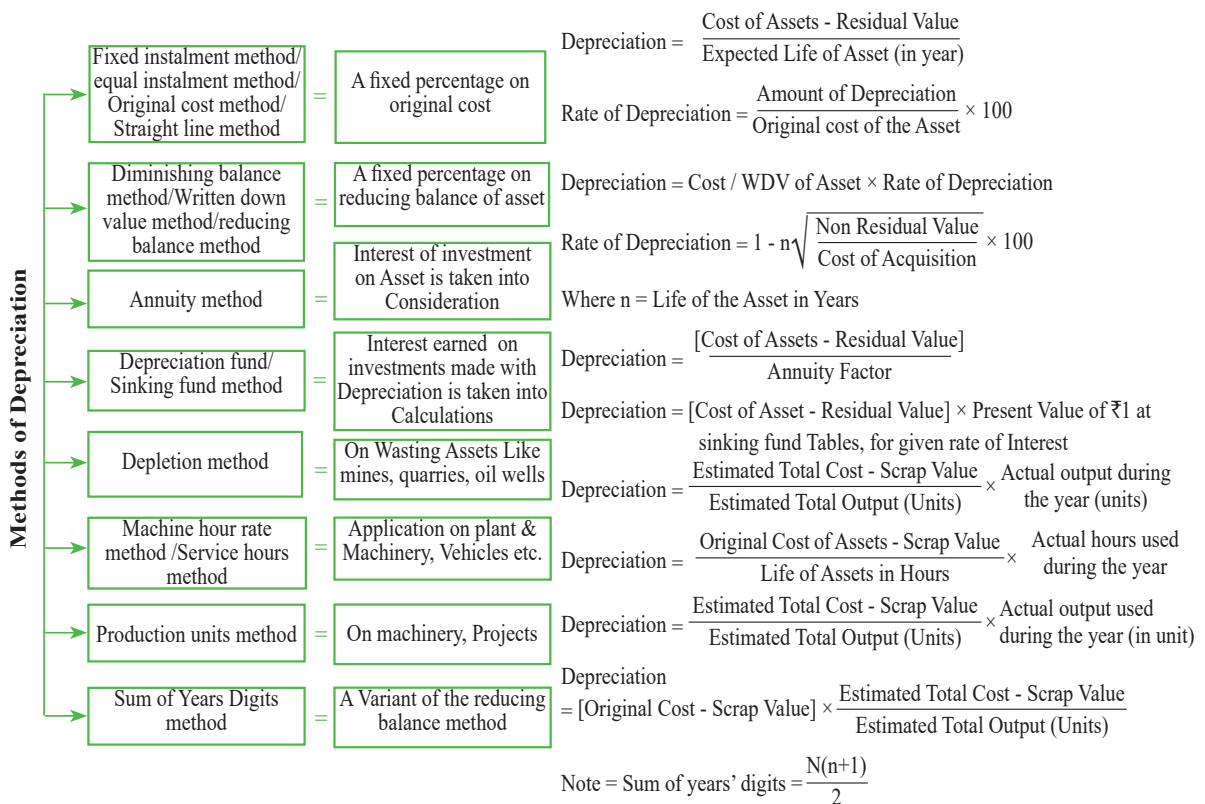


Figure 1.8: Methods of Depreciation

⊙ Fixed/Equal Instalment or Straight-Line Method

Following are the features of this method:

- Under this method, depreciation is always calculated on the 'Original Cost' of the fixed asset.
- An equal amount of depreciation is written-off in every accounting period of the economic life of the fixed asset.
- The written down value (i.e., depreciated value) of a fixed asset gets reduced to either the Scrap value or Nil value (when there is no scrap value).

The formula for calculating the amount of depreciation p.a. is as follows:

$$\text{Depreciation p.a.} = \frac{\text{Original Cost of Fixed asset} + \text{Other Capital costs} - \text{Estimated Scrap Value}}{\text{Life of the fixed asset (in years)}}$$

Consider the following illustration.

Illustration 43.

A Ltd. purchased a machine costing ₹4,25,000. Installation expenses incurred ₹25,000. The estimated useful life of the asset is 10 years having a scrap value of ₹30,000. Determine the amount of depreciation p.a. under SLM.

Solution:

Given, Original Cost = ₹4,25,000; Other Capital Costs = ₹25,000; Scrap value = ₹30,000.

Life of the asset = 10 years.

$$\begin{aligned} \text{Here, Depreciation p.a.} &= \frac{\text{Original Cost of Fixed asset} + \text{Other Capital costs} - \text{Estimated Scrap Value}}{\text{Life of the fixed asset (in years)}} \\ &= \frac{\text{₹4,25,000} + \text{₹25,000} - \text{₹30,000}}{10} = \text{₹42,000} \end{aligned}$$

⊙ Reducing / Diminishing Balance Method or Written Down Value Method

Under this method, the depreciation is calculated on the Book Value of the fixed asset. To be more specific, in the year of acquisition, depreciation is calculated on the Original Cost of the asset, and in the subsequent years it is calculated on the Written Down Value of the asset.

- The rate of depreciation remains constant every year.
- The amount of depreciation goes on decreasing over the years.
- Under this method w.d.v. of the asset never gets reduced to zero.

The formula for calculating the amount of depreciation p.a. is as follows:

Depreciation p.a. = Opening W.D.V (or original cost for new asset) × Rate of depreciation.

$$\text{Rate of depreciation} = \left(1 - \sqrt[n]{\frac{\text{Scrap Value}}{\text{Original cost}}} \right) \times 100$$

Consider the following illustration.

Illustration 44.

A Ltd. purchased a machine costing ₹4,80,000. Installation expenses incurred ₹20,000. It provides depreciation @10% p.a. on the WDV of the machine. Determine the amount of depreciation p.a. under WDV method for year 1 and 2.

Solution:

Total cost of the machinery = 4,80,000 + 20,000 = ₹5,00,000

Depreciation p.a. for 1st Year = 5,00,000 × 10% = ₹50,000

Depreciation p.a. for 2nd Year = (5,00,000 – 50,000) × 10% = ₹45,000.

1.9.5 Methods of Recording Depreciation:

Depreciation can be recorded in the books of account by two different methods. They are discussed below:

1. When a provision for Depreciation Account is maintained:

In case of this method, the amount of depreciation to be charged in a particular year is debited to Depreciation A/c and credited to Provision for Depreciation Account. The Asset Account appears in the books at original cost. In case the asset is sold, the provision for Depreciation Account is transferred to the Asset Account. Any amount released on account of sale of asset is also credited to Asset Account. The balance, if any, in the Asset Account is transferred to the Profit and Loss Account.

2. When a provision for Depreciation Account is not maintained:

In case a Provision for Depreciation Account is not maintained, the amount of depreciation is debited to the Depreciation Account and credited to the Asset Account. The Asset Account thus appears in the books at written down value. The Depreciation Account is transferred to the Profit and Loss account like any other item of expense.

⊙ **Accounting Treatment under Different Method**

Sl. No.	Transaction	If Provision for Depreciation A/c is maintained					
		If Provision for Depreciation A/c is NOT maintained (ordinary method)		If Asset Disposal A/c is NOT opened		If Asset Disposal A/c is opened	
1.	For the purchase of an asset (including exp. Incurred till it is brought into use)	Assets A/c To Cash/Bank A/c	Dr.	Asset A/c To Cash/Bank A/c	Dr.	Asset A/c To Cash/Bank A/c	Dr.
2.	For the depreciation on the asset.	Depreciation A/c To Cash/Bank A/c	Dr.	Depreciation A/c To Prov. for Dep. A/c	Dr.	Depreciation A/c To Prov. for Dep. A/c	Dr.
3.	For the transfer of depreciation to P & L A/c	Profit & Loss A/c To Depreciation A/c	Dr.	Profit & Loss A/c To Depreciation A/c	Dr.	Profit & Loss A/c To Depreciation A/c	Dr.
4.	When the asset is to be sold a. For the transfer of original cost of the asset to Asset Disposal A/c	No Entry		No Entry		Asset Disposal A/c To Asset A/c	Dr.

b. For the transfer of provision for Depreciation A/c	No Entry		Prov. for Dep A/c To Asset A/c	Dr.	Prov. for Dep A/c To Asset Disposal A/c	Dr.
c. For the sale of asset	Cash / Bank A/c To Asset A/c	Dr.	Cash / Bank A/c To Asset A/c	Dr.	Cash / Bank A/c To Asset Disposal A/c	Dr.
d. For the profit on the sale of asset.	Asset A/c To Profit & Loss A/c	Dr.	Asset A/c To Profit & Loss A/c	Dr.	Asset Disposal A/c To Profit & Loss A/c	Dr.
e. For the loss on the sale of asset	Profit & Loss A/c To Asset A/c	Dr.	Profit & Loss A/c To Asset A/c	Dr.	Profit & Loss A/c To Asset Disposal A/c	Dr.

Illustration 45.

Calculate the Rate of Depreciation under Straight Line Method (SLM) in each of the following cases:-

Machine No.	Cost of Machine (₹)	Expenses incurred at the time of purchase to be capitalized (₹)	Estimated Residual Value (₹)	Expected Useful Life in years
1	90,000	10,000	20,000	8
2	24,000	7,000	3,100	6
3	1,05,000	20,000	12,500	5
4	2,50,000	30,000	56,000	10

Solution:

Machine No	Cost of Machine (₹)	Expenses incurred at the time of purchase to be capitalized (₹)	Total Cost of Asset = (b+c) (₹)	Estimated Residual Value (₹)	Expected Useful Life in years	Depreciation = (d-e)/f (₹)	Rate of Depreciation under SLM = (g/d)×100
a	b	c	d	e	f	g	h
1	90,000	10,000	1,00,000	20,000	8	10,000	10%
2	24,000	7,000	31,000	3,100	6	4,650	15%
3	1,05,000	20,000	1,25,000	12,500	5	22,500	18%
4	2,50,000	30,000	2,80,000	56,000	10	22,400	8%

Illustration 46.

A machine is purchased for ₹ 7,00,000. Expenses incurred on its cartage and installation ₹ 3,00,000. Calculate the amount of depreciation @ 20% p.a. according to Straight Line Method for the first year ending on 31st March, 2024, if this machine is purchased on:

(a) 1st April, 2023 (b) 1st July, 2023 (c) 1st October, 2023 (d) 1st January, 2024

Solution:

Here, Total Cost of Asset = Purchased Price + Cost of Cartage and Installation

$$= ₹ 7,00,000 + ₹ 3,00,000 = ₹ 10,00,000$$

So, Depreciation

$$= \text{Total Cost of Asset} \times \text{Rate of Depreciation} \times \frac{\text{Period from the date of purchase of date of closing accounts}}{12}$$

a) The machine was purchased on 1st April, 2023:

$$\text{Amount of Depreciation} = ₹ 10,00,000 \times 20\% \times \frac{12}{12} = ₹ 2,00,000$$

b) 1st July, 2023

$$\text{Amount of Depreciation} = ₹ 10,00,000 \times 20\% \times \frac{9}{12} = ₹ 1,50,000$$

c) 1st October, 2023

$$\text{Amount of Depreciation} = ₹ 10,00,000 \times 20\% \times \frac{6}{12} = ₹ 1,00,000$$

d) 1st January, 2024

$$\text{Amount of Depreciation} = ₹ 10,00,000 \times 20\% \times \frac{3}{12} = ₹ 50,000$$

Illustration 47.

A company whose accounting year is the calendar year, purchased on 1st April, 2021 Machinery costing ₹ 30,000. It purchased further machinery on 1st October, 2021 costing ₹ 20,000 and on 1st July, 2022 costing ₹ 10,000. On 1st January, 2023 one third of the Machinery installed on 1st April, 2021 became obsolete and was sold for ₹ 3,000. Show how machinery account would appear in the books of the company, it being given that machinery was depreciated by fixed installment method at 10% per annum.

