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PAPER - VIII : ACCOUNTING FOR BANKERS

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PAPER – VIII

ACCOUNTING FOR BANKERS

UNIT - I

Basic Accounting : Concept and Conventions – Accounting Equations – Meaning of Accounting – Groups Interested in Accounting Information – Journal, Ledger, Subsidiary Books – Trail Balance – Final Accounts of Sole – Proprietorship.

UNIT - II

Bank Reconciliation Statement-Average Due Date – Account Current.

Unit - III

Bills of Exchange - Meaning - Entries in the Books of Drawer and Drawee - Dishonor - Noting and Protest - Renewal – Accommodation Bills.

UNIT - IV

Classification of Errors – Rectification In different States of Accounting Cycle – Suspense Account – Effect of Rectification on Net Profit – Rectification of Errors during the subsequent accounting period.

UNIT - V

Final Accounts of Banking Companies Special Features of Bank Accounting, Revised formats of Bank Accounts: P&L A/c. and Balance Sheet: Preparation of Final Accounts of Banking Companies.

BOOKS RECOMMENDED

- Shukla & Grewal t.S. Advanced Accounting, Vol-1, S.Chand & Co. New Delhi.
- Gupta R.L. Advance Accounting, Sulthan Chand, New Delhi.
- Ganesan, S. and Kalavathi S.R. Corporate Accounting, Thirumalai Publication, Nagarcoil –1.
- Reddy T.S. & Moorthy Financial Accounting, Margam Publications.

CONTENTS

UNIT - I

INTRODUCTION TO ACCOUNTING

ACCOUNTING AS THE LANGUAGE OF BUSINESS

Arnold W. Johnson in his book 'Elementary Accounting' says that "modern accounting has often been called 'the language of business.' Its responsibility is applying a thorough knowledge of the theory of accounting i.e., generally accepted principles of accounting to the practical field of business in order that income and financial position may be stated fairly"

The basic function of language is to serve as a means of communication. Accounting serves the purpose of communicating the results of business operations to all the interested parties such as proprietors managers, creditors and investors.

Definition of Accounting

According to the American Institute of Certified Public Accountants (AICPA) "Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money transactions and events which are of financial character and interpreting the results thereof.

This comprehensive definition highlights in a logical sequence the different steps in the accounting process and some important attributes of accounting. The following detailed explanation makes each of them clear.

ATTRIBUTES AND STEPS OF ACCOUNTING

1. Recording: Systematic recording of business transactions is the first step in the accounting process. Each and every transaction is recorded as and when it occurs, in chronological order. Every entry recorded has to be supported reliable documentary evidence. Recording of business transactions is usually done in journal or in subsidiary books which are 'books of original entry'. The method of recording is adjusted according to the size and nature of business d the type of transactions.

Small firms and individuals may adopt the journal system. Bigger firms How subsidiary books system which consists of purchases book, sales book, purchase returns book, sales returns book, bills receivable book, bills payable 'ok, cash book and journal proper.

2. Classification: It is the process of grouping transactions or entries on a predetermined basis. The classification takes the form of 'accounts' in a separate «ok known as Ledger. Separate accounts are opened for each expense, income, property, liability and persons with whom the business has dealings.

Classification facilitates segregation of numerous business transactions into identifiable groups.

For example, goods sold to a customer on credit are recorded in sales book, cash received from him is recorded in cash book. Goods returned by him are sown in sales returns book. They are grouped in one place in the ledger in his personal account. Thus, each ledger account provides the complete picture of "e dealings in relation to that particular person or property or expense or come.

3. Summarising: The classified data in the ledger is presented periodically i a manner which is understandable and useful to the owners and other interested parties. Summarising takes place in the form of trial balance, trading account, profit and loss account and balance sheet. The trial balance ensures the arithmetical accuracy of the recording and classification process. Each account in the ledger is balanced and the net balance is shown in the trial balance. The trading account reveals the gross profit of the business. Profit and DSS account shows net profit or loss for the accounting period. The balance sheet portrays the financial position of the business.

4. Significant manner: The accounting process of recording, classifying ad summarising must be carried on in a significant manner. Each business has its own peculiarities, special problems and particular requirements. The management of the business needs specific types of information for controlling and decision-making purposes. Sales and purchases may have to be shown for each product, division, department, and branch separately. Profit or loss may be required independently for each product or service.

‘Significant manner' as per the requirement of the firm has to be incorporated at every stage in the process of recording, classifying and summarising business transactions.

5. In terms of money : All business transactions have to be recorded in terms of money. It is the medium through which all the business transactions are expressed. Land and buildings in square feet, furniture and fixtures in number, stock in units are all recorded as per their monetary values. 'Money measurement' is the basis for accounting.

6. Transactions and events of financial character: All those business transactions and events which are financial in character are recorded in accounts. All the events, dealings and happenings which have no financial effect are completely ignored in the accounting process. For example, working conditions, skilled work force, sales policies, employees' morale etc., are all important for a business. But they have no 'financial character' and are omitted from accounting process.

7. Interpreting the results: Interpretation of the results is needed for various purposes. The trends observed in sales, purchases, expenses etc., are useful for future planning of operations; Data about customers and suppliers have to be interpreted to decide about credit policies. The owners are interested in the amount and growth of profit. The creditors are interested in the liquidity and stability of the business.

Interpretation is usually done through Ratios and Flow statements. They are useful in evaluating past performance and providing guidance for future plans and operations.

Need for Accounting

A businessman invests capital with the objective of making profit and thereby increasing his resources. He incurs various expenses like salaries, rent and stationery to operate his business. He receives income from different sources like commission, interest and discount. He deals with several persons in the course of buying and selling of goods, purchasing and selling of assets and borrowing money for financing the business. He acquires various properties and assets like building, machinery, furniture to generate revenue.

Effective management of business requires control over expenses to reduce the cost of operation and to make the business profitable. Assets must be properly maintained to increase their productivity. Liabilities of a business have to be repaid in due time. Dealings with customers and suppliers must be managed properly to keep them satisfied. In order to maintain property in good condition, to repay debts in time, to reduce the expenses and to increase sales, the businessman requires complete information about all his business transactions.

In practice, it is impossible for any businessman to memorise and recollect all his business dealings. Moreover, he will be interested in knowing at the end of each year (i) what he owns? (ii) what he owes? (iii) how much profit he has earned? (iv) what his financial position is? To relieve businessmen from the burden of memorising all the business dealings and for providing necessary information. Accounting was developed.

Businessmen also require accounting records to submit in courts to prove their claims or to defend in courts against claims made by outsiders. They are required to produce business records to tax authorities whenever demanded. Similarly, financiers require accounting records of businessmen to decide about sanctioning of loans. Thus, transactions relating to business have become so important that their recording has become a necessity.

ACCOUNTING CONCEPTS

(1) Business Entity Concept

A business entity is an organisation of persons to accomplish an economic goal. According to the entity concept, the entity that represents the association of persons is considered distinct and separate from the owners, managers and employees of the enterprise. The accounting entity may be the business unit itself (sole proprietorship, partnership firm, joint stock company, co-operative societies &r a government enterprise) or a defined part of business (i.e., a department), or an amalgamation of related businesses (i.e., a holding company), depending on the user's needs. It can be a non-business group like a club, religious body which engages in economic activities.

The entity concept de-limits the area to be covered by accounting records and reports. It determines what is to be recorded and what is to be excluded from the books of accounts. A separate set of books is to be maintained for the accounting entity. The personal transactions of the owners and managers which are not connected to the business unit are excluded from the books of accounts, All business transactions of financial nature, including transactions with the owners are recorded in the books of the business. For example, if a sole trader withdraws money from the business for personal use, it is recorded as drawings by the owner. If he buys a car with the money withdrawn, it is ignored in the books of the business.

All the financial transactions are recorded from the point of view of the entity itself and not from the point of view of the other parties such as customers, suppliers, partners, owners etc. For example, when a firm sells goods to a customer it is recorded as 'sale' by the firm and not as 'purchases' by the customer.

Similarly, when dividend is paid to the shareholders of the company, it is dividend paid by the company and not dividend received by the shareholders.

The entity concept underlines the accounting concept of profit in which a sharp distinction is made between the operating expenses of the business and payment to owners. All payments to owners are recorded as repayment of capital or drawings or loan or distribution of profits. They are not treated as expenses of the business. The owners are entitled for the capital invested by them and also for the profits earned by the business entity.