Solution:

Dr.		Machinery Account				Cr.
2021	Particulars	₹	2021	Particulars	₹	
Apr.1	To Bank A/c	30,000	Dec.31	By Depreciation A/c (on ₹ 30,000 for nine months and on ₹ 20,000 for 3 months)	2,750	
Oct. 1	To Bank A/c	20,000	Dec.31	By Balance c/d	47,250	
		50,000			50,000	
2022			2022			
Jan.1	To Balance b/d	47,250				
July1	To Bank A/c	10,000	Dec.31	By Depreciation A/c (on ₹ 50,000 for one year and on ₹ 10,000 for 6 months)	5,500	
			2023			
			Dec.31	By Balance c/d	51,750	
		57,250			57,250	
2023			2023			
Jan.1	To Balance b/d	51,750	Jan. 1	By Bank a/c	3,000	
			Jan.1	By Profit and Loss A/c (loss on sale) (1)	5,250	
			Dec.31	By Depreciation (on ₹ 50,000 for one year) A/c	5,000	
			Dec.31	By Balance c/d	38,500	
		51,750			51,750	
2024						
Jan.1	To Balance b/d	38,500				

Working Note:

(1) Calculation of Loss on sale of 1/3 of the Machinery

	₹	₹
Cost of Machinery (30000 × 1/3)		10,000
Less: Depreciation for 2021 for 9 months	750	
Depreciation for 2022	1,000	
		1,750
Written down value of Machinery 1-1-2023		8,250
Less: Amount realized		3,000
Loss transferred to profit and loss A/c		5,250

Illustration 48.

On July 1, 2021 Granites Ltd. purchased second hand machine for ₹40,000 and reconditioned the same by spending ₹6,000. On January 1, 2022 a new machine was purchased for ₹24,000. On June 30, 2023 the machine purchased on January 1, 2022 was sold for ₹16,000 and another machine was installed at a cost of ₹30,000.

The company writes off 10% on original cost every year on March 31. Show the Machinery account update.

Solution:

Dr.		Machinery Account		Cr.	
Date	Particulars	₹	Date	Particulars	₹
1-7-21	To Bank (₹40,000 + ₹6,000)	46,000	31-3-22	By Depreciation A/c $\text{₹}46,000 \times \frac{9}{12} \times \frac{10}{100} = 3,450$	
1-1-22	To Bank	24,000		$\text{₹}24,000 \times \frac{3}{12} \times \frac{10}{100} = 600$	4,050
			31-3-22	By Balance c/d	65,950
		70,000			70,000
1-4-22	To Balance b/d	65,950	31-3-23	By Depreciation A/c (on ₹70,000 at 10%)	7,000
			31-3-23	By Balance c/d	58,950
		65,950			65,950
1-4-23	To Balance b/d	58,950	30-6-23	By Bank (Sale of Machinery)	16,000
30-6-23	To Bank	30,000	30-3-24	By P & L A/c (1)	4,400
			31-3-24	By Depreciation (2)	7,450
			31-3-24	By Balance c/d	61,100
		88,950			88,950
1-4-24	To Balance b/d	61,100			

Working Notes:**1. Calculation of Loss on sale of machinery:**

Particulars	₹	₹
Cost of Machinery on 1-1-2022		24,000
Less: Depreciation upto 31-3-2022 ($\text{₹}24,000 \times \frac{3}{12} \times \frac{10}{100}$)		600
Less: Depreciation upto 31-3-2023 (on ₹24,000 at 10%)		2,400
Less: Depreciation till the date of sale of machinery i.e. (30-6-2023) ($\text{₹}24,000 \times \frac{3}{12} \times \frac{10}{100}$)		600
Less: Amount realized on sale of machinery		16,000
Loss on sale of machinery		4,400

2. Calculation of depreciation on the balance of machinery form 1-4-2023 to 31-3-2024:

Particulars	₹
Depreciation on the machinery sold for 3 months form 1-4-2023 to 30-6-2023 (date of sale) ($\text{₹}24,000 \times \frac{3}{12} \times \frac{10}{100}$)	600
On ₹46,000 at 10%	4,600
On ₹30,000 at 10% for 9 months ($\text{₹}30,000 \times \frac{9}{12} \times \frac{10}{100}$)	2,250
	7,450

Illustration 49.

A company purchased some machineries for ₹1,00,000 on 1st April, 2019. It charges depreciation @ 10% p.a. on reducing balance method every year. On 30th September, 2023 a part of machinery was sold for ₹14,000, the original cost of the machine was ₹20,000. Calculate the profit or loss on sale of machinery.

Solution:

Particulars	₹	₹
Original cost of the machines as on 1.4.2019		20,000
(-) Depreciation for the year 2019-2020	2,000	
2020-21	1,800	
2021-22	1,620	
2022-23	729	
2023-24		6,149
Written down value as on 30-9-2023		13,851
Sale price		14,000
Profit on sale of machinery		149

Illustration 50.

On 1.1.2021 a machine was purchased for ₹ 1,00,000 and ₹ 50,000 was paid for installation. Assuming that the rate of depreciation was 10% on Reducing Balance Method, calculate amount of depreciation upto 31.12.2023.

Solution:

Year	Opening Book Value (₹)	Rate	Depreciation (₹)	Closing Book Value (₹)
2021	1,50,000	10%	15,000	1,35,000
2022	1,35,000	10%	13,500	1,21,500
2023	1,21,500	10%	12,150	1,09,350

Note: Cost of the machine (i.e. Opening Book Value for the year 2021)

= Cost of Purchase + Cost of Installation

= ₹ 1,00,000 + ₹ 50,000 = ₹ 1,50,000

Illustration 51.

A Manufacturing concern whose books are closed on 31st March, Purchased Machinery for ₹ 1,50,000 on 1st April 2020. Additional machinery was acquired for ₹ 40,000 on 30th September, 2021 and for ₹ 25,000 on 1st April, 2023. Certain machinery, which was purchased for ₹ 40,000 on 30th September, 2021, was sold for ₹ 34,000 on 30th September, 2023.

Give the Machinery Account for the year ending 31st March, 2024 taking into account depreciation at 10% per annum on the written-down value.

Solution:

Dr.			Machinery Account			Cr.		
Date	Particulars	₹	Date	Particulars	₹			
2020 April	To Bank	1,50,000	Mar. 31	By Depreciation	15,000			
				By Bal. c/d	1,35,000			
		1,50,000			1,50,000			
2021 April 1	To Bal. b/d	1,35,000	2022 Mar. 31	By depreciatio (13,500+2,000)	15,500			
Sept. 30	To Bank	40,000		By Bal. c/d	1,59,500			
		1,75,000			1,75,000			
2022 Apr. 1	To Bal b/d	1,59,500	Mar. 31	By Depreciatio (12,150+3,800)	15,950			
				By Bal. c/d	1,43,550			
		1,59,500			1,59,500			
2023 April 1	To Balance b/d	1,43,550	2023 Sept. 30	By Depreciation A/c	1,710			
	To Bank (additions)	25,000		By Bank A/c	34,000			
2023 Sept. 30	To P & L A/c (profit on sale of machinery) (₹ 34,000 - ₹ 32,490)	1,510	2024 Mar. 31	By Depreciation (10,935 + 2,500)	13,435			
				By Bal. c/d	1,20,915			
		1,70,060			1,70,060			
2024 April 1	To Bal. b/d	1,20,915						

Calculation of profit on sale of machinery:

Particulars	₹	₹
Cost of machinery on 30-9-2021		40,000
Less: Depreciation for 2021-2022 (i/1 year)	2,000	
2022-23	3,800	
2023-24 (1/2 year)	1,710	
		7,510
		32,490
Less: Amount realized on sale of machinery		34,000
Profit on sale of Machinery		1,510

Illustration 52.

One lathe machine whose original value was ₹1,20,000 on 1.4.2021, being the date of installation was sold on 30.9.2023 for ₹1,00,000. Depreciation is charged at the rate of 10% on reducing balance. Show machinery account and assets disposable account.

Solution:

Dr. **Machinery Account** **Cr.**

Date	Particulars	₹	Date	Particular	₹
2021 Apr. 1	To Balance b/d	1,20,000	2021 Mar 31	By Depreciation A/c (1,20,000*10%)	12,000
			Mar 31	By Balance c/d	1,08,000
		1,20,000			1,20,000
2022 Apr. 1	To Balance b/d	1,08,000	2023 Mar 31	By Depreciation A/c (1,08,000*10%)	10,800
			Mar 31	By Balance c/d	97,200
		1,08,000			1,08,000
2023 Apr. 1	To Balance b/d	97,200	Sep 30	By Machinery disposal A/c	97,200
		97,200			97,200

Dr. **Machinery Disposal Account** **Cr.**

Particular	₹	Particular	₹
To Machinery A/c	97,200	By Bank A/c	1,00,000
To Profit and Loss A/c (profit on sale of Machinery)	7,660	By Depreciation A/c (1.4.23-30.9.23)	4,860
	1,04,860		1,04,860

Accounting Treatment of Bad Debts and Provision for Doubtful Debts

1.10

⦿ Concept of Provisions

A provision is defined as a charge against profit for the purpose of providing for any liability or loss. The anticipated liability or loss is expected but may or may not be ascertained with reasonable accuracy. It is an internal non-cash expense. If the amount of a known liability or loss can be ascertained with substantial accuracy, it should be treated as a liability and not a provision. A provision is created for any of the following purposes:

- a) For liabilities and charges (e.g., provision for taxation);
- b) Valuation adjustment for fixed assets (e.g., provision for depreciation);
- c) Valuation adjustment for current assets (e.g., provision for doubtful debts).

⦿ Credit Sales, Bad Debt, Doubtful Debt

Organisations are often found to sell goods on credit. This is because credit sales attract more buyers as they need not to pay for the goods immediately; rather, they get an additional period for the paying their dues. This period is known as credit period which may range from a few days to a few months depending upon the contractual terms. Thus, on any reporting date, there remains amount receivable from customers or debtors. This is known as debt.

On the basis of the chances of collection from the debtors, debts may be classified into the following three categories: Good Debts, Bad Debts and Doubtful Debts.

Good Debts: This represents the debts which are likely to be realised in full.

Bad Debt: This represents the debt which are confirmed to be uncollectible or irrecoverable. This is a confirmed loss.

Doubtful Debt: This represents the debt the collectability of which is not certain due to factors such as the customer's becoming insolvent.

⦿ Provision for Doubtful Debt

Since, bad debt is a confirmed loss, the same is charged to Profit and Loss A/c along with a reduction of the receivables (i.e., Debtors). However, as doubtful debts are not confirmed loss, they cannot be debited to Profit and Loss A/c until they are confirmed to be so. Therefore, this is an anticipated liability or loss which is expected but not ascertainable with reasonable accuracy on the date of reporting. Hence, it requires a provision. Such a provision also justifies the conservatism principle which advocates providing for all possible losses.

Hence, Provision for Doubtful Debt is the amount charged against the profit by an entity to provide for the possible collection loss from customers.

c) For creating necessary provision at the end of the year

i) When Closing Provision > Opening Provision

Profit and Loss A/c Dr.

 To Provision for Doubtful Debt A/c

ii) When Closing Provision < Opening Provision

Provision for Doubtful Debt A/c Dr.

 To Profit and Loss A/c

Consider the following illustrations.

Note: Recovery of Bad Debt

Bad debt written off in any earlier year(s), if recovered during the current year) is directly credited to Profit and Loss A/c.

Note: Presentation of Provision for Doubtful Debt

The Provision for Doubtful Debt is shown as a deduction from the Sundry Debtors in the Balance Sheet of the entity.

Illustration 53.

The Balance Sheet of X as on 31.12.2021 included the following items:

Particulars	₹
Sundry Debtors	98,000
Less: Provision for bad debts	2,450
	95,550

At the end of the following financial years, the gross amount of Debtors (before deducting a provision) were as under:

As on 31.12.2022—₹94,000; As on 31.12.2023—₹1,02,000.

On each of these years there was a provision for bad debts calculated on the same percentage basis as on 31.12.2021.

The actual amount of bad debts written off from Debtors Accounts over those periods were:

For the year ended 31.12.2022—₹2,600; For the year ended 31.12.2023—₹2,300.

You are required to prepare Bad Debts Account and Provision for Doubtful Debts Account for the years 2022 and 2023 (as per Method 1 and Method 2).

Solution:**Under Method 1****In the books of X
Bad Debts Account**

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
2022 Dec. 31	To Sundry Debtors A/c	2,600	2021 Dec. 31	By Provision for Doubtful Debts A/c	2,600
2023 Dec. 31	To Sundry Debtors A/c	2,300	2022 Dec. 31	By Provision for Doubtful Debts A/c	2,300

Dr. Provision for Doubtful Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2021 Dec. 31	To Bad Debts A/c	2,600	2021 Jan. 1	By Balance b/d	2,450
	To Balance c/d (2.5% on ₹94,000)	2,350	Dec. 31	By Profit and Loss A/c	2,500
		4,950			4,950
2022 Dec. 31	To Bad Debts A/c	2,300	2022 Jan. 1	By Balance b/d	2,350
	To Balance c/d (2.5% on ₹1,02,000)	2,550	Dec. 31	By Profit and Loss A/c (Balancing figure)	2,500
		4,850			4,850
			2023 Jan. 1	By Balance b/d	2,550

Note: Percentage of provision to be created = $(2,450/98000 \times 100) \% = 2.5\%$

Under Method 2**In the books of A
Bad Debts Account**

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
2022 Dec. 31	To Sundry Debtors A/c	2,600	2022 Dec. 31	By Profit and Loss A/c	2,600
2023 Dec. 31	To Sundry Debtors A/c	2,300	2023 Dec. 31	By Profit and Loss A/c	2,300

Dr. Provision for Doubtful Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2022 Dec. 31	To Profit and Loss A/c	100	2022 Jan. 1	By Balance b/d	2,450
	To Balance c/d (2.5% on ₹94,000)	2,350	Dec. 31		
		2,450			2,450
2023 Dec. 31	To Balance c/d (2.5% on ₹1,02,000)	2,550	2023 Jan. 1	By Balance b/d	2,350
			Dec. 31	By Profit and Loss A/c (Balancing figure)	200
		2,550			2,550
			2024 3 Jan. 1	By Balance b/d	2,550

Note: Percentage of provision to be created = $(2,450/98000 \times 100) \% = 2.5\%$

⊙ **Discount Allowed and Provision for Discount on Debtors**

It is a common practice of the entities to allow cash discount to its customers for prompt settlement of receivables. Discount allowed during the year is deducted from Debtors and the same is debited to Profit and Loss A/c as an expense. However, for any discount expected to be allowed on the balance amount of receivable, it would be prudent to create a provision so that the profit is not inflated. This provision is known as Provision for Discount on Debtors.

⊙ **Accounting for Discount Allowed and Provision for Discount on Debtors**

The accounting for Discount Allowed and Provision for Discount on Debtors is similar to what has been discussed in case of Bad Debt and Provision for Doubtful Debt.

Note: Provision for discount on debtors is calculated on the balance of sundry debtors after adjusting bad debts (after Trial Balance), provision for doubtful debts and discount allowed.

Illustration 54.

Following are the balances taken from the Trial Balance of a trader as on 31.12.2023.

	Dr.	Cr.
Particulars	₹	₹
Sundry Debtors	1,00,000	
Bad debts	7,000	
Discount allowed	3,000	
Provision for Doubtful debts		12,000
Provision for discount on Debtors		6,000

You are required to prepare Bad Debts Account, Discount Allowed Account, Provision for Doubtful Debts Account and Provision for Discount on Debtors Account. Also, show how they appear in the Profit and Loss Account and in the Balance Sheet, after considering the following:

- Further bad debts and discount allowed are ₹3,000 and ₹2,000 respectively;
- Provision for bad debts and provision for discount on Debtors to be created @ 10% and @ 5% respectively. (Under Method 1 and 2)

Solution:

Under Method 1

In the books of the Trader

Dr.			Cr.		
Bad Debts Account					
Date	Particulars	₹	Date	Particulars	₹
2023 Dec. 31	To Sundry Debtors A/c	7,000	2022 Dec. 31	By Provision for Bad Debts A/c	10,000
	To Sundry Debtors A/c	3,000			
		10,000			10,000

Dr.			Cr.		
Discount Allowed Account					
Date	Particulars	₹	Date	Particulars	₹
2023 Dec. 31	To Sundry Debtors A/c	3,000	2023 Dec. 31	By Provision for Discount on Debtors A/c	5,000
	To Sundry Debtors A/c	2,000			
		5,000			5,000

Dr.			Cr.		
Provision for Doubtful Debts Account					
Date	Particulars	₹	Date	Particulars	₹
2023 Dec. 31	To Bad Debts A/c	10,000	2023 Jan. 1	By Balance b/d	12,000
	To Balance c/d	9,500	Dec. 31	By Profit and Loss A/c (Balancing figure)	7,500
	(10% on ₹95,000)	19,500			19,500

Dr. Provision for Discount on Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2023 Dec. 31	Flo Discount Allowed A/c	5,000	2023 Jan. 1	By Balance b/d	6,000
	₹(3,000 + 2,000) To Balance c/d	4,275	Dec. 31	By Profit and Loss A/c	3,275
	(5% on ₹85,500}	9,275		(Balancing figure)	9,275

Dr. Profit and Loss Account for the year ended 31st December, 2023 (includes) Cr.

Particulars	₹	Particulars	₹
To Provision for Doubtful Debts A/c	7,500		
To Provision for Discount on Debtors A/c	3,275		

Balance Sheet as at 31st December, 2023 (includes)

Liabilities	₹	Assets	₹	₹
		Sundry Debtors (Note 3)	95,000	
		Less: Provision for Doubtful Debts	9,500	
			85,500	
		Less: Provision for Discount on Debtors	4,275	
				81,225

Solution:

Under Method 2

In the books of the Trader

Dr. Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2023 Dec. 31	To Sundry Debtors A/c	7,000	2023 Dec. 31	By Profit and Loss A/c	10,000
	To Sundry Debtors A/c	3,000			
		10,000			10,000

Dr. Discount Allowed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2023 Dec. 31	To Sundry Debtors A/c	3,000	2023 Dec. 31	By Profit and Loss A/c	5,000
	To Sundry Debtors A/c	2,000			
		5,000			5,000

Dr. Provision for Doubtful Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2023 Dec. 31	To Profit and Loss A/c (b. f)	2,500	2023 Jan. 1	By Balance b/d	12,000
	To Balance c/d (10% on ₹95,000)	9,500			
		12,000			12,000

Dr. Provision for Discount on Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2023 Dec. 31	To Profit and Loss A/c (b. f)	1,725	2023 Jan. 1	By Balance b/d	6,000
	To Balance c/d (5% on ₹ 85,500)	4,275			
		6,000			6,000

Dr. Profit and Loss Account for the year ended 31st December, 2023 (includes) Cr.

Particulars	₹	Particulars	₹
To Bad Debt	10,000	By Provision for Doubtful Debt	2,500
To Discount Allowed	5,000	By Provision for Discount on Debtors	1,725

Balance Sheet as at 31st December, 2023 (includes)

Liabilities	₹	Assets	₹	₹
		Sundry Debtors (Note 3)	95,000	
		Less: Provision for Bad Debts	9,500	
			85,500	
		Less: Provision for Discount on Debtors	4,275	
				81,225

Working Notes:

- Provision for bad debts and provision for discount on debtors appearing in the Trial Balance represent opening provisions.
- Bad debts are increased to ₹ 10,000 (₹ 7,000 + ₹ 3,000) and discount allowed to ₹ 5,000 (₹ 3,000 + ₹ 2,000).
- Following are the required Journal Entries.

Bad Debts Account	Dr.	₹ 3,000	
To Sundry Debtors Account			₹ 3,000
Discount Allowed Account	Dr.	₹ 2,000	
To Sundry Debtors Account			₹ 2,000
- The closing balance of sundry debtors becomes ₹ 95,000 [₹ (1,00,000 - 3,000 - 2,000)].
- Provision for discount on debtors is to be created @ 5% on (₹ 95,000 - ₹ 9,500) = ₹ 85,500.

Exercise

A. Theoretical Questions

⊙ Multiple Choice Questions (MCQ)

1. The revenues and expenses of a company are displayed in which statement?
 - (a) Balance Sheet
 - (b) Cash Flow Statement
 - (c) Income Statement
 - (d) Periodicity
2. The main Purpose of Financial Accounting is?
 - (a) To Provide financial information to shareholders
 - (b) To maintain Balance Sheet
 - (c) To minimize taxes
 - (d) To keep track of liabilities
3. Accounting provides information on
 - (a) Cost and income for managers
 - (b) Company's tax liability for a particular year
 - (c) Financial conditions of an institutions
 - (d) All of the above
4. The determination of expenses for an accounting period is based on the concept of
 - (a) Objectivity
 - (b) Materiality
 - (c) Matching
 - (d) Periodicity
5. Accounting does not record non-financial transactions because of
 - (a) Entity Concept
 - (b) Accrual Concept
 - (c) Cost Concept
 - (d) Money Measurement Concept
6. Provision for bad debt is made as per the
 - (a) Entity Concept
 - (b) Conservatism Convention
 - (c) Cost Concept
 - (d) Going Concern Concept

7. Fixed Assets and Current Assets are categorized as per concept of
 - (a) Separate Entity
 - (b) Going Concern
 - (c) Consistency
 - (d) Time period
8. Omission of paise and showing the round figures in Financial Statements is based on
 - (a) Conservatism Concept
 - (b) Consistency Concept
 - (c) Materiality Concept
 - (d) Realization Concept
9. P & L Account is prepared for period of one year by following
 - (a) Consistency Concept
 - (b) Conservatism Concept
 - (c) Accounting Period Concept
 - (d) Cost Concept
10. An expenditure is capital in Nature when
 - (a) The receiver of the amount is going to treat it
 - (b) It increase the quantity of fixed assets for the purchase of fixed assets
 - (c) It is paid as interests on loans for the business
 - (d) It is maintains a fixed assets
11. Capital expenditures are recorded in the
 - (a) Balance Sheet
 - (b) Profit and Loss A/c
 - (c) Trading A/c
 - (d) Manufacturing A/c
12. Which of the following transaction is of capital nature
 - (a) Purchases of a truck
 - (b) Replacement of old trucks
 - (c) Cost of repairing of truck
 - (d) All of the above
13. ₹5,000 incurred for up gradation of computer by installation of 128 MB Ram is
 - (a) Capital Expenditure
 - (b) Deferred Revenue Expenditure

- (c) Revenue Expenditure
 - (d) None of the above
14. Entrance fee of ₹ 20,000 received by a club is a
- (a) Capital Receipts
 - (b) Revenue Receipt
 - (c) Capital Expenditure
 - (d) Revenue Expenditure
15. Life membership fees received by a club is a
- (a) Revenue Expenditure
 - (b) Capital Expenditure
 - (c) Deferred Revenue Expenditure
 - (d) Capital Receipt
16. Cost of goods purchased for resale is an example of
- (a) Capital Expenditure
 - (b) Revenue Expenditure
 - (c) Deferred Revenue Expenditure
 - (d) None of These
17. Import duty of raw material purchased
- (a) Revenue Expenditure
 - (b) Capital Expenditure
 - (c) Deferred Revenue Expenditure
 - (d) None of These
18. Received from Soloman & co., an invoice for ₹ 1,500 for repairs to factory walls
- (a) Revenue Expenditure
 - (b) Capital Expenditure
 - (c) Deferred Revenue Expenditure
 - (d) None of These
19. Compensation received from government for compulsory acquisition of land
- (a) Revenue Expenditure
 - (b) Capital Expenditure
 - (c) Deferred Revenue Expenditure
 - (d) None of These