From legal point of view, a joint stock company is recognised as separate legal entity from the shareholders. Partnership firms and sole trading businesses do not have legal entity, but they have business entity for accounting purposes.

The business entity concept implies that accounting has to maintain financial records of the business, record incomes and expenses of the business, ascertain profit or loss made by the business entity and show its financial position periodically. The owners of the business entity have to be treated like financiers but eligible for profits and responsible for losses.

(2) Going Concern Concept

According to International Accounting Standard -1 (IAS-1) "The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation".

This concept assumes that a business entity has continuity of life. It will continue for an indefinite period of time. It has no need or intention to close down.

This concept is important for valuation of assets and liabilities. It recognises the value of assets and liabilities of the business enterprise on the basis of their productivity and not on the basis of their current realisable value. Many assets derive their value from employment in the firm. If the firm ceases to operate, their realisable values may be a fraction of their book values or their value to the firm in generation of income. For example, approach roads laid to connect a factory with a highway will be worthless when the factory is closed down. So, realisable values of assets are ignored. They are valued at cost less depreciation for the purpose of balance sheet.

Historical cost of the fixed assets is recovered throughout their useful life by way of charging depreciation. This is based on the assumption that the business continues for the foreseeable future. The depreciation is an allocation of future cost and is not based on valuation of asset.

Going concern concept is the basis for several business transactions. Outsiders enter into contracts and dealings with a firm. Financial institutions lend money to a business unit. Creditors supply goods on credit and customers buy goods on credit. All such transactions are based on the treatment of a business unit as a going concern. Similarly, prepaid expenses and accrued incomes are treated as assets on the presumption of continuation of business.

Going concern concept influences accounting practices in relation to valuation of assets and liabilities, depreciation of the fixed assets, treatment of outstanding and prepaid expenses and incomes.

(3) Money Measurement Concept

All business transactions are measured, expressed and recorded in terms of money. 'Money' provides a common denominator or unit of measurement by means of which heterogeneous facts about a business can be expressed in terms of quantities which can be added or subtracted and summarised. Money, as a common denominator helps to quantify a diverse range of data to enable determination of profit or loss and financial position. The 'Rupee' is the common unit of measurement for economic events and transactions in India since it is the legal tender used as the medium of exchange.

The money measurement concept excludes all business transactions and events which cannot be measured in terms of money. Thus, quality of the products, value of skilled labour force, working conditions, production policies, disputes etc., cannot be recorded in accounts in spite of their importance to the business. The concept is invaluable in summarising business operations, assets and liabilities. Buildings in square feet, land in square meters, furniture in numbers, stock of liquids in litres and bank balance in Rupees cannot be added up for balance sheet purpose unless they are all expressed in terms of the common measure of money. Managerial planning and control must also take shape in monetary terms. The main objective of a business unit is to make profits and planning is directed towards this end. Optimum production and sales policies, decisions become meaningful and can be better understood with the uage of monetary denomination.

Accounting records provide evidence of the financial dimensions of the rights and obligations resulting from legal contracts. They have to be kept in the form of legal currency of the country. The accounting records also are used as a basis for providing financial information for shareholders, employees, tax authorities etc. These users of accounts data can comprehend the information s expressed in monetary terms alone. The money measurement concept imposes certain limitations on a business unit. Important events, Specific strengths and weaknesses of a firm which cannot be measured in terms of money are not recorded in accounting. This restricts the availability of data for managerial decision making. All assets and liabilities are recorded whenever they are acquired or contracted at the value assigned to them on that date. Any changes in their market prices or the impact of inflation on their values are not recognised. This renders the values shown unrealistic.

In spite of its limitations, money measurement concept is indispensable because it is the common denominator for recording diverse transactions in the books of accounts.

(4) Dual Aspect Concept

Every business transaction recorded in the books of accounts of a business has two aspects - receiving of benefit and giving of benefit. Both the aspects of each transaction must be recorded in appropriate accounts of the business.

For example, when a building is acquired by a firm (receiving of benefit), it has to pay cash (giving of benefit) or create an obligation for payment in future (benefit to be given) Recording of the transaction takes place through debiting the building account and crediting cash account or the personal account of the seller, thus showing both the benefit receiving and giving aspects.

Dual aspect concept is the basis for double entry system of book-keeping which is universally used. The governing principle of double entry system is that 'for every debit there is an equal and corresponding credit'. Dual aspect concept is also the basis for 'accounting equation' developed by American accountants. The equation is Assets = Equities.

'Assets' represents all properties acquired by a business for generating income in the short run (current assets) or long run (fixed assets). 'Equities' represent the claims of different claimants, including the owners, against the assets. The equities are usually subdivided into capital and liabilities to distinguish between the claim of owners from the outsiders. Thus, the equation can be restructured as follows:

Capital + liabilities = Assets

or

Capital = Assets - Liabilities.

Capital denotes the funds provided by the owners of the business and liabilities represents the funds provided by the outsiders. In the equation, assets and liabilities are the independent variables and capital is the dependent variable, since it is the difference between assets and liabilities Every business transaction of financial nature affects the accounting equation through its dual aspect Increase in an asset may result in increase of liabilities or capital or decrease of some other asset. Decrease in a liability may result in decrease of an asset, increase in capital or another liability. The accounting equation provides an insight into the impact of each transaction on the assets, liabilities and capital, Dual aspect concept is the edifice on which modem accountancy is built and developed.

(5) Accounting period Concept or Periodicity Concept

A business unit may continue for an indefinite period. It is possible to ascertain overall profit or loss of the business when it is liquidated. But practically it is not possible to wait for an indefinite period. The interested parties like owners or shareholders, creditors, tax authorities need periodical reports about the business performance. So, it is necessary to sub-divide the indefinite life span of a firm into smaller time units for measurement of performance and understanding the financial position. Such smaller and usable time frame is called an accounting period. The period should not be too short which results in the burden of preparing financial statements frequently. It should not be too Song which renders the information useless. The usual accounting period is one year as it helps to absorb seasonal fluctuations in business, to assess and pay income tax and undertake any remedial measures to rectify poor performance. Now-a-days the length of the accounting period is determined by statute.

Accounting period concept is the basis for segregation of capital expenditure from revenue expenditure. All expenses whose benefit is derived within the accounting period are revenue expenses. All incomes pertaining to the period are revenue incomes. All expenses whose benefit is derived over several accounting periods is capital expenditure.

Accounting period helps to measure the income generated during the specific accounting period which makes it possible to distribute it to the owners. It makes comparison of the results of one accounting period with those of another possible, leading to comparative performance evaluation. Mercantile system or accrual system of accounting is needed to show all incomes and expenses pertaining to the accounting period at the time of finalising the accounts.

(6) Cost Concept

Accounting is a historical record of the transactions of a business entity. According to cost concept, assets are recorded at the price paid to acquire them.

This cost is the basis for all subsequent accounting for the assets. The assets are gradually depreciated on the basis of cost and the effective life of the asset. The market values of assets are not considered either for valuation or depreciation of such assets. This practice is also supported by the going concern concept. Market values cannot be accurately ascertained. They are also subject to frequent fluctuations. Subjective estimates of the accountants can distort market values. Cost concept provides the reliable objective evidence for recording and depreciating the assets.

Recently, the historical cost concept has been criticised for three reasons. Firstly, the historical cost does not reflect true value of the asset. Secondly, assets shown on cost basis do not provide a true and fair view of the financial position of a business unit. Thirdly, the cost concept ignores inflation which erodes the value of money and the true worth of assets. The traditional accounting system has undergone a lot of change over the years. Now, it is not exclusively based on historical cost. Different measurement bases like 'present value of future cash flows of assets', 'current cost', 'replacement cost' are also used according to suitability to depict true and fair view of the financial position of a business unit. Cost concept is still the predominantly used basis for valuation and depreciation of business assets.