20. All revenue receipts and expenditures are shown in
- (a) Balance Sheet
 - (b) Trading and Profit and Loss A/c
 - (c) Cash Flow Statement
 - (d) Statement of Affairs
21. A bad debt recovered during the year will be
- (a) Capital Expenditure
 - (b) Revenue Expenditure
 - (c) Capital Receipt
 - (d) Revenue Receipt
22. Insurance claim received on account of machinery damaged completely by fire is
- (a) Capital Receipt
 - (b) Revenue Receipt
 - (c) Capital Expenditure
 - (d) Revenue Expenditure
23. Amount of ₹ 5,000 spent as lawyers' fees to defend a suit claiming that the firm's factory site belonged to the plaintiff's land is
- (a) Capital Expenditure
 - (b) Revenue Expenditure
 - (c) Deferred Revenue Expenditures
 - (d) None
24. Money spent ₹ 10,000 as travelling expenses of the directors on trips abroad for purchase of capital assets is
- (a) Capital Expenditure
 - (b) Revenue Expenditure
 - (c) Deferred Revenue Expenditures
 - (d) None
25. Nominal Account represents
- (a) Profit & gain
 - (b) Loss/Expenses
 - (c) None
 - (d) Both (a) and (b)

26. S.B.I Account is a ...
- (a) Nominal
 - (b) Artificial Personal Account
 - (c) Representative Personal Account
 - (d) None
27. The process of recording business transactions in a book of original entry is known as
- (a) Journal
 - (b) Balance
 - (c) posting
 - (d) none
28. Prepaid rent is a
- (a) Nominal A/c
 - (b) Representative Personal A/c
 - (c) Tangible Assets A/c
 - (d) None
29. In an Account if debit > credit side, the balance is known as the
- (a) Negative balance
 - (b) Debit balance
 - (c) Positive balance
 - (d) Credit balance
30. A sale of goods to Ram for cash should be debited to:
- (a) Ram
 - (b) Cash
 - (c) Sales
 - (d) Capital
31. A withdrawal of cash from business by the proprietor should be credited to
- (a) Drawing A/c
 - (b) Capital A/c
 - (c) Cash A/c
 - (d) Purchase A/c
32. Rent Account is
- (a) Personal
 - (b) Real

- (c) Nominal
(d) None
33. Ledger contains various _____ in it
- (a) Transactions
(b) Entries
(c) Accounts
(d) None
34. The process of transfer of entries from day book to ledgers is called _____
- (a) Simple posting
(b) Journal posting
(c) Transaction
(d) Ledger posting
35. The rent paid to landlord is credited to
- (a) Landlord's A/c
(b) Rent A/c
(c) Cash A/c
(d) None
36. Which financial statement represents the accounting equation-
Assets = Liabilities + Owner's equity:
- (a) Income Statement
(b) Statement of Cash flows
(c) Balance Sheet
(d) None
37. The debts written off as bad, if recovered subsequently are
- (a) Credited to Bad Debts Recovered A/c
(b) Credited to Trade Receivables Account
(c) Debited to Profit and Loss Account
(d) None
38. A trial balance will not balance if _____
- (a) correct entry is posted twice
(b) The purchase on credit basis is debited to purchases and credited to cash
(c) ₹ 500 cash payment to creditors is debited to creditors for ₹ 50 and credited to cash as ₹ 500
(d) None of the above

39. A Trial Balance shows
- (a) Honesty of accountants
 - (b) Accuracy of account
 - (c) Only arithmetical accuracy of accounts
 - (d) None of these
40. The process of recording business transactions in a book of original entry is known as
- (a) Journal
 - (b) Balance
 - (c) Posting
 - (d) none
41. Ledger contains various ____ in it
- (a) Transactions
 - (b) Entries
 - (c) Accounts
 - (d) None
42. The process of transfer of entries from day book to ledgers is called ____
- (a) Simple posting
 - (b) Journal posting
 - (c) Transaction
 - (d) Ledger posting
43. A Ledger is also called
- (a) Book of Original entry
 - (b) Book of Primary entry
 - (c) Book of Final entry
 - (d) None of the above
44. Whenever errors are noticed in the accounting records, they should be rectified _____
- (a) At the time of preparation of Trial Balance
 - (b) without waiting the accounting year to end
 - (c) After the preparation of Final Accounts
 - (d) in the next accounting year
45. Sales of Shyam of ₹ 500 not recorded in the books would affect ____
- (a) Shyam's Account
 - (b) Sales Account

- (c) Sales Account and Shyam's Account
 - (d) Cash Account
46. Errors of carry forward from one year to another affects ___
- (a) Personal Account
 - (b) Real Account
 - (c) Nominal Account
 - (d) both (a) and (b)
47. Goods worth ₹272 returned by Lala passed through the books as ₹722. The rectification entry is
- (a) Lala will be debited by ₹450
 - (b) Lala will be debited by ₹272
 - (c) Lala will be credited by ₹722
 - (d) Lala will be credited by ₹272
48. If a receipt of ₹200 from rajesh (debtor) has not been recorded in the books the profits would show
- (a) An increase of ₹2,000
 - (b) A decrease of ₹200
 - (c) Neither an increase nor a decrease
 - (d) None of the above
49. A credit purchase of ₹950 from sudhir was recorded in purchases book as ₹590. The rectification entry is ___
- (a) purchases account will be debited by ₹360
 - (b) sudhir will be credited by ₹590
 - (c) purchases account will be debited by ₹950
 - (d) sudhir will be credited by ₹950
50. Which of these errors affect only one account
- (a) errors of casting
 - (b) errors of carry forward
 - (c) errors of posting
 - (d) All the three
51. If goods worth ₹1,750 returned to supplier is wrongly entered in sales returns book as ₹1,570, then ___
- (a) Net Profit will decrease by ₹3,140
 - (b) Gross Profit will increase by ₹3,320
 - (c) Gross Profit will decrease by ₹3,500
 - (d) Gross Profit will decrease by ₹3,320

52. Which of the following is one sided error
- (a) ₹ 500 purchase of old equipment not recorded
 - (b) ₹ 500 being expense on travelling expense in the books of account at all credited to travelling expenses
 - (c) Both
 - (d) None
53. Which of the following errors affects the agreement of a Trial Balance?
- (a) Mistake in balancing an account
 - (b) Omitting to record a transaction entirely in the subsidiary books
 - (c) Recording of a wrong entry in the subsidiary books
 - (d) Posting an entry on the correct side but in the wrong account
54. Which of the these errors affect only one account
- (a) Errors of casting
 - (b) Errors of carry forward
 - (c) Errors of posting
 - (d) All the three
55. Which of these errors affect two or more accounts
- (a) Errors of complete omission
 - (b) Errors of principle
 - (c) Errors of posting to wrong account
 - (d) All the three
56. Which of the following error is an error of principle
- (a) ₹5,000 received from sham credited to Ram A/c.
 - (b) ₹5,000 incurred on installation of new plant debited to travelling expenses A/c
 - (c) ₹500 paid for wages debited to Salary A/c
 - (d) ₹500 being purchase of raw material debited to Purchase A/c ₹50
57. ₹200 paid as wages for erecting a machine should be debited to
- (a) Repair A/c
 - (b) Machine A/c
 - (c) Capital A/c
 - (d) Furniture A/c
58. Bank Reconciliation Statement compares a Bank Statement with _____.
- (a) Cash Payment Journal
 - (b) Cash Receipt Journal

- (c) Financial Statements
 - (d) BankBook
59. On the Bank Statement, cash deposited by the company is known as
- (a) Credit
 - (b) Debit
 - (c) Liability
 - (d) Expenses
60. In Bank Book, the favourable balance indicates
- (a) Credit Balance
 - (b) Debit Balance
 - (c) Bank Overdraft
 - (d) Adjusted Balance
61. In Bank Book, bank charges of ₹5,000 was not recorded. Name the correct Bank Book adjustment
- (a) It will be credited in Bank Book
 - (b) It will be debited in Bank Book
 - (c) No adjustment needed in the Bank Book
 - (d) Charges will be added to the Bank Book Balance
62. A Bank Reconciliation Statement is prepared by?
- (a) Banker
 - (b) Accountant of the business
 - (c) Auditors
 - (d) Registrar
63. When preparing a Bank Reconciliation Statement, if you start with debit balance as per Cash Book cheques sent to bank but not collected should be
- (a) Added
 - (b) Deducted
 - (c) Not required to be adjusted
 - (d) None
64. Balance as per adjusted Cash Book ₹274. Cheques not yet presented ₹730. Cheques deposited not yet recorded by bank ₹477 balance as per Pass Book will be
- (a) ₹528
 - (b) ₹527
 - (c) ₹500
 - (d) none

64. A debit balance in the depositor's Cash Book will be shown as
- (a) A debit balance on the Bank Statement
 - (b) A credit balance on the Bank Statement
 - (c) An overdrawn balance on Bank Statement
 - (d) None of the above
65. Which of these types of errors are not detected during Bank Reconciliation?
- (a) Cash embezzlement by the cashier
 - (b) cheque deposited but not credited by bank
 - (c) Casting mistakes in bank column of cash book
 - (d) Interest or commission charged by the bank but not accounted for in cash book.
66. Which of these documents is not required for Bank Reconciliation
- (a) Bank column of Cash Book
 - (b) Bank Pass Book
 - (c) Bank Statement
 - (d) Trial Balance
67. From the following details ascertain the adjusted bank balance as per Cash Book – overdraft as per cash book ₹ 80,000; cheque received entered twice in the Cash Book ₹ 5,000; credit side of bank column cast short by ₹ 500; bank charges amounting to ₹ 200 entered twice; cheque issued but dishonoured ₹ 2,000.
- (a) ₹ 80,500
 - (b) ₹ 85,500
 - (c) ₹ 85,000
 - (d) ₹ 83,300
68. Which of these items are taken in to consideration for preparation of adjusted Cash Book
- (a) Mistake in Cash Book
 - (b) Mistake in Pass Book
 - (c) Cheque issued but not presented for payment
 - (d) Cheques deposited but not cleared
69. When overdraft as per Cash Book is the starting point, a cheque of ₹ 500 deposited in to bank but not recorded in Cash Book will be:
- (a) Added by ₹ 500
 - (b) Deducted by ₹ 500
 - (c) Added by ₹ 1,000
 - (d) Deducted by ₹ 1,000

71. Bank has directly paid ₹1,250 for rent as per standing instructions. In BRS starting with Pass Book overdraft
- (a) ₹1,250 will be added to Pass Book overdraft
 - (b) ₹2,500 will be added to Pass Book overdraft
 - (c) This amount will be ignored
 - (d) ₹1,250 will be deducted from Pass Book overdraft.
72. When credit balance as per Pass Book is the starting point bank charges are –
- (a) Subtracted
 - (b) Added
 - (c) Neither of the two
 - (d) None
73. The Bank Reconciliation Statement is prepared
- (a) to rectify the mistakes in the Cash Book
 - (b) to arrive at the bank balance
 - (c) to arrive at the cash balance
 - (d) to bring out the reasons for the difference between the balance as per Cash Book and the balance as per Bank Statement
74. Benefits of preparing Bank Reconciliation Statement includes –
- (a) it brings out any errors committed in preparation
 - (b) highlights under delay in clearance of cheques of Cash Book/ Bank Pass Book deposited but not credited
 - (c) Help known actual bank balance
 - (d) all the three
75. Debit balance as per Bank Pass Book mean –
- (a) surplus cash
 - (b) bank overdraft
 - (c) Terms deposits with bank
 - (d) none of these
76. Debit side of Bank Pass Book corresponds to –
- (a) credit side of Cash Book
 - (b) debit side of Cash Book
 - (c) debit side of Trial Balance
 - (d) credit side of Balance Sheet

77. Difference in bank balance as per Pass Book and Cash Book may arise on account of
- (a) Cheque issued but not presented
 - (b) cheque issued but dishonored
 - (c) cheque deposited and credited by bank
 - (d) All of (a) and (b) above
78. Trial Balance is used to check the accuracy of
- (a) Balance Sheet balances
 - (b) Ledger Accounts balances
 - (c) Cash Flow Statement balances
 - (d) Income Statement balances
79. When is Trial Balance normally prepared?
- (a) At the end of an accounting period
 - (b) At the end of a year
 - (c) Frequently during the year
 - (d) At the end of a month
80. Which of the following account with normal balance is shown at the debit side of a Trial Balance?
- (a) Creditors Account
 - (b) Unearned Income Account
 - (c) Rent Income Account
 - (d) Cash Account
81. In Trial Balance, which accounts with normal balance is recorded at the credit side?
- (a) Bank Account
 - (b) Equipment Account
 - (c) Cash Account
 - (d) Accrued Expenses Account
82. A Trial Balance shows up on both the equal sides of the credit and debit column:
- (a) This means that though the arithmetic is correct,
 - (b) This means that there would be only a single there are still chances of some errors in the sheet error in the sheet
 - (c) This means that there would be more than one error in the sheet
 - (d) This means that there is no error in the sheet

83. Depreciation refers to the process of ____.
- (a) Asset valuation
 - (b) Allocation of cost of the assets over the period of its life
 - (c) verification of assets
 - (d) increasing or decreasing the value of asset
84. In case the depreciable assets are revalued, the provision for depreciation is based on
- (a) market value of the assets
 - (b) historical cost of assets
 - (c) depreciated value of the assets
 - (d) The revalued amount over the estimate of the remaining useful life of such asset
85. Which of the following is the internal causes for depreciation?
- (a) wear and tear
 - (b) depletion or exhaustion
 - (c) both (a) & (b)
 - (d) none of the above
86. Which are the methods of depreciation prescribed by the income tax act ____
- (a) Straight Line and Annuity Method
 - (b) Sinking Fund and Double Declining Method
 - (c) Equal Installment and Written Down Value Method
 - (d) Production Hour and Sum of Year's Digit Method
87. Depreciation is not provided for which of the following asset?
- (a) goodwill
 - (b) land
 - (c) inventory of goods
 - (d) both (b) & (c)
88. Obsolescence means decline in the value due to
- (a) physical wear and tear
 - (b) efflux of time
 - (c) fall in market price
 - (d) innovations and inventions

89. The Depreciation Account is closed at the end of the year by transfer to the
- (a) General Reserve A/c
 - (b) Profit and Loss A/c
 - (c) Provision for Depreciation A/c
 - (d) Fixed Asset A/c
90. Which of the following is an external cause for depreciation
- (a) Obsolescence
 - (b) time element
 - (c) abnormal occurrences
 - (d) all of the above
91. Accumulated depreciation is an example of
- (a) A liability
 - (b) An expense
 - (c) An income
 - (d) An unrecorded revenue
92. Purchase price of machine ₹8,90,000, freight and cartage ₹7,000, installation charges ₹30,000, Insurance charges ₹20000, residual value is ₹40,000, estimated useful life 5 years. Calculate the amount of annual depreciation under straight line method?
- (a) ₹1,77,400
 - (b) ₹1,81,400
 - (c) ₹1,97,400
 - (d) ₹1,77,900
93. Depreciation of a ten-year lease is best done on the method
- (a) WDV
 - (b) SLM
 - (c) Annuity method
 - (d) both (a) & (b)
94. Original cost is ₹1,50,000 residual value is 10,000, depreciation for 3rd year @ 10% p.a. under WDV method___
- (a) ₹14,000
 - (b) ₹12,150
 - (c) ₹11,340
 - (d) ₹12,240

95. For charging depreciation, on which of the following assets, the depletion method is adopted?
- (a) Plant & Machinery
 - (b) Land & Building
 - (c) Goodwill
 - (d) Wasting assets like mines and quarries
96. The value of an asset after deducting depreciation from the historical cost is known as
- (a) Fair Value
 - (b) Market Value
 - (c) Net Realizable Value
 - (d) Book Value
97. If the original cost of the machine = ₹ 1,00,000, life = 5 years residual value = ₹ 2,000. If the depreciation for 4th year as per SLM is ₹ 19,600, then the rate of depreciation p.a. is
- (a) 10%
 - (b) 15%
 - (c) 20%
 - (d) 5%
98. To write off bad debt, following entry is passed:
- (a) Provision for bad debts debit: Debtors credit
 - (b) Provision for bad debts debit: Bad debts credit
 - (c) Bad debts debit: Debtors credit
 - (d) none of the above
99. A recovery of bad debt
- (a) increases net income
 - (b) decreases net income
 - (c) increases gross profit and net income
 - (d) None of the above
100. Provision for discount allowed on outstanding debtors balances should be calculated, at an appropriate rate, on _____
- (a) total debtors
 - (b) total debtors net of any bad debts written off
 - (c) total debtors less. total creditors
 - (d) total debtors net of any bad debts written off and after deducting the cumulative amount of any provision for doubtful debts

101. Bad Debts are recorded on which accounting principle:
- (a) Going Concern
 - (b) Substance Over Form
 - (c) Prudence
 - (d) None of the above
102. Provisions are
- (a) External Transactions
 - (b) Internal Transactions
 - (c) Either (a) or (b)
 - (d) None of the above
103. Original cost = 12,60,000; Salvage value = Nil; Useful life = 6 years. Depreciation for the first year under sum of years digits method will be
- (a) 3,60,000
 - (b) 1,20,000
 - (c) 1,80,000
 - (d) 2,80,000
104. The number of productions of similar units expected to be obtained from the use of an asset by an enterprise is called as
- (a) Unit life
 - (b) Useful life
 - (c) Production life
 - (d) Scape life
105. If a concern proposes to discontinue its business from March 2023 and decides to dispose of all its plants within a period of 4 months, the Balance Sheet as on March 31, 2023 should indicate the plants at their.
- (a) Historical cost
 - (b) Net realizable value
 - (c) Cost less depreciation
 - (d) Salvage vale
106. In the case of downward revaluation of a plant which is for the first time revalued, the account to be debited is
- (a) Plant account
 - (b) Revaluation Reserve
 - (c) Profit & Loss account
 - (d) None of the these

107. The portion of the acquisition cost of the tangible asset, yet to be allocated is known as
- (a) Written down value
 - (b) Accumulated Value
 - (c) Realisable Value
 - (d) Both (b) & (c)
108. Original cost of a machine was 25,20,000 salvage value was 1,20,000, useful life was 6 years. Annual depreciation under Straight Line Method
- (a) 4,20,000
 - (b) 4,00,000
 - (c) 3,00,000
 - (d) 2,00,000
109. The cost of a machine is 20,00,000. Two years later the book value is 10,00,000. The Straight-line percentage depreciation is
- (a) 50%
 - (b) 33-1/3%
 - (c) 25%
 - (d) 16.67%
110. A machinery with original cost of 10,00,000 and Nil Salvage value acquired on 1st April 2019 with 4 years useful life was depreciated using Straight Line Method. It was decided to sell the machinery on 1st October 2022 for 1,20,000. What shall be the gain or (loss) on the sale of Machinery?
- (a) Loss of 1,30,000
 - (b) Gain of 1,20,000
 - (c) Loss of 5,000
 - (d) None of these
111. Which of the following assets does not depreciate?
- (a) Machinery and equipment
 - (b) Patents
 - (c) Land
 - (d) Building
112. A company purchased a machinery on April 01, 2017, for 15,00,000. It is estimated that the machinery will have a useful life of 5 years after which it will have no salvage value.
- The depreciation charged during the year 2021-22 was
- (a) 5,00,000
 - (b) 4,00,000
 - (c) 3,00,000
 - (d) 2,50,000

⦿ **State True or False**

1. Accounting is the 'language of business'.
2. 'Profit/loss' is the core accounting measurement.
3. Accounting Standards are Institutional Framework.
4. The Schedules of the Companies Act also provide important guidelines on the form and contents of Financial Statements.
5. Consistency is one of the accounting concepts.
6. Accounting is concerned with both monetary and non-monetary transactions.
7. Joint venture follows the Going Concern Concepts.
8. An expenditure is revenue in nature, when it benefits the current period.
9. Paper purchased for use as stationery is Capital Expenditure.
10. Purchase of machinery for sale is Revenue Expenditure.
11. Gratuity and pension paid to employees after retirement is Deferred Revenue Expenditure.
12. A bad debt recovered during the year is Revenue Receipt.
13. Freight paid on purchase of machinery is to be treated as Revenue Expenditure.
14. Repainting of building done every 3 years is "Revenue Expenditure".
15. Premium received on issue of share is Capital Profit.
16. A motor truck costing ₹ 15,000 and standing in the books at ₹ 7,250 was sold for ₹ 1200. "Capital Loss ₹ 4,750 & Capital Expenditure ₹ 1200".
17. A motor car which was purchased for ₹ 20,000 and had its book value ₹ 12,000 was sold for ₹ 17,000. The capital profit will be "₹ 5000".
18. Ram has assets of ₹ 20,000 and liabilities of ₹ 4,000 his capital therefore would be ₹ 16,000.
19. Depreciation is loss.
20. Double accounting system owes its origin to Luca Pacioli.
21. Profit or loss have no effect on Net Worth.
22. Capital Account is a Real Account.
23. Trial Balance is a Final Accounts
24. Trial Balance contains the balances of only Personal and Real Accounts.
25. After preparation of ledgers, the next step is the preparation of Trial Balance.
26. Journal is the book of Final Entry.
27. Trade Discount will be entered in the book of accounts.

28. Ledger is the book of Primary Entry.
29. An entry which has more than one debit and or credit is called Simple Entry.
30. At the time of journalising, it is necessary to analyse a transaction in terms of debit and credit.
31. Narration is not necessary for each and every journal entry.
32. Posting is done in Ledger.
33. Error of commission permit the trial balance to agree
34. The discount column of the cash book is not posted is an example of error of omission
35. Full omission do not affect trial balance
36. An error in wrong casting of the sales day book will not affect the personal account of debtors
37. Mistake in balancing an account will affect the agreement of a trial balance
38. Total of purchase journal is short by ₹1,000 will not affect trial balance
39. Recording a transaction in a wrong book of original entry with wrong amount will affect the trial balance
40. Under casting or overcasting of a subsidiary book is an example of error of commission
41. The mistake of treating a liability as an income or vice versa will affect the trial balance
42. ₹500 purchase of old equipment not recorded in the books of account at all is an one sided error
43. Bank Reconciliation Statement is prepared by the Bank.
44. Bank Reconciliation Statement is prepared to detect the errors that take place to accounting.
45. Bank reconciliation statement is generally prepared at the end of the year.
46. Unfavourable balance as per Bank Book means overdraft balance.
47. An unpresented cheque is a cheque given to company's creditor but the creditor has not presented it for payment to your company's bank account.
48. A credit balance in the pass book indicates excess of deposits over withdrawals.
49. A bank reconciliation statement is a part of pass book.
50. Bank charges increase debit balance as per bank pass book.
51. Bank pass book is also known as bank statement.
52. Reserve bank of India prepares bank reconciliation statement.
53. Bank overdraft as per cash book means debit balance.
54. The balance of cash book shows cash in hand.
55. Cheque deposited and cleared on the same date will not affect bank and cash balance.
56. Trial balance document is required for bank reconciliation.