(7) Realisation Concept or Revenue Recognition Concept

"Revenue is the gross inflow of cash, receivables or other consideration arising in the course of an enterprise from the sale of goods, services and from holding of assets". According to the realisation concept, revenue is considered as earned on the date when it is realised. The term 'realisation' implies the legal liability to pay by the buyer or user or customer. The revenue should be recognised only when it is legally due and realisable. When goods are sold, the date of placing the order, the date of receiving cash are irrelevant for recognition of sales income. The date of passing of title to the goods is relevant for income recognition. Income from investments and other such incomes are to be recorded when they become payable. Advance payment of cash by customers for goods should be ignored for the purpose of income recognition. In hire purchase transactions, the down payments and instalments received or due can be taken as income though title to the goods is passed only when last instalment is puid. Till such time, the amounts paid or payable are treated as hire charges.The realisation concept is vital for determining incomes pertaining to an accounting period. It avoids the possibility of inflating incomes and profits.

(8) Matching Concept

Primary objective of commercial enterprises is profit making. The accountants are responsible to match the revenues earned during an accounting period with the cost associated with the period to ascertain the profit earned. Matching of revenues and costs relevant to a specific period is called the matching concept. It is the basis for finding reliable profit for a period which can be safely distributed to the owners. All the revenue expenses and incomes associated with the accounting period have to be identified. Outstanding and prepaid expenses and incomes have to be properly adjusted. Depreciation and necessary provisions have to be made.

Matching of the costs with revenue has to be done in two stages. Direct costs are matched with sales revenue to ascertain gross profit. Indirect costs are matched with gross profit and other incomes to ascertain net profit from operations. Non operating losses like loss on sale of fixed assets, abnormal losses due to theft, fire, etc., capital expenses to be written off like preliminary expenses, underwriting commission should also be matched with the operating profit to find disposable net profit. Mercantile system of accounting facilities matching of costs with revenues in order to ascertain profit or loss of an accounting period. Periodical matching of cost and revenue provides reliable measure of the progress of an enterprise.

(9) Accrual Concept

This concept makes a distinction between receipt of cash and the right to receive cash and payment of cash and the legal obligation to pay cash in relation to revenues and expenses respectively. Revenues and costs are accrued i.e., recognised as they are earned or incurred and not as money is received or paid. The accrual concept is the basis for mercantile system of accounting. Accounts maintained on cash basis ignore the accrual aspect and use paying and receiving f cash as the criteria for recording expenses and incomes. While finalising accounts, all expenses and losses pertaining to the accounting period must be listed out. Any outstanding expenses and prepaid expenses must be recorded. Similarly, all incomes associated with the period should be included. Any accrued incomes and incomes received in advance must be appropriately recorded.The accrual concept ensures that the profit or loss shown is on the basis of all facts relating to all expenses and incomes.

10) Objective Evidence Concept

All accounting entries must be based on objective evidence. 'Objective' refers to verifiability, reliability and absence of bias. No transaction must be recorded in the books of accounts without verifiable documentary evidence. Examples are cash receipts for payment made, bank paying-in counterfoils or bank statements for deposits in bank, invoice copies for purchases etc. The confidence of users of financial statements can be achieved through systematic adherence to this concept.

Objective evidence concept facilitates auditing of accounts and eliminates unauthorised entries in the books of accounts, improving their reliability. Management decisions based on such accounts are likely to be more successful. Accounting achieves authenticity, accuracy and reliability by following the concept of objective evidence.

ACCOUNTING CONVENTIONS

1) Convention of Full Disclosure

According to this convention, all accounting statements should be prepared honestly. This should be evident through the transparency of the statements. The statement should disclose fully all the significant information. Facts, figures and the details which are of material interest to the owners, investors, creditors etc., must be clearly presented in the financial statements. This type of disclosure needs proper classification, summarisation, aggregation and explanation of the numerous business transactions.

The convention of disclosure is gaining importance due to the shift in the growth of business organisations. Modern business world is dominated by joint stock companies where ownership is completely separated from the management. The Companies Act 1956, has made several provisions for the disclosure of essential information by companies. Detailed form and schedules are prescribed by the Act. The basis for valuation of investments and inventories has to be specifically stated. Contingent liabilities have to be listed out. The scope for concealment of information by joint stock companies is very limited.

The footnotes, comments, descriptive captions, supplementary schedules etc., in the accounting reports are an invaluable aid for full disclosure. For example, market value of investments may be given as a foot note. Revaluation reserves included in the reserves and surpluses may be indicated through £ separate caption. The full disclosure does not imply providing any information required by anybody or revealing trade secrets and strategies. But the legitimate demands for information of the interested parties like shareholders and creditors should be fully satisfied.

(2) Convention of Consistency

The basic aim of the doctrine of consistency is to preserve the comparability and reliability of financial statements. According to this convention, the rules., practices and concepts used in accounting should be continuously observed and applied year after year. Comparisons of results among different accounting periods can be significant and meaningful only when consistent practices were allowed in ascertaining them. Valuation of stock can be done in different acceptable ways like average price method or cost price method. It can also be on the basis of cost or market price whichever is lesser. Similarly, depreciation can be provided under different methods; investments can be valued in several ways. Whichever method or practice is followed, it should be followed regularly. if any change is implemented it must be clearly indicated with reasons for the change.

According to E.L. Kohler, consistency can be at three levels - vertical, horizontal and dimensional.

Vertical consistency refers to consistency in the various aspects of financial statements in the same year in a firm.

Horizontal consistency refers to consistency of practices between different years in a firm.

Dimensional consistency refers to consistent accounting practices in the financial statements of different firms in the same industry.

Consistency serves the purpose of eliminating personal bias, whims and fancies of the accountants. They will have to follow consistent rules, practices sad methods. The convention of consistency makes the financial statements more reliable and comparable for the needs of the end users.

3) Convention of Materiality

Materiality means 'relative importance'. All important items and facts should be accounting statements. Unimportant and immaterial details need not be separately given. Otherwise, the accountant becomes over burdened with unnecessary details. For example, a plastic container for drinking water can be clubbed with general expenses instead of separately being disclosed as an asset.

According to the American Accounting Association (AAA) "An item should be regarded as material if there is reason to believe that knowledge of it would influence the decision of informed investor". The test of materiality can be applied to three aspects, (i) information (ii) amounts (iii) procedures.

(i) Loans to directors and employees can be material information and should be separately disclosed, as per Banking Companies Regulation Act.

(ii) Adjusting amounts to the nearest Rupee is based on materiality of amounts.

(iii) Disclosing procedural changes in valuation of inventories is based on materiality of procedures.

The term 'Material' is subjective, amenable for interpretation of individual accountants. Similarly, what is material in one firm may be immaterial for another firm. What is material in one accounting year may not be so in the subsequent years. In spite of these limitations, maximum possible material details should be provided in the financial statements.

(4) Convention of Conservatism

Conservatism is a policy of caution or 'playing safe'. It demands taking a 'gloomy' view of a situation. Conservatism is the defensive accounting mechanism against 'uncertainty'. According to Kohler, "Conservatism is a guideline 'which chooses between acceptable accounting alternatives for recording events and transactions so that the least favourable immediate effect on assets, income and owner's equity is reported".

Uncertainty is unavoidable in the estimation of useful life of assets, contingent liabilities, realisation of receivables etc. The convention of conservatism demands that the least favourable situation to the firm will materialise and precautions should be taken on that basis.

When stocks are valued, the usual principle followed is 'cost or market price whichever is lower'. If market price is more than cost, stock is shown at cost only. All provisions like provision for doubtful debts, provision for discount on debtors, provision for contingencies are based on the convention of conservatism. Conservatism may result in understatement of assets and income and overstatement of provisions and liabilities. This may result in secret reserves. Over emphasis on conservatism may bring about a conflict with the convention of full disclosure. Conservatism, within limits, serves a useful purpose. It should not be taken to extremes where it can distort the operating results and financial position of a business unit.

ACCOUNTING EQUATION

Dual aspect concept is the basis for rules of debit and credit used in the Double entry system of book keeping. According to this concept, every business transaction recorded in accounts has two aspects - giving of benefit and receiving of benefit. The former is the credit aspect and the latter the debit aspect. Both the aspects have to be recorded in accounts appropriately. American accountants we derived the rules of debit and credit through a 'novel' medium i.e., accounting equation. The equation is as follows:

Assets = Equities.

The basis for the equation is the principle of 'Rights'. Accounting deals with property and rights to property. The total of the properties owned by a Business is equal to the total of the 'Rights' to the properties. The properties owned by a business are called assets. The rights to properties are called equities.