57. In arriving at adjusted cash balance errors in the pass book is not taken into account.
58. A Trial Balance is a list of ledger balances.
59. A Trial Balance is a statement and not an account.
60. A Trial Balance does not ensure accounting accuracy.
61. A Trial Balance is prepared only once in a year.
62. A Trial Balance is prepared before the preparation of financial statements.
63. In case of mineral resources depreciation is not provided, but depletion is charged.
64. Under straight line method the cost of the asset written off in equal proportion, during its economic life.
65. Depreciation is charged on tangible fixed assets and it is not charged on any current asset.
66. Depreciation is a process of allocation and not of valuation.
67. An asset is purchased for ₹25,000, depreciation is to be provided annually according to straight line method useful life if the asset is 10 years and scrap value is ₹5,000. The rate of depreciation is 10%.
68. If the written down value of the machine on 1-1-2023 is ₹9,72,000 what will be the value of machine on 1-1-2021. If the method is RBM and rate of depreciation is 10%. The value on 1-1-2021 is ₹12,00,000.
69. Under the RBM of depreciation, the value of machinery never comes to zero and, under SLM of depreciation the value of machinery comes to zero at the end of its useful life.
70. Original cost of a machine was ₹2,52,000. Salvage value was ₹12,000, Depreciation for 2nd year @ 10% under WDV method is ₹21,600.
71. The portion of the acquisition of cost of the asset, yet to be allocated is known as written down value.
72. Under diminishing balance method, depreciation decreases every year.
73. Discount allowed is called bad debt.
74. The amount that is not recoverable from the debtors is termed as bad debts.
75. Provision for doubtful debt is debited to Sundry debtors.
76. Provision is a charge against profit.
77. Increase in provision for doubtful debts is a gain for the firm.

● **Fill in the Blanks**

1. _____ is the discipline that incorporates certain principles or rules of accounting.
2. The _____ is a body of interrelated objectives and fundamentals.
3. It is generally assumed that the business will not liquidate in the near forcible future because of _____.
4. The capital contributed by the proprietor is treated as a liability according to _____.

5. GAAP's means _____.
6. Revenue receipts are shown in _____.
7. Any donation received for a specific purpose is a _____.
8. Capital expenditure provide _____ benefit.
9. Amount received from a bank as a midterm loan for working capital _____.
10. ₹3,500 spent on painting new factory is _____.
11. Extension to building occupied on lease for 5 years _____.
12. ₹20,000 received from an issue of further shares the expenses of issue being ₹2500 _____.
13. Taxes paid _____.
14. Revenue is generally recognized as being earned at that point of time when _____.
15. Capital receipts are shown in _____ side of Balance Sheet.
16. White washing expenses are _____.
17. ₹2,500 spent on the overhaul of Machinery purchased second hand is _____.
18. ₹1,200 spent on repairs on machinery _____.
19. Inauguration expenses incurred on the opening of new manufacturing unit in an existing business. _____.
20. Subsidy of ₹40,000 received from the government per working capital _____.
21. Cash Account is _____ account.
22. Liability Account has _____ balance.
23. Interest Account has _____ balance.
24. Opening entries are generally passed through _____.
25. Goodwill Account is a/an _____.
26. The debit balance in a Nominal Account shows _____.
27. The allowance made for prompt payment is called _____.
28. The left hand side of an account is called _____ side.
29. If the debit side of goods account exceeds the credit side the difference will be _____.
30. The balance of _____ account will be shown in the debit column of trail balance.
31. The equality of debit and credit of the _____ does not mean that the individual accounts are also accurate.
32. Trail Balance is statement which shows the _____ or the totals of all the accounts.
33. _____ lists the balance and the title of account in the ledger.
34. Closing stock appearing in the Trial Balance is shown on the _____ Balance Sheet.

35. The balance of liabilities account will be shown in the _____ of the Trial Balance.
36. Opening entries are generally passed through _____.
37. The left-hand side of an account is called _____.
38. If the debit side of goods account exceeds the credit side the difference will be _____.
39. The balance of _____ account will be shown in the debit column of Trail Balance.
40. _____ is the abbreviation used for debit.
41. The _____ is often called “the king of all books.”
42. Unintentional omission or commission of amounts and accounts in the process of recording transactions are known as _____.
43. In case trial balance does not agree difference is put to _____.
44. If an effect of an error is cancelled by the effect of some other error, it is commonly known as _____.
45. The equality of debits and credits can be tested periodically by preparing a _____.
46. It is easy to detect _____ than _____.
47. On purchase of old furniture, the amount spent on its repair should be debited to _____.
48. A credit sale wrongly passed through purchases book will _____ the Trial Balance.
49. Goods sold to Sethi for ₹ 640 was recorded in his account as ₹ 460. In the rectifying entry, Sethi’s Account will be debited with _____.
50. Casting errors is an error in _____.
51. Goods sold to Busy & co on credit, worth ₹ 4,000 were not recorded in books. The rectification entry is _____.
52. Treating revenue expenses as a capital expenditure is an example of _____ errors.
53. The difference in the Trial Balance is transferred to _____ account.
54. ₹ 200 received from Smith whose account was written off as a bad debt should be credited to _____.
55. _____ amount will be credited in Gopal Account when goods purchased from Gopal for ₹ 3,600 but were recorded as ₹ 6,300.
56. Rectified entries to be passed in _____.
57. Pass Book is a copy of _____ as it appears in the ledger of the bank.
58. When money is withdrawn from the bank, the bank _____ the account of the customer.
59. Normally, the bank book shows a debit balance, Pass Book shows _____ balance.
60. When the cheques are not presented for payment, favourable balance as per the Bank Book is _____ than that of the Pass Book.

61. When a banker collects the bills and credits the account, Pass Book overdraft shows ___ balance.
62. Bank Reconciliation Statement is not a part of ___.
63. The debit side of the Pass Book was under-cast by ₹7,000. In the BRS, starting with Cash Book balance ___.
64. Unfavorable balance as per Bank Pass Book means which of ___.
65. Overdraft as per Cash Book means ___.
66. ___ prepares Bank Reconciliation Statement.
67. Bank balance shown in Trial Balance ___.
68. A debit balance in the depositor's Cash Book will be shown as ___.
69. The total of payment side of cash book is ₹700 short. If Bank Reconciliation Statement is started with Pass Book over drafts balance then : ___.
70. While preparing Bank Reconciliation Statement from debit balance of Cash Book cheques paid into bank but not yet cleared are ___.
71. Cheque of ₹6,250 deposited on 8.4.2023, realized on 14.4.2023. In the BRS as on 30.4.2023, starting with Cash Book balance, this item will be ___.
72. Credit balance in the Cash Book means ___.
73. When balance as per Pass Book is the starting point interest allowed by bank ___.
74. A Bank Reconciliation Statement is prepared by ___.
75. Debit balance as per Bank Pass Book means ___.
76. When debit balance as per Cash Book is the starting point unpresented cheques are ___.
77. Carriage inwards is entered into the _____ column of the Trial Balance.
78. The debit and credit columns of the Trial Balance should always be _____.
79. Ledger accounts with credit balances are placed in the _____ column of the Trial Balance.
80. Returns outwards are placed in the credit column of the Trial Balance because it has a _____ balance.
81. A Trial Balance is prepared using the information from a company's _____.
82. Depreciation means ___.
83. Amortization means ___.
84. Depreciation Accounts is _____ type of account.
85. _____ is a charge against the profits.
86. The amount of depreciation charged on a machinery will be debited to _____ account.
87. Profit on sale of machinery is _____ to P&L.
88. The amount charged to depreciation declines in _____.

89. Formula to calculate rate of depreciation under diminishing balance method ____ .
90. Depreciation is a ____ item.
91. Obsolescence of a depreciable asset is caused by ____ changes.
92. In case of down ward revaluation of an asset which is for the first time revalued, the account debited is ____.
93. ____ is an expenses accruing from use of fixed assets.
94. For providing depreciation on hand tools, the appropriate method of depreciation is ____.
95. In ____ method physical wear and tear are more important than economic obsolescence.
96. Formula to calculate depreciation under straight line method ____.
97. A provision is created for valuation adjustment for ____.
98. ____ represents the debts which are likely to be realised in full.
99. Bad debt is a confirmed ____.
100. ____ represents the debt the collectability of which is not certain.
101. Provision for doubtful debt is calculated on the balance of ____ after adjusting bad debts.

⊙ **Short Essay Type Questions**

1. What do you mean by Accounting Cycle? Discuss its stages.
2. Write a short note on Accounting Equation.
3. Discuss the various types of accounts.
4. What do you mean by Double Entry System? State its features.

⊙ **Essay Type Questions**

1. State the functions of accounting.
2. Discuss the objectives of accounting.
3. Write short note on
 - (i) Conceptual Framework of Accounting
 - (ii) Legal Framework of Accounting
 - (iii) Institutional Framework of Accounting
 - (iv) Regulatory Framework of Accounting
4. Distinguish between Accounting Concepts and Accounting Conventions.
5. Write a short note on:

- (a) Entity Concept
 - (b) Going Concern Concept
 - (c) Periodicity Concept
 - (d) Money Measurement Concept
 - (e) Accrual Concept
 - (f) Dual Aspect Concept
 - (g) Matching Concept
 - (h) Realisation Concept
 - (i) Cost Concept
 - (j) Convention of Conservatism
 - (k) Convention of Consistency
 - (l) Convention of Materiality
 - (m) Convention of Full disclosure
6. State with reasons whether the following are Capital Expenditure or Revenue Expenditure:
- (i) Expenses incurred in connection with obtaining a licensee for starting the factory were ₹10,000.
 - (ii) ₹1,000 paid for removal of stock to a new site.
 - (iii) Rings and Pistons of an engine were changed at a cost of ₹5,000 to get full efficiency.
 - (iv) ₹2,000 spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the Plaintiff. The suit was not successful.
 - (v) ₹10,000 were spent on advertising the introduction of a new product in the market, the benefit of which will be effective during four years.
 - (vi) A factory shed was constructed at a cost of ₹1,00,000. A sum of ₹5,000 had been incurred for the construction of the temporary huts for storing building materials.

B. Numerical Questions

⊙ Comprehensive Numerical Problems

1. Journalise the following transactions:

2023	Particulars	₹	2023	Particulars	₹
Jan 3	Received cash from Ram	15,000	Jan. 17	Receive from Hari	1,100
4	Purchased goods for cash	2,500	20	Bought Furniture from Ram	2,200
11	Sold goods to Hari	3,200	27	Paid rent	480
13	Paid Ramesh	1,400	30	Paid salary	1,100

[Answer: Total of Journal: ₹26,980]

2. Journalise the following transactions:

2023	Particulars	₹	2023	Particulars	₹
Jan 1	Started business with cash	50,000	Jan.15	Paid to M/s Singh & Co.	21,000
2	Paid into bank	36,000		Discount allowed by them	1,000
3	Bought goods from M/s Singh & Co. on credit	22,000	25	Sold goods to M/s Ray & Co.	5,000
4	Purchased furniture	4,200	26	Received Cheque from M/s Sharda & co. in full settlement of amount due by them	4,560
	Purchased adding machine & typewriter (Payment in all cases made by cheque)	8,400	31	Paid for: Electric Charges	100
6	Paid for postage	215		Paid salary	1,500
8	Sold goods for cash	5,400		Paid rent by cheque	2,000
9	Sold goods on credit to M/s Sharda & co.	4,600		Drew for private use	3,500

[Answer: Total of Journal: ₹ 1,69,515]

3. Journalise the following transactions in the Books of Rama & Co.

2023	Particulars	₹	2023	Particulars	₹
Jan 1	Business started with	50,000	Jan15	Cash paid to Z in full settlement of his account	8,800
	Cash deposited in Bank	20,000	16	Cash received from Y in full settlement of his account	24,500
	Goods purchased	10,000	20	Goods sold to B	6,000
2	Furniture purchased for cash	3,000		Goods purchased	9,000
	Office Stationary purchased for cash	2,000	25	Cash withdrawn from bank	5,000
3	Goods purchased from X	20,000		Cash paid to X	4,000
5	Goods sold to Y	25,000	28	Allowed us a discount	100
	Paid rent	1,000		Cash received from B	3,000
8	Paid for repairs	800	30	Allowed a discount	200
9	Paid for advertisement	1,500	31	Cash deposited in bank	4,000
	Cash paid to X	10,000		Cash paid for electricity	400
	discount received	50		Cash paid for Salaries	1,000
10	Good purchased from Z	9,000		Wages paid	500

	Goods purchased in cash from A	6,000		Rent paid	400
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[Answer: Total of Journal: ₹ 2,25,950]

4. Prepare the Ledger account of Mr. Solkar from the following:

2023 March 1	Debit balance to his account ₹ 2,000.
3	Sold goods on credit to him worth ₹ 10,800
8	Received cash from him ₹ 12,600 and allowed discount of ₹ 200.
10	Solkar bought goods on credit ₹ 3,000.
15	Received cash from him ₹ 2,900 and allowed him discount ₹ 100
20	Purchased goods on credit from Solkar worth ₹ 2,000
25	Paid cash to Solkar ₹ 1,000
28	Returned goods to him ₹ 200.
31	Paid cash to him in full settlement of his account ₹ 780.