Equities can be sub-divided into equity of the owners which is known as capital and equity of creditors who represent the debts of the business known as liabilities. These equities may also be called internal equity and external equity. Internal equity represents the owners' equity in the assets and external equity presents the outsiders' interest in the assets. Based on the bifurcation of equity, ie accounting equation can be restated as follows:

Assets = Liabilities + Capital

or

Capital = Assets - Liabilities.

When a business is started, entire resources needed may be supplied by the owner or owners. Later on, additional funds may be mobilised through credit purchases and loans. For example, Gokul starts a business with a capital of Rs. 10,000, the accounting equation will be

Gokul's Capital Rs. 10,000 = Cash Rs. 10,000.

The Balance Sheet on that date appears as follows:

Balance sheet on that date appears as follows:

Capital & Liabilities	**Amount (Rs.)**	**Property & Assets**	**Amount (Rs.)**
Gokul's capital	10,000	Cash	10,000

The balance sheet of a business is an expression of the accounting equation. It is also called balance sheet equation. It shows the relationship between assets of the business and capital and liabilities.

Rules for Accounting Equation

The following' rules' help in understanding the accounting equation clearly.

(1) Capital: When capital is increased, it is credited, when capital is withdrawn, it is debited.

(2) Outsiders' liabilities: When liabilities increase, outsiders' accounts are credited. When liabilities decrease, their accounts are debited.

(3) Revenue Income: Owner's equity is increased by the amount of revenue income.

(4) Revenue Expense: Owner's equity is decreased by the amount of revenue expenses.

(5) Assets: If there is increase in assets, the assets, accounts are debited. If there is decrease in assets, the assets' accounts are credited.

Interaction between assets and liabilities and their effect on Accounting equation:

(a) Sometimes, one asset decreases and another asset increases due to a transaction. For example, when debtors are collected, debtors decrease and cash increases. This does not change the accounting equation.

(b) One liability decreases and another liability increases due to a transaction. For example, creditors are paid through bank overdraft. Creditors decrease and bank overdraft increases. This transaction also does not alter the total figures in the accounting equation.

(c) Assets may increase and correspondingly liabilities may increase due to some transactions. For example, loan taken from bank increases cash on the assets side and bank loan on the liabilities side. This transaction alters the total figures in the accounting equation.

(d) Assets decrease and liabilities also decrease correspondingly due to some transactions. For example, creditors paid in cash decreases creditors on liabilities side and cash on the assets side.

Conclusion

Accounting equation is aformula which indicates the 'equivalence' of assets md capital and liabilities. Recording of all business transactions is based on accounting equation. Balance Sheet is the end result of accounting process. The balance sheet itself conforms to accounting equation.

Illustration

Give Accounting equation for the following transactions of Naresh for the yearended31.12.94.

- i) started business with cash Rs. 36,000
- ii) paid rent in advance Rs. 800
- iii) purchased goods for cash Rs. 10,000, and on credit Rs. 4,000
- iv) sold goods for cash Rs. 8,000 (costing Rs. 4,800)
- v) rent paid Rs. 2,000 and rent outstanding Rs. 400
- vi) bought a motor cycle for personal use Rs. 16,000
- vii) purchased equipment for cash Rs. 1,000
- viii) paid to creditors Rs. 1,200
- ix) depreciation of equipment Rs. 50
- x) business expenses Rs. 800

Solution:

	Equities				**Assets**		
S. No.	**Rent outstanding**	**Creditor**	**Capital**	**Cash**	**Rent paid in advance**	**Stock of Goods**	**Equipment**
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
1	-	-	36,000	36,000	-	-	-
	-	-	-	-800	+800	-	-
2	-	-	36,000	35,200	800	-	-
	-	+ 4,000	-	-10,000	-	+14,000	-
3	-	4,000	36,000	25,200	800	14,000	-
	-	-	+3,200	+8,000	-	-4,800	-
4	-	4,000	39,200	33,200	800	9,200	-
	+ 400	-	-2,400	-2,000	-	-	-
5	400	4,000	36,800	31,200	800	9,200	-
	-	-	-16,000	-16,000	-	-	-
6	400	4,000	20,800	15,200	800	9,200	-
	-	-	-	-1,000	-	-	+1,000
7	400	4,000	20,800	14,200	800	9,200	1,000
	-	-1,200	-	-1,200	-	-	-
8	400	2,800	20,800	13,000	800	9,200	1,000
	-	-	-50	-	-	-	-50
9	400	2,800	20,750	13,000	800	9,200	950
	-	-	-800	-800	-	-	-
10	400	2800	19,950	12,200	800	9200	950
		Rs.23,150			**Rs.23,150**		

GROUPS INTERESTED IN ACCOUNTING INFORMATION

Accounting information is used by different groups of people, both inside and outside the organisation. According to Slawihand Reynolds "Conceptually, accounting is the discipline that provides information on which external and internal users of the information may base decisions that result in the allocation of economic resources in society".

I. INTERNAL USERS OF ACCOUNTING INFORMATION

The internal users comprise of owners, management and employees.

(i) Owners: The sole trader or partners or shareholders who have provided the capital of a business unit are interested in its performance and progress. They are primarily interested in the revenues and expenses, profit or loss, net worth and external liabilities. They expect reasonable return on their investment in the form of profits. They are also concerned about the risk and uncertainty attached to their investment. They require detailed data about comparative earnings of the business, future prospects and divisible profits.

(ii) Management: Sole traders and partners usually manage their own business. But companies are managed by paid professionals. Management of a business involves making day to day decisions on routine matters and also policy decisions, whenever needed. Accounting date is the basis for most of the decisions made by management. The trends m sales and purchases, relationship of expenses to the turnover, productivity of workers, comparative profitability of different products and divisions etc., are some of the vital data required by management for planning and controlling the business operations.

iii) Employees; The work force is interested in the profitability of the business which affects their bonus, incentives and working conditions. The success or failure of the business is linked to their livelihood. Labour unions use the accounting data in their bargaining strategies with the management.

II. EXTERNAL USERS OF ACCOUNTING INFORMATION

Various outside groups and individuals make use of accounting information for their own purposes'.

(i) Creditors and Financiers: Suppliers of goods and services, commercial banks, public deposit holders, debenture holders etc., are included in this category. They are interested in the liquidity position and repaying capacity of the business.

(ii) Potential Investors: Those who are interested in investing their surplus funds should know about the financial condition of a business unit while making their investment decisions. They are more interested in future earnings and risk.

(iii) Consumers; Those who use the products and services of a firm are interested in knowing the justification for the prices charged to them. They examine the expenses, sales and profits to see if they are paying fair prices for the products and services.

(iv) Tax authorities: Accounting information helps them in computing Sales tax, Income tax etc., to be collected from business units. They scrutinise the revenues and expenses of business firms to determine their accuracy.

(v) Government: The scarce financial resources of the country are used by business enterprises. Performance of business unite in different industries helps the Government in policy formulation for development of trade and industry. Government also administers prices of certain trades. In such cases, Government agencies have to ensure that the guidelines for pricing are followed:

(v) Research Scholars: The published financial statements are especially used by researchers to evaluate the performance of individual firms, industries and trade. They make use of the data relating to sales, profits, dividends, interest, taxes etc., in their analysis and evaluation.

SELF EVALUATION QUESTIONS

1. A business entity is an organisation is of persons to accomplish an ____________
2. Capital = Assest – _______________
3. Conventions of consistency can be three level ___________________, _______________________________

ANSWER

1. economic goal
2. liability
3. vertical, horizontal, dimensional

BRANCHES OF ACCOUNTING

Providing information according to the needs of internal and external-users has been recognised as the primary objective of accounting. Modem business world has become highly competitive and technology oriented. Management of business units has become highly complex, needing varied types of information. To satisfy the additional demand of management for information, several new branches of accounting have been developed. The following are the most important of the branches of accounting:-

1. Financial Accounting: The accounting for revenues, expenses, assets and liabilities that is commonly carried on in the general offices of business is known as Financial Accounting. The financial accounting information is ^pressed in two main types of financial statements, viz:

(i) Profit & Loss Account (matching the incomes and expenses of the accounting period to ascertain the profit or loss)

(ii) The Balance sheet (showing assets and liabilities, revealing financial position as on that date)

The owners, creditors, management, employees, financiers etc., make use Iinformation provided by financial accounting.

2. Cost Accounting: It is that branch of accounting which deals with ossification, recording, allocation, summarisation of current and prospective cost. It determines cost of production and distribution by departments, functions, products etc. Cost accounting is essential for pricing of products and services id for cost reduction and cost control. Cost accounting data is useful to the management of the business; outsiders are not usually provided with costing data.

3. Management Accounting: It is that branch of accounting which is meant exclusively for managerial decision making. It provides necessary information the management for discharging its functions of planning, organising, co-ordinating, directing and controlling. It usually provides data on funds and cash flows, investment projects, preparation and implementation of budgets e. Almost all the policy decisions of management are made on the basis of unary data provided by management accounting.

THE ACCOUNTING CYCLE –BOOKS AND RECORDS

As per the definition (already explained on page 1.2) of Accounting, recording, classifying, summarising and finalising all business transactions are the important stages in the Accounting cycle.

1. Recording is the first step which is usually accomplished through Journal or subsidiary books.
2. Classifying is achieved through ledger.
3. Summarising is accomplished by preparation of Trial Balance.
4. Finalising is through preparation of Trading Account, Profit and Loss Account and Balance sheet.

It is essential to understand the objective of each stage and the books and records maintained to achieve the objective.

Recording of business transactions in a systematic manner is the first step in the accounting process. Each transaction has to be recorded as and when it occurs, in chronological order. Every thing recorded must be supported by reliable documentary evidence like cash receipts and other vouchers.

Recording of business transactions is usually done in journal or subsidiary books. Small firms or sole traders may use the single journal system and the bigger firms and companies may use subsidiary books system.

JOURNAL

The French word, “Jour’ means ‘day’, ‘Journal’, therefore means a daily record of business transactions.

Journal is a book of ‘primary entry’ or ‘original entry’. All transactions are initially recorded in the journal. The ruling of the journal is such that any business transaction can be analysed under the head of debit and credit. A thorough understanding of the principles of debit and credit which are the basis for Journal is essential for every student of accountancy to get a thorough grasp of the subject. The following is a specimen ruling of Journal.

Journal

Date	Particulars	L.F	Debit Amount (Rs.)	Credit Amount (Rs.)

Transaction are recorded in the Journal in chronological order, according to dates. 'Particulars column' specified the accounts to be debited and credited. 'L.F.' represents 'Ledger Folio' which means the page number in Ledger into which the journal entry is posted. Debit amount and credit amount represent the amount to be debited and credited to the respective accounts mentioned in the entry. Every journal entry is accompanied by a 'narration' which explains the details of transaction for which the entry is written. The following is a specimen journal entry.

Date	Particulars	L.F	Debit Amount (Rs.)	Credit Amount (Rs.)
1999.Dec.6	Cash A/c. to Raman's A/c.		20,000	
	Dr			
	(Being amount received from Raman on account)			20,000

The entry written on Dec. 6, 1999 specified that cash account in the ledger is to be debited Rs.20,000 and Raman's account is to be credited Rs.20,000. the narration explains that the amount received is 'on account' which means Raman has a running account with the business.

The entry declares that cash account is debtor to Raman's account. So. cash account received benefit from Raman.

Recording of journal entries correctly requires full understanding of the 'Rules for debit and credit

Transaction Analysis for journal entries

Any business transactions should be analysed through the following three steps to write correct journal entry.

a. The accounts affected by the transaction have to be identified.

b. The identified accounts shoulde be classified as to personal or real or nominal.

c. The accounts to be debited and credited should be decided on the basis of 'Rules' governing debiting and crediting.

The following are some examples:

S.No.	Transactions	Accounts Affected	Name of Account	Account to be debited or credited	Rule/Reason
1	Purchased goods for cash	Purchases A/c.	Real A/c.	Debited	Debit what comes in
		Cash A/c.	Real A/c.	Credited	Credit what goes out Cash goes out.
2	Paid cash to Raghu	Raghu's A/c.	Personal A/c.	Debited	Debit the receiver Raghu received cash
		Cash A/c.	Real A/c.	Credited	Credit what goes out cash goes out.
3	Paid rent to Landlord	Rent A/c.	Nominal A/c. Expenditure	Debited	Debit all expenses
		Cash A/c.	Real A/c.	Credited	Credit what goes out cash goes out
4	Purchased machinery on credit from X	Machinery A/c.	Real A/c.	Debited	Debit what comes in Machinery comes in
		X's A/c.	Personal A/c.	Credited	Credit the giver Xgives benefit
5	Withdrawn cash from bank	Cash A/c.	Real A/c.	Debited	Debit what come in
		Bank A/c.	Personal A/c.	Credited	Cash comes in Credit the giver Bank gives

Important points to note

1. When money is paid for expenses like rent, salary etc., the expense accounts concerned should be debited. The persons who received the money should not be debited.
2. Purchase, sales etc., if names of supplier or customer are given, should be assumed to be on credit basis even if not specifically mentioned so.
3. Any expenses incurred while acquiring fixed asses like machinery, building etc., should be added to the asset cost.
4. Compound entry: A particular transaction may affect more than two accounts. Debits or credits or both may be more than one account. However, the total debit should be equal to the total credit.
5. Trade discount is to be reduced from the 'list' price of sales or purchase and entry should be written for net amount only.
6. Goods accounts : The articles or products in which a firm deals are termed as 'goods' for that firm. Purchase A/c. Sales A/c. Purchase returns A/c. and sales returns A/c. are all different types of goods accounts and thus 'Real accounts' by nature.
7. Purchase A/c. is meant for purchase of goods only. It should not be used for purchase of assets like machinery or for purchase of stationary, etc.
8. Sales A/c. is concerned with sales of goods only. It should not be used in case of sale of assets.
9. Owner's transactions: When owner provides money to the business, it is capital. Capital account is credited. If owner withdraws money or anything else like goods, it is drawings. Drawings account is debited.
10. Payments for owner: Payment made on owner's behalf for income tax, insurance premium, purchase of assets for his personal use etc., should be treated as drawings.
11. Abnormal losses of goods: Loss by fire, loss by theft or pilferage etc., of goods should be treated as abnormal losses and credited to Trading a/c. after debiting the respective loss accounts.
12. Goods utilised : Goods purchased for the purpose of sales may be used for other purposes. If the owner takes goods, drawings A/c. is debited and purchases A/c. is credited; if goods are distributed as 'samples', advertising account is debited and purchases a/c. is credited. If goods are given as charity, charity A/c. (loss) is debited and purchses A/c, is credited.
13. Cancellation of discount allowed: Cheque may be received from a customer and he is allowed discount. If the cheque is dishonoured, the discount allowed also should be cancelled by crediting discount allowed A/c.

LEDGER

'Ledger' is the second important stage in the accounting cycle or process. In this stage of accounting cycle, all recorded business transactions or entries are grouped on a predetermined basis. Such classification or grouping takes the form of 'Accounts' in a separate book known as 'Ledger'. The 'accounts' in the ledger provide identifiable 'grouping' to the numerous business transactions.

'Ledger' is the main book of accounts in a business. Subsidiary books, though books of original entry, are of secondary importance only. 'Ledger and the accounts it contains; are the core of accounting process.

The ledger contains various accounts - accounts relating to persons, properties and assets, expenses and incomes. A ledger account may be described as 'A summary statement of all the transactions relating to a person, asset, expense or income which have taken place during a given period of time and shows their net effect'.

In subsidiary books, there is no scope to 'summarise'. Goods sold to a customer on credit are entered in sales book; cash received from his is recorded in cash book; goods returned by him are shown in sales returns book etc., They are all grouped in one place in the ledger in his personal account. 'Each ledger account provides the complete picture of the dealings in relation to a particular person or property or expense or income'.

The ledger may be a single book, divided into three parts, say, page 1 to 300 personal accounts; 301 to 500 real accounts and 501 to 1000 nominal accounts etc. But the more popular method is to have three separate books of ledger. General or impersonal ledger contains all other accounts except those of debtors and creditors. The debtors ledger contains the personal accounts of trade debtors and the Creditors ledger contains the account of trade creditors.

ACCOUNT

An account is usually in the 'T' format and contains two sides - the left hand side called 'debit side' and the right hand side called 'credit side'. The heading mentions the name of the account. On both sides of the account, date column is maintained.

When an entry is written on the left hand side of an account, it is called 'Debiting'. When an entry is made on the right hand side of an account, it is known as 'Crediting.