5. Prepare Ledger Accounts for the following transactions

Debit Balance on January 1, 2023:

Cash in Hand ₹ 8,000. Cash at Bank ₹ 25,000, Inventory of goods ₹ 20,000, Building ₹ 10,000. Trade receivables: Vijay ₹ 2,000 and Madhu ₹ 2,000

Credit Balance on January 1, 2023:

Trade Payables: Anand ₹ 5,000, Capital ₹ 55,000

Following were further transactions in the month of January, 2023:

Jan. 1 Purchased goods worth ₹ 5,000 for cash less 20% trade discount and 5% cash discount.

Jan. 4 Received ₹ 1,980 from Vijay and allowed him ₹ 20 as discount

Jan. 8 Purchased plant from Mukesh for ₹ 5,000 and paid ₹ 100 as cartage for bringing the plant to the factory and another ₹ 200 as installation charges.

Jan. 12 Sold goods to Rahim on credit ₹ 600

Jan. 15 Rahim became insolvent and could pay only 50 paise in a rupee

Jan. 18 Sold goods to Ram for cash ₹ 1,000.

6. Enter the following transactions in the subsidiary books of Soundarya Saree Shop.

2023 Aug 1	Purchased from Pathi Silk Kendra, 100 Silk sarees at ₹ 250 each.
5	Purchased from NSR and company, 200 Kanchi Silk sarees at ₹ 1,000 each
7	Sold to Kumar on account, 50 printed sarees at ₹ 300 and 100 Kanchi sarees at ₹ 1,000 each
8	Claimed for damages from Pathi Silk Kendra ₹ 500
9	Returned damaged goods to NSR and Co. 5 Kanchi sarees

12	Purchased from Sudharshan Silks 150 Mysore Silk at ₹250 each, 100 Handloom sarees at ₹750 each, less trade discount at 10%
16	Sold to Kala on account 20 printed sarees at ₹300 each, 25 Kanchi sarees at ₹1,300 each, 20 Mysore Silk sarees at ₹300 each, less trade discount at 5%.
20	Sold to Kusum sarees, 40 Handloom sarees at ₹1,000 each
21	Kumar returned, 10 printed sarees and 20 Kanchi sarees
25	Returned to Sudharshan's Silk, 25 Mysore Silk
27	Returned from Kusum sarees, 10 handloom sarees
30	Purchased from Nandi Silk, 400 Nandi brand sarees at ₹500 each

7. Enter the following transactions in Simple Cash Book and post them into ledger:

2023 July 1	Balance of cash in hand ₹15,000
8	Purchased goods for cash from X for ₹3,200
15	Sold goods for cash ₹4,800
20	Received commission ₹650
	Paid commission ₹550
31	Paid salary to the office clerk ₹1,000 and office rent ₹600

[Answer: Cash Book Balance = ₹15,100]

8. Enter the following transactions in a two (Cash & discount) Column and post them into Ledger Accounts:

2023	Particulars	₹	2023	Particulars	₹
Dec.1	Commenced business with cash	50,000	Dec.16	Paid into bank	10,000
2	Brought goods for cash	28,000	18	Cash sales	2,500
5	Received cash from Arun	2,000	20	Purchased stationery for cash	250
7	Paid cash to Sanjay	2900	23	Paid suresh cash	3900
	Discount allowed by him	100		Discount allowed	100
10	Paid wages	3000	26	Received from Rajesh	1,900
14	Received from Rajesh cash	950		Allowed him discount	100
	Allowed him discount	50	30	Paid salaries	2,000

[Answer: Cash Balance = ₹7,300, Discount = Dr. ₹150, Cr. ₹200]

9. Prepare a Three Column Cash Book from following transactions and bring down the balance for the start of next month.

2023	Particulars	₹	2023	Particulars	₹
Apr.1	Cash in hand	2,500	Apr.19	Paid into Bank	400
1	Cash at bank	10,000	23	Withdrew from Bank for private exp.	600
2	Paid into Bank	1,000	24	Received cheque from Patel	1,430
5	Bought furniture and issued cheque	2,000		Allowed him discount	20

8	Purchased goods for cash	500	26	Deposited Patel's cheque into bank	
12	Received from mohinder	980	28	Withdrew cash from Bank for the office use	2,000
14	Cash sales	4,000	30	Paid rent by cheque	800
16	Paid to Amarnath by cheque	1,450			
	Discount allowed	50			

[Answer: Cash = (Dr.) ₹7,580, Bank = (Dr.) ₹5,980, Discount = (Dr.) ₹40, Cr. ₹50]

10. Prepare a Three Column Cash Book from following transactions having cash, bank and discount columns:

2023 Apr.1	Balance of cash in hand ₹400, overdraft at Bank ₹5,000
4	Invested further capital ₹10,000 out of which ₹6,000 deposited bank
5	Sold goods for cash ₹8,000
6	Collected from Sridhar a debtor of last year ₹8,000 discount allowed ₹200
7	Paid Ramvilas, out creditor, ₹2,500, discount allowed by him ₹65
13	Commission paid to Robert our agent ₹530
14	Office furniture purchased from Keshar ₹200
17	Draw cheque for personal use ₹700
18	Collection from Atal ₹4,000; deposited in the bank on 19 th
20	Draw from bank for office use ₹500
21	Draw cheque for petty cash ₹150
29	Drew from the bank and paid salary of office staff ₹1,500
30	Deposited cash in the bank ₹10,000

[Answer: Cash in hand ₹7,870, Bank = (Dr.) ₹12,150, Discount = (Dr.) ₹200, (Cr.) ₹65]

11. Prepare Columnar Petty Cash Book on imprest system from the following particulars:

2022	Particulars	₹	2022	Particulars	₹
June 1	Received for petty cash payments	1,000	June 20	Paid for conveyance	44
2	Paid for postage	80	25	Paid for travelling expenses	160
5	Paid for stationery	50	27	Paid for postage	100
8	Paid for advertisement	100	28	Wages to office cleaner	20
12	Paid for wages	40	30	Paid for telegrams	40

16	Paid for carriage	30	30	Sent registered notice to landlord	6
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[Answer: Petty Cash balance = ₹330]

12. The Bank statement of Mr. J. White dated 31.12.2023 showed a balance with his Bank of ₹924, when checked with his Cash Book the following were noted:
- During December, the Bank had paid ₹200 for a yearly contribution of Mr. White, made to a local charity, as per his standing order. This amount appeared in the Bank statement but not in the Cash Book.
 - The Bank had credited his account with ₹28 interest and had collected on his behalf ₹230 as dividends. No corresponding entries were made in the Cash Book.
 - A cheque of ₹65 deposited into the Bank on 28.12.2023 was not cleared by the Bank till after 31.12.2023.
 - A cheque of ₹150 deposited into and cleared by the Bank before 31.12.2023 was not entered in the Cash Book, through an oversight.
 - Cheques drawn by and posted to parties by Mr. White on 31.12.2023 for ₹73, ₹119 and ₹46 were presented for payment to the Bank only on 3.1.2024.

[Answer: Bank Balance as per Cash Book (Dr.) ₹543]

13. Mr. Suresh request you to ascertain the Bank balance as per the Pass Book for January 2023, as his cash clerk reported a figure of ₹11,515 (credit) as on 31.1.2023. Scrutiny revealed the following discrepancies:
- Cheques issued and deposited by the cash clerk in January 2023, were ₹15,000 and ₹7,000 respectively. However, against the above, the Bank had paid out and debited cheques worth ₹9,000 only and cleared and credited cheques worth ₹4,000 only, by 31.1.2023.
 - A customer had paid in ₹6,400 directly into Suresh's Bank account, the effect of which was missing in the Cash Book
 - Bank commission of ₹45 charged and interest earned ₹1,400 on investments of Mr. Suresh, where only recorded in the Pass Book.
 - Total cash withdrawals of ₹3,000 by self and bearer cheques for office use, were recorded erroneously as ₹5,000 in the Cash Book.

[Answer: Bank Balance as per Pass Book (Dr.) ₹1,240]

14. Based on the following information prepare a Bank Reconciliation statement as on 31st December 2023 and find the balance as per pass book:
- Bank overdraft as per cash book on 31-12-2023 ₹6,340.
 - Interest on overdraft for 6 months ending 31.12.2023 ₹160 is entered in pass book.
 - Bank charges amounted to ₹30 for the above periods were entered in the pass book.
 - Cheques issued but not presented upto 31.12.2023 amounted to ₹1168
 - Cheques sent for collection to the bank but not collected up to 31.12.2023 amounted ₹2,170.

f) Interest on investments collected by the bank and entered in the pass book ₹ 1200.

[Answer: Over Draft Balance as per Pass Book (Dr.) ₹ 6,332]

15. The following is a summary from Cash Book of M/s Adarsh Trading for the month of Sept 2023:

Particulars	(₹)	Particulars	(₹)
Balance b/d Receipts	1,407	Payments	15,520
	15,073	Balance c/d	960
	16,480		16,480

On investigation it was found that:

- Bank charges of ₹ 35 were not entered in the Cash Book.
- A cheques of ₹ 47 issued to supplier was entered by mistake as a receipt in the Cash Book.
- A cheques of ₹ 18 was returned by the bank marked as 'refer to drawer' but it's not entered in Cash Book.
- The balance brought forward in Sept 2022 should have been ₹ 1,470.
- Cheques paid to suppliers ₹ 214, ₹ 370 and ₹ 30 have not been presented for payment.
- Deposits of ₹ 1,542 on 30th Sept were cleared by the bank on 2nd October.
- The bank charged a cheque wrongly to Adarsh trading ₹ 72.
- Bank statement shows overdraft of ₹ 124 as on 30th Sept 2023.

Show what adjustments will you make in the cash book and prepare a Bank Reconciliation Statement as on 30.09.2023.

[Answer: Revised Cash Book Balance (Dr.) ₹ 876]

16. From the following particulars prepare a Bank Reconciliation Statement to find out the causes of difference in two balances as on August 31st, 2023 for Five Star (Pvt.) Ltd.