All the accounts must be 'debited and credited for relevant transactions as per the rules for debiting and crediting

POSTING OF JOURNAL TO LEDGER

'Ledger being the second stage in the accounting cycle, it is dependent on 'journal' for 'information flow'. Journal is the source for all entries made in ledger accounts. Thus, one can claim, 'ledger', is the ground floor of a building standing on the 'Foundation' of journal.

When journal is in the form of entries, each entry specifies the account to be debited and the account to be credited. As per the 'instruction' in the journal entry, one account is to be 'debited' i.e., on the left hand side of the account entry is to be made; and another account is to be 'credited' i.e., on the right hand side of the account entry is to be made. For example,

Journal Entry

Date	Particulars	Debit Rs.	Credit Rs.
01.08.1999	Raman's A/c. Dr. To sales A/c. [Being credit sales made]	5,000	 5,000

Raman's Account

Date	Particulars	Rs.	Date	Particulars	Rs.
01.08.1999	To sales A/c.	5,000			

Sales account

Date	Particulars	Rs.	Date	Particulars	Rs.
			01.08.1999	By Raman's A/c.	5,000

In the subsidiary book system, one posting to the ledger is made on the day the transactions is entered in subsidiary books like purchases book, sales book, returns books cash book, B.R. book. However, at the end of the month, the purchases book, sales book, etc., are totalled and the total is posted to the respective accounts in the ledger. Thus, one posting is avoided for each individual transaction resulting in saving of time and effort.

Throughout the accountings year, posting of journal or subsidiary books into ledger takes place in a systematic manner. By the end of the accounting year, ledger reflects the sum result of all the business transactions of the firm.

BALANCING OF LEDGER ACCOUNT

It is customary to balance all ledger accounts at the end of an accounting year. However, any account can be balanced any time, if necessary.

Balancing is done as follows:

a. Both sids of an account are totalled separately;

b. Difference between the totals of both sides is ascertained; and

c. The difference is entered on the side on which the total is short. In the particulars coloumn, 'Balance c/d' is written.

d. If the left had side of an account is more, it is called 'Debit balance'. It is written on the right hand side as 'By balance c/d. If the right hand is more, it is termed as 'Credit balance'. It is written on the left hand side as 'To balance c/d.

e. Balances of accounts for expenses, incomes, sales purchases etc., are transferred to Trading & P&L A/c. Balances in personal and real accounts are carried forward to the next year by carrying the balances down. Balance 'c/d' from debit side appears on the credit side as Balance 'b/d and vice versa.

Ledger balances obtained at the end of an accounting year from the basis for finalisation of accounts.

Distinction between Journal and Ledger

1. **Primacy:** Journal is the book of original entry; ledger is dependent on journal for data.
2. **Recording:** In the journal, recording is in chronological order - as and when transactions take place. In ledger recording is analytical. Transactions relating to particular accounts are entered in those accounts. No specific order is followed.
3. **Evidence Value:** As book of primary entry, journal has better 'evidence value in case of legal problems. However, ledger is the primary source for assessing business results.
4. **Focus:** In journal the focus is on 'transaction'. Both aspects - debit and credit - of a transaction are to be recorded. In ledger, the focus is on account. All dealings relating to an account must be recorded in the accounts
5. **Terminology:** Recording in journal is called 'Journalysing' Recording in ledger is called 'posting'.
6. **Importance:** Ledger is the main book of accounts. Journal is 'subsidiary' which means secondary.
7. **Timing:** Journalising is a continuous process. It has to be done day after day, as and when transactions take place. Ledger can be intermittent. It can be done any time-either daily or once in a while, according to need or convenience.

SUBSIDIARY BOOKS

Maintaining a single 'Journal book' in which journal entries are written for each transaction and posting them to ledger is practicable in small business where a single accountant can maintain accounts or the owner himself can do the accounts work. In bigger businesses, transactions are so numerous and varied that a single journal book is absolutely inadequate and cumbersome.

Several accounts assistants may have to do accounts work as a team and share the burden. It may be necessary to group similar transactions even at journal stage in the shape of 'special journals' to minimise and facilitate ledger work. Thus, the system of Subsidiary books as an alternative for single journal was developed.

Subsidiary books comprise of the following:

a. Purchases book to record credit purchases of goods;
b. Sales book to record credit sales of goods;
c. Purchase returns book to record returns to suppliers.
d. Sales returns book to record returns from customers.
e. Cash book to record all cash receipts and payments.
f. Bills receivable book to record bills received.
g. Bills payable book to record bills payable accepted.
h. General journal or journal proper to record any other transactions which cannot be entered in the above specialised subsidiary books.

Benefits of Subsidiary Book System

Subsidiary books result in the following benefits:

a. **Reduction in work:** Over all work reduces in this system compared to a single journal because one posting alone is made on the date of the transactions. Consolidated monthly posting is made for the second aspect.
b. **Permits group work:** Single journal can be written by one person alone. Work in subsidiary books can be carried on by many accountants.
c. **Accuracy:** Accounts will be more accurate because of specialised work and monthly summarised postings.
d. **Better information:** A lot of useful date like total credit sales, credit purchase, returns, etc., is mad available which is not possible in journal system.
e. **Cash book:** Cash book itself takes the place of journal as well as ledger account. Thus, separate cash account is not needed. In case of three column cash book, even bank A/c. is not needed in the ledger.

Basic documents for Subsidiary Books

a. **Inward invoice:** This is the document sent by the suppliers of goods giving details of goods sent, price, value, discount etc. It is the basis for entries in purchase book.
b. **Outward Invoice:** This is a document sent by the firm to the customers, showing the details of goods supplied, their price and value, discounts, etc. It is the basis for writing sales book.

c. **Debit note:** When goods purchased from suppliers are returned, a debit note is sent to them showing the goods returned and their value. It is the basis for purchase returns book.

d. **Credit Note:** When customers return goods, a credit note is prepared by the firm and sent to them mentioning the amount credited to them based on the goods received as returns. This note is the basis to write sales returns book.

e. **Cash receipts and Vouchers:** These are the vouchers and receipts for cash received and paid. Entries in cash book are made on the strength of the vouchers and receipts. They are also useful for auditing purpose.

Preparation of Individual Subsidiary Books

(A) PURCHASE BOOK

Purchase book is also known as 'bought book' 'purchase day book', 'invoice book'; and 'purchase journal'.

a. All credit purchases of goods are recorded in this book. Periodical total of this book provides total credit purchase of goods made by the firm.

b. Cash purchase of goods and credit or cash purchase of assets are ignored in this book.

c. 'Inward invoices' received from suppliers, duly verified, from the basis for entries in purchase book.

Method of Recording

In the chronological order of goods purchased on credit, the names of suppliers with details of goods bought and number of inward are recorded in the book with net amount payable. Any trade discount allowed is deducted from the gross invoice value of goods received.

Method of Posting

a. Whenever a credit purchase of goods is made and recorded in purchases book, immediately the supplier's account in the ledger is credited with the net purchase value.

b. At the end of the month, the purchases book is totalled. The total amount of credit purchases for the month is debited to the 'purchases account' in the ledger. Thus, the 'double entry' in the ledger is completed at the end of every month.

Purchases book saves the need for separate journal entry for every credit purchase of goods and daily posting to purchases account in the ledger. It can provide the total of credit purchases any time it is needed. Reducing such figure from the total purchases can provide total cash purchases also. Thus, purchases, book results in saving of time, labour and more comprehensive information.

(B) Sales Book

Sales book is also known as 'Day book', 'Sales day book', 'Sold book', 'Sales journal' etc.

a. All credit sales of goods are recorded in this book. Periodical totals of this book provide the total credit sales of goods by the firm.

b. Cash sales of goods and credit sales of assets are not shown in this book.

c. 'Outward invoices' form the basis for making entries in the sales book. The invoices must be properly authenticated.

Method of Recording

According to the dates and time of credit sales taking place, they are recorded in the sales book. The name of customer with details of goods sold and the net amount receivable is recorded. Trade discount if any, is deducted in arriving at the net sale value.

Method of Posting

a. Whenever a credit sale of goods is made and it is recorded in the sales book, the customers account in the ledger is debited immediately with the net sale value.

b. Sales book is totalled at the end of each month. The total credit sales for the month are credited to the 'Sales account' in the ledger. This posting completes the 'double entry' in the ledger for credit sales.

Sales book avoids the need for a separate journal entry and its posting to two ledger accounts whenever goods are sold on credit. It provides the total credit sales of goods at any given time. The difference between total sales shown by the sales account in the ledger and the sales book total represents the total cash sales. Thus, sales book saves time and effort and also provides more useful information for decision - making.

PURCHASE RETURNS BOOK

It is also called 'Returns outward book' and 'Purchase returns journal'.

a. Goods returned to suppliers which were originally purchased on credit are recorded in this book. Periodical totals of this book provide data on purchase returns by the firm.

b. 'Debit notes' sent by the firm to the suppliers when goods are returned form the basis for entries in this book.

Method of Recording

As per the dates of returns made, entries are recorded in purchase returns book. Name of supplier, with details of goods returned and the relevant debit note number are shown with the net amount.

Method of Posting

a. When goods are returned to supplier, entry is made in the purchase returns books. Immediately, the supplier's account is debited in the ledger.

b. Purchase returns book is totalled at the end of every month. The total is credited to the purchase returns account in the ledger. This posting completes 'Double Entry' in the ledger for the purchase returns during the month.

Purchase returns book saves time and effort in the recording and posting of the returns. It also gives data about total purchase returns at any given time.

SALES RETURNS BOOK

This book is also called 'Returns inward book' and 'Sales Returns Journal'.

a. Goods returned by customers which were originally sold on credit are recorded in this book. Monthly totals of this book provide data on 'sales returns'.

b. 'Credit notes' sent to the customers after receiving the goods returned by them form the basis for entries in this book.

Method of Recording

According to the dates of returns received from customers, entries are made in sales returns book. Name of customer with details of goods returhed and credit note number are shown along with net amount.

Method of Posting

a. When return is received from customer, entry is made in the sales returns book. Immediately customer's account is credited in the ledger.

b. Sales returns book is totalled at the end of every month. The total is debited to 'Sales returns Account' in the ledger which completes 'double entry' in the ledger for the sales returns during the month. Sales return book saves time and effort in the recording and posting of the returns.

It also provides summarised returns from credit customers at any given time.

CASE BOOK

Business firms of every size have a large number of payments and receipts - either in the form of cash or through bank. In the traditional journal - ledger system, writing entries for every receipt and posting them to cash and bank accounts in the ledger constitutes majority of the accounting work. In the subsidiary book system, the entire work relating to cash and bank transactions is minimised and simplified through 'Cash book'.

Cash book plays a 'dual role' by serving as a subsidiary book and also as a ledger account.

It is the book of original entry because receipts and payments are recorded in the cash book and they are posted to the different accounts in the ledger.

Cash book also serves the purpose of a ledger because it is written like an account with opening and closing balances and with debit and credit sides. There is no need to open cash account in the ledger.

There are four types of cash book:

a. Simple cash book or single column cash book.
b. Two column cash book with cash and discount columns.
c. Two column cash book with bank and discount columns; and
d. Three column cash book with cash, bank and discount columns.

(a) Simple Cash book

This type of cash book contains debit side and credit side, showing all receipts of cash on debit and payments of cash on credit side. Debit side is called receipts side and credit side is called payments side.

Posting from simple cash book: As and when a transaction is entered in the cash book, it has to be posted to the corresponding account in the ledger. Expenses are shown on credit side of cash book and the respective nominal accounts are debited in the ledger. Incomes are shown on the debit side and the concerned nominal accounts are credited in the ledger. Similar procedure is adopted for personal accounts and real accounts also.

Balancing of simple cash book: Debit side of cash book should always be more because it is not possible to pay more cash than what is available. The closing balance of cash is taken to balance sheet as an asset.

(b) Two column cash book with cash and discount columns

The method of maintaining this cash book is almost like simple cash book. However, on the debit side as well as on credit side, a discount column is maintained. When payments are made, discount received on payments is shown in the discount column on the credit side. Similarly, when cash is received, discount may be allowed to the customers which is recorded in the discount column on the debit side.

Posting to Ledger

Cash received and paid is posted to the respective accounts in the ledger just as in simple cash book. Discount shown on the credit side of cash book is immediately credited to discount received account in the ledger. Similarly, discount shown on the debit side of the cash book is debited to the discount allowed account in the ledger. The discount columns are separately totalled at the time of balancing of the cash book. The totals represent discount allowed and discount received during the period.

(c) Two column cash book with bank and discount columns

Large corporations and big firms usually make all payments through cheques and receipts are also through cheques. Such companies and firms maintain a cash book with bank discount columns only. All cheques issued are shown on payments side, all cheques received and deposited in bank are shown on the receipts side. Discount allowed and received columns are also maintained on the receipts side and payments side respectively.

Postings from the cash book are made into the ledger as and when transactions take place.

(d) Three columnar cash book

This type of cash book is of maximum utility because it minimises work relating to accounts and presents a summarised picture of the liquidly position of a business.

On both sides of cash book, separate columns are opened for discount, cash and bank. All transactions relating to cash receipts and cash payments are shown in the cash coloumns of receipts side and payment side respectively. Similarly, all cheqeus issued for payment areshown in the bank column on credit side. All deposits - both cash and cheques - are shown on the debit side in the bank column. Discount allowed on both cash and cheques received is shown on debit side. Discount received on bith cash paid and cheques issued is shown on credit side.

POSTING:

Receipts and payments - both cash and bank - are debited and credited in the ledger in the usual way, as and when transactions take place.

Some special items:

(1) Contra entries: when cash is depostied into bank, it is debited in bank column on debit side and credited in cash column on the credit side. Similarly, when cash is withdrawn for business use, cash column is debited on the receipts side and bank column is credited on the payments side. Thus, both debit and credit aspects of 'contra entries' are completed in cash book itself. There is no need to post them to ledger. Such transactions are marked with 'c' on both sides in Three columnar cash book (See illustration 15).

(2) Cheques Received: The general principal is 'cheque received is like cash received'. So cheques received are shown in the cash cash column on the debit side of cash book. When the cheques are deposited in bank after some time, a 'contra entry' is written. However, when cheques received are sent on the same day to bank for collection, they can be directly shown in Bank column on debit side without entering in cash column

(3) Cheques dishonoured: They are shown in the credit side of cash book in the bank column because to the extent of the cheque returned. Balance at bank reduces. The account of the person whose cheque is dishonoured will be debited in the ledger.

(4) Balance of Cash book: Cash column and bank column are separately balanced. In cash column, there must be some balance always. In bank column, there can be balance or overdraft, depending on deposits and payments out of bank.

PETTY CASH BOOK

Meaning and purpose: 'Petty' is a derivation of the French word 'Pett' which means small. So, it is meant to be a small cash book, not in physical size but in recording 'small payments'. A business makes numerous routine small payments day after day like postage, stationery, cartage, refreshments, cleaning, etc. If all these paymetns are recorded in the main cash book, it becomes too bulky and the principal cashier becomes overburdened.

In most of the medium and large - sized business establishements, a separate cashier is entrusted with the job of making all the small routine payments and maintain accounts for them. He is called 'petty cashier' and the book he maintains is called 'petty cash book'. thus, the basic purpose of petty cash book is to relieve the burden of main cashier and avoid cluttering of the cash book with numerous small payments.

Imprest system: The amount which may be needed during a specific period (say, a month) for small payments is estimated and fixed as 'Imprest amount'. It can be revised periodically with growth and expansion in payments. At the begiing of the period the imprest amount is handed over to petty cashier. He makes all the payments and collects vouchers to the main cashier who examines them and after satisfying himself about their accuracy hands over to the petty cashier starts the next period with the 'predetermined imprest amount' afresh.

For example, if imprest amount is Rs.1000 per month and during a month, the petty casher has a closing balance of Rs. 70 in his he has spent Rs.930 during the month. After submission of account and vouchers, the main cashier gives cash or cheque for Rs. 930 to the petty cashier so that he can start the next month with Rs. 1000 again.

The imprest system provides control and systematised approach to the petty cash payments.

Analytical petty cash book or Columnar petty cash book

Unclassified petty cash payments may lead to uncontrolled expenses. Showing the entire amount paid by petty cashier as 'petty expenses' is undesirable from control point of view. The analytical petty cash book system was devised to make petty cash payments more organised and recording more convenient and efficient.