Particulars	(₹)
i) Bank Overdraft as per Bank Statement	17,000
ii) Check issued but not encashed during the August	2,200
iii) Dividends on shares collected by banker	2,300
iv) Interest charged by the bank recorded twice in the Bank Book	500
v) Check deposited as per Bank Statement not entered in Bank Book	3,400
vi) Credit side of the Bank column in Bank Book cast short	1,000
vii) Club dues paid by bank as per standing instruction not recorded in Bank Book	1,200
viii) Uncredited check due to outstation	3,900

[Answer: Balance as per Bank Book (Cr.) ₹ 19,300]

17. From the following particulars, you are required to find out the errors in cash book and bank statement by using missing method and prepare Bank Reconciliation Statement as on 31.12.2023, for Chand Bibi Ltd:

Particulars	(₹)
i) Bank balance overdraft as per Bank Book	80,000
ii) Cheque recorded for collection but not sent to the bank	10,000
iii) Credit side of the Bank Book cast short	1,000
iv) Premium on proprietor's Life Insurance Policy (LIP) paid on standing order	5,000

v) Bank Charges recorded twice in the Bank Book	100
vi) Customer's cheque returned by the bank as dishonored	4,000
vii) Bill Receivable collected by the bank directly on the behalf of company	20,000
viii) Cheque received entered twice in the Bank Book	6,000
ix) Cheque issued but dishonored on technical grounds	3,000
x) A cheque deposited into the bank of worth ₹ 45,000 but ₹ 8,000 cheque was not collected by bank	

[Answer: Balance as per Bank Statement (Dr.) ₹ 90,900]

18. Prepare a Trial Balance from the following information:

Particulars	(₹)
Cash A/c	9,46,400
Capital A/c	7,50,000
Loan A/c	2,50,000
Purchases A/c	51,500
Sales A/c	21,000
Bank A/c	22,400
Loss by Fire A/c	5,500
Commission Received A/c	3,500
Discount Allowed A/c	100
Loss by Theft A/c	1,000
Interest Received A/c	2,400

[Answer: Total ₹ 10,26,900]

19. Prepare a Trial Balance from the following information:

Particulars	₹
Cash A/c	34,150
Capital A/c	40,000
Purchases A/c	6700
Sales A/c	4,200
Machinery A/c	5,800
Creditors A/c	5,000
Interest Allowed A/c	150
Debtors A/c	2,000
Discount Received A/c	100
Return Inwards A/c	300
Commission Received A/c	250
Conveyance A/c	450

[Answer: Total ₹ 49,550]

20. M/s Suba Pharmaceuticals has imported a machinery on 1st July, 2021 for ₹1,60,000 paid custom duty and freight ₹80,000 and incurred erection charges ₹60,000. Another local machinery costing ₹1,00,000 was purchased on January 1, 2022. On 1st July, 2023 a portion of the imported machinery (value one third) got out of order and was sold for ₹34,800. Another machinery was purchased to replace the same for ₹50,000. Depreciation is to be calculated at 20% p.a. on straight line method. Show the machinery account for 2021, 2022 and 2023. (Accounting period January to December)

[Answer: Balance in Machinery Account ₹2,05,000; Loss on sale ₹25,200]

21. A manufacturing concern, whose books are closed on 31st March, purchased machinery for ₹1,50,000 on 1st April 2019. Additional machinery was acquired for ₹40,000 on 30th September 2020 and for ₹25,000 on 1st April, 2022. Certain machinery, which was purchased for ₹40,000 on 30th September, 2020 was sold for ₹34,000 on 30th September, 2022. Give the machinery account for the year ending 31st March, 2023 taking into account depreciation at 10% per annum on the written – down value.

[Answer: Balance in Machinery Account ₹1,20,915; Profit on sale of Machinery = ₹1,510]

22. A Transport company purchased 5 trucks at ₹2,00,000 each on April 1, 2021. The company observes calendar year as its accounting year.

On October 1, 2023 one of the trucks is involved in an accident and is completely destroyed. Insurance company pays ₹90,000 in full settlement of the claim. On the same day the company purchases an used truck for ₹1,00,000 and spends ₹20,000 on its overhauling.

Prepare truck account (in clummnar form) for the three years ending on December, 2023 if the company writes off depreciation @ 20% per annum on

Original cost method and diminishing balance method.

[Answer: Balance i) ₹4,74,000; Loss on sale of machinery ₹10,000
ii) ₹5,49,200; Loss on sale of machinery ₹25,600]

23. From the following information determine amounts to be transferred to the Profit & Loss Account (₹):

- | | |
|--|---------|
| a. Sundry Debtors as on Mar. 31, 2023 | ₹50,000 |
| b. Provisions for bad debt as on Apr. 1, 2022 | ₹4,000 |
| c. Bad debts written off during the year 2022-23 | ₹1,000 |
| d. Recovery of bad debts earlier written off | ₹1,000 |

Provision for bad debts is maintained @ 5%.

[Answer: Provision to be transferred to the Credit side of P/L A/c ₹500; Bad Debt Recovery ₹1,000]

24. The Provision for Doubtful Debts A/c shows a balance of ₹5,000 on Jan. 1, 2023. The Bad Debts during the year 2023 amounted to ₹3,000. The Sundry Debtors on Dec. 31, 2023 are ₹50,000. On Dec. 31, 2023, there is an additional Bad Debts of ₹3,000. Create a new Provision for Bad Debts @ 10% on Debtors. You are required to show how the different items will appear in the firm's Profit and Loss A/c and Balance Sheet.

[Answer: New Provision ₹4,700]

25. The Trial Balance of Mr. Y as on May 31, 2023 included the following figures (Figures in ₹):

01.06.2023	Provision for Doubtful Debts	4,000
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	Provision for Discount Allowed Bad Debts	2,000
	written-off during the year	
31.05.2024	Sundry Debtors	45,480
	Discount Allowed during the year	2,400
	Bad Debts recovered during the year	950

Write off further ₹480 (judged completely irrecoverable). Maintain the provision for doubtful debts @10% and the provision for discount allowed @ 2%.

[Answer: Provision for doubtful debt ₹4,500 and Provision for Discount on debtors ₹810]

26. How will you rectify the following errors discovered before preparation of the trial Balance?
- ₹1,000 spent for repairs of buildings has been posted to building account
 - A sale of ₹730 to Mohinder Singh has been entered in the Sales Book as ₹370.
 - Goods worth ₹500 purchased from Bankey Lal have been omitted to be recorded in the books.
 - ₹400 paid as salary to a clerk has been debited to his personal account
 - ₹75 discount allowed by a creditor has been debited to Discount Account.
 - The Total of Sales Book has been added ₹100 too much.
 - Office furniture purchased for ₹1,800 has been passed through the Purchases Book.
27. Write out the journal entries to rectify the following errors using a suspense account:
- The total of discount allowed from the Cash Book for the month of December 2023 amounting to ₹350 was not posted.
 - An amount of ₹175 entered in the Sales Return Book has been posted to the debit of Ram, who had returned the goods.
 - Bad Debts aggregating to ₹250 were written off during the year in the sales ledger, but were not adjusted in the general ledger
 - Goods of the value of ₹500 returned to Shyam were entered in the Sales Day Book and posted there from to the credit of his account.
 - A sale of ₹800 made to Mohan was correctly entered in the Sales Day Book but wrongly posted to the debit of Mahesh as ₹80.
28. The debit side of the Trial Balance Showed ₹1,000 less than the credit side. The Suspense Account was debited with ₹1,000. Later on following errors were detected. Prepare Suspense Account passing the necessary rectification entries without giving narrations:
- Goods return by a customer ₹300 entered in the customer's account but not entered in the Sales Returns Account.
 - Goods sold to Mahesh on credit for ₹700 was entered in the Sales Book but not posted to his account.
 - 580 paid by Varsha traders was credited to their account ₹508.
 - ₹260 due from Dinesh was not entered in the schedule of S. Drs.

e) Purchases book was overcast by ₹ 188.

[Answer: Total of suspense Account = ₹ 1,260]

29. Following mistakes were located in the books of a concern after its books were closed and a Suspense Account was opened in order to get the Trial Balance agreed:

- (i) Sales Day Book was overcast by ₹ 100.
- (ii) A sale of ₹ 50 to x was wrongly debited to the account of Y.
- (iii) General expenses of ₹ 18 were posted in the General Ledger as ₹ 80.
- (iv) A bill receivable for ₹ 155 was passed through Bills Payable Book. The bill was given by P.
- (v) Legal expenses of ₹ 119 paid to Mr. Duftry were debited to his Personal Account.
- (vi) Cash received from C. Dass has been debited to G. Dass ₹ 150.
- (vii) While carrying forward the total of one page of the Purchases Book to the next, the amount of ₹ 1,235 was written as ₹ 1,325.

Find out the nature and amount of the Suspense Account and pass entries for the rectification of the above errors in the subsequent year's book.

Answer:

Multiple Choice Questions (MCQ)

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
c	a	d	c	d	b	b	c	c	b	a	a	a	a	d	b	a	a	d
20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38
b	d	a	b	a	d	b	a	b	b	b	c	c	c	d	c	c	a	c
39	40	41	42	43	44	45	46	47	48	49	50	51	52	53	54	55	56	57
c	a	c	d	c	b	c	d	a	c	a	d	d	b	a	d	d	b	b
58	59	60	61	62	63	64	65	66	67	68	69	70	71	72	73	74	75	76
d	a	b	a	b	b	b	b	a	d	d	a	b	d	b	d	d	b	a
77	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95
d	b	a	d	d	a	b	d	c	c	d	d	b	a	a	a	b	b	d
96	97	98	99	100	101	102	103	104	105	106	107	108	109	110	111	112		
d	c	c	a	d	c	b	a	b	b	c	a	b	c	c	c	c		

State True or False

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
T	T	T	T	F	F	F	T	F	T	F	T	F	F	T	F	T	T
19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36
T	T	F	F	F	F	T	F	F	F	F	T	F	T	F	T	T	T
37	38	39	40	41	42	43	44	45	46	47	48	49	50	51	52	53	54
T	F	F	T	F	F	F	F	F	T	T	T	F	T	T	F	F	T
55	56	57	58	59	60	61	62	63	64	65	66	67	68	69	70	71	72
T	F	T	T	T	T	F	T	T	T	T	T	F	T	T	T	T	T
73	74	75	76	77													
F	T	F	T	F													

● **Fill in the Blanks**

1	Accountancy	2	Conceptual Framework
3	Going Concern Concept	4	Business Entity Concept
5	Generally Accepted Accounting Principles	6	Trading and P & L Account
7	Liability or capital receipt	8	Long period
9	Capital Receipt	10	Capital Expenditure
11	Deferred Revenue Expenditure	12	Capital receipt ₹ 20,000 and deferred revenue expenditure ₹ 2500
13	Revenue Expenditure	14	Sale is effected
15	liabilities	16	Revenue Expenditure
17	Capital Expenditure	18	Revenue Expenditure
19	Revenue Expenditure	20	Revenue Receipt
21	Real	22	credit
23	'debit or credit'	24	'General journal'
25	'intangible asset'	26	Expenditure
27	Cash Discount	28	Debit
29	Closing stock	30	Assets/Expenses
31	"Trial Balance"	32	"balances"
33	Trial Balance	34	asset side of
35	credit column	36	General Journal
37	Debit	38	Closing Stock
39	Assets/Expenses	40	Dr.
41	Ledger	42	errors.
43	Suspense Account	44	Compensating errors
45	Trial Balance	46	errors, frauds.
47	Furniture Account	48	Affect
49	₹ 180	50	totaling
51	sales account will be credited	52	principle
53	suspense	54	Bad Debts Recovered Account
55	₹ 3,600	56	Journal Proper
57	Customer Account	58	debit

59	credit	60	less
61	less	62	Cash Book
63	₹ 7,000 will be added to Cash Book balance.	64	bank overdraft and debit balance in Pass Book
65	credit balance in bank column of the Cash Book	66	Business Enterprises
67	as per Cash Book	68	A credit balance on the bank statement
69	₹ 700 will be less	70	deducted
71	ignored	72	bank overdraft
73	subtracted	74	the bank account holder
75	bank overdraft	76	added
77	debit	78	equal
79	credit	80	credit
81	ledger accounts	82	decrease in the value of an asset
83	charging a period with the proportionate cost of an intangible asset	84	Nominal
85	Provision	86	Depreciation
87	credited	88	reducing balance method
89	$\left(1 - \sqrt{\frac{R}{C}}\right)$	90	(non- cash)
91	Technological	92	Profit and Loss Account
93	Depreciation	94	Revaluation Method
95	Straight Line	96	Cost of the Asset – Estimated Scrap Value / Estimated Life Time
97	Fixed Assets	98	Good Debts
99	loss	100	Doubtful Debt
101	sundry debtors		