Based on past experience, all the petty cash payments are classified into a limited number of homogenous compact groups. Separate columns are opened for each group in the petty cash book with a column for overall total expenditure. The left hand side of the Analytical petty cash book shows opening balance for the period and amount received from the main cashier. The right hand side shows total payments and analytical columns for different groups of expenses.

At the end of the period, all the analytical columns columns are individually totalled. Total of all these columns should tally with the total payments column. Receipts and total payments columns are balanced and the balance is carried forward to the next period.

Benefits or merits of petty cash book on imprest system with analytical columns:

1. Main cash bookis not made unduly bulky with numerous small payments.
2. Main cashier is relieved of the burden of making all the small payments.
3. Petty cashier is made responsible for making small payments and maintaining petty cash book with appropriate vouchers. This method ensures proper control over small payments. The petty cashier is under the control of the main cashier.
4. The imprest system provides a sort of 'ceiling' on small payments.
5. Columnar system ensures 'single posting' of most of the 'Normal Accounts' instead of daily posting of all small payments into these expense accounts.

Posting of Entries from Petty cash book

a. A petty cash account is opened in the ledger. When cash or cheque is handed over to the petty cashier, it is recorded on the payments side of the main cash book. Petty cash account in the ledger is debited.

b. At the end of a period, the total amount spent on various expense groups is ascertained by totalling each of the analytical columns. The respective nominal accounts are debited and petty cash account is credited in the ledger after passing a journal entry in the 'general journal'.

c. The balance shown in petty cash book and that shown in the petty cash account in the ledger should be the same. Such balance is taken to trial balance from the ledger and finally to the assets side of the balance sheet.

BILLS RECEIVABLE BOOK

This book is also called 'Bills receivable journal'. It is used to record the full details of the bills received customers and others.

a. Bills receivable book records the bills drawn by the firm on customers who accpet them and also any bills endorses in favour of the term by customers, through drawn by others.

b. The bills receivable book shows full details retaining to bills received by the firm like date of receipt, the person from whom received, acceptor, bill date, amount, term, due date, etc.

c. Entries are made in the book whenever bills are received. Immediately personal account in the ledger is credited. At the end of the month, the total of bills receivable book is posted to the debit of bills receivable account in the ledger, thus completing the double entry.

Bills receivables books is the reference book for complete details of bills received by the firm during any given period.

BILLS PAYABLE BOOK

This book is also called 'Bills payable journal'. It is used to record all the details of bills payable accepted by the firm.

a. Bills payable book records all the bills accepted by the firm in favour of suppliers or others.

b. The bills payable book shows full details regarding bills accepted like date of the bill, names of drawer and payee, term and due date, amount of the bill etc.

c. Entries are made in the bills payable book whenever bills payable are accepted. Immediately personal account in the ledger is debited. At the end of the month, the total of bills payable book is posted to the credit of bills payable account in the ledger, thus completing the double entry for bills payable in the ledger.

Bills payables book is like a reference book for complete details of bills payables issued by the firm during a period.

GENERAL JOURNAL (OR) JOURNAL PROPER

This is the 'Residual book' under subsidiary book system. 'Residue' means left overs'. All those business transactions which cannot be recorded in any of the other subsidiary books are recorded in the form of 'Journal entries' in the general journal and the entries are posted to ledger. Purchase book. Sales book, cash book, etc represent 'grouping' of similar or related transactions. The rest of the 'Miscellaneous transactions' find place in the journal proper. The following are the important transactions which are usually recorded in journal proper.

1. Credit purchase of assets and credit sale of assets: (They can not be shown in purchases book or sales or cash book).
2. Purchase of business;
3. Expenses shown by analytical columns of petty cash book;
4. Transfer entries;
5. Closing entries - by means of which all nominal accounts, purchases, sales, etc. are taken to trading account and profit and loss account.
6. Adjustment entries -which are necessary to record closing stock, depreciation, outstanding and prepaid expenses, etc.

We can say that the general journal or journal proper acts as 'ombudsman' in subsidiary book system by taking care of all miscellaneous transactions and items which can not recorded in the 'specialised books' opened for particular groups of transactions.

ILLUSTRATION

Journalise the following transactions:

1. Purchased goods for cash Rs.10,000
2. Purchased stationery for cash Rs. 500
3. Purchased furniture for cash Rs. 3000
4. Sold goods for cash Rs. 8000
5. Sold goods to jane for cash Rs. 3000
6. Sold goods to james Rs.2000
7. Paid rent to Krishnan, the landlord Rs.800
8. Paid salary of Rs.8000
9. Paid Lokesh, the managr his salary of Rs.3000
10. Paid freight on goods purchased Rs. 300
11. Paid freight on machine purchased Rs. 400
12. Paid wages Rs. 500
13. Paid wages to erect a machine Rs.1000
14. Received Rs.800 from Kamal.
15. Received Rs.600 from Kamal as interest
16. Received Rs. 7000 from Kamal as loan at 5% interest

Solution:

Journal Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
1	Purchase A/c. Dr. To cash A/c. [Being cash purchase of goods]		10000	10000
2	Stationary A/c. Dr. To cash A/c. [Being cash purchase of stationary]		500	500
3	Furniture A/c. Dr. To cash A/c. [Being cash purchase of furniture]		3000	3000
4	Cash A/c. Dr. To Sales A/c. [Being cash sales made]		8000	8000
5	Cash A/c. Dr. To Sales A/c. [Being cash sales Jane]		3000	3000
6	James A/c. Dr. To Sales A/c. [Being good sold on credit]		2000	2000
7	Rent A/c. Dr. To Cash A/c. [Being rent paid to Krishnan, the landlord]		800	800
8	Salary A/c. Dr. To Sales A/c. [Being Manager’s Salary pain in cash]		8000	8000

9	Salary A/c. Dr. To Cash A/c. [Being Manager's Salary paid in cash]		3000	3000
10	Freight A/c. Dr. To Cash A/c. [Being freight paid for goods]		300	300
11	Machinery A/c. Dr. To Cash A/c. [Being payment of freight on machinery]		400	400
12	Wages A/c. Dr. To Cash A/c. [Being payment of wages]		500	500
13	Machinery A/c. Dr. To Cash A/c. [Being wages paid to erect machine]		1000	1000
14	Cash A/c. Dr. To Kamal's A/c. [Being amount received from Kamal on account]		800	800
15	Cash A/c. Dr. To Interest A/c. [Being interest received from Kamal]		600	600
16	Cash A/c. Dr. To 5% Load A/c. [Being loan from Kamal for interest]		7000	7000

Notes:

A) 1-2-3: Purchases account is to be debited for purchase of goods. But for purchase of stationary, furniture etc., purchases account should not be debited. Respective items should be debited.

B) 5: For cash sale the buyers' name is to be ignored in the entry. It may be shown in narration.

C) 6: When sale is made to a specific person, it should be assumed as credit sale, unless otherwise given.

D) 7: When rent, an expenditure is paid, landlord's name is to be ignored. It may be shown in narration.

E) 9: When salary is paid, the name of the employee is immaterial. It can be shown in narration only.

F) 11-13: Freight, wages and any other expenses incurred for machinery till it is installed should be debited to machinery account itself.

G) 15-16: Amounts received as interest and loan should not be credited to personal account of the person who gives. They should be credited to interest A/c. and loan A/c.

Trial Balance

Meaning:

All business transactions are initially recorded in Journal or Subsidiary books. Then they are transferred to ledger by posting to relevant accounts. After balancing the ledger accounts of a business enterprises, statement is prepared to show separately the debit and credit balances. Such a statement is know as the 'Trail balance'. It is not an account. It is a statement in which debit and credit balances of all the accounts in the ledger are shown to test the arirhmetical accuracy of the books of accounts. The fundamental principle of double entry system of book-keeping is that every debit has a corresponding credit and viceversa. Therefore, the total of the debit balances must be equal in aggregate to the total of the credit balances when the accounts are balanced. Thus, to find out the arithmetical correctness of the book-keeping work, we prepare a summary of balances as they appear in the ledger at some particular date. This summary of balances is known as a 'Trail balance'. Or to put in others words, we take a trail of ledger balances, like a tailor taking a trail of a suit, for the purpose of providing the arithmetical accuracy of the records. Therefore it is called 'Trial balance'. No doubt it is a useful device and it helps in preparation of final accounts since it contains all the Personal, Real and Nominal accounts. As it is prepared by taking up the balances of ledger accounts, both debit and credit sides of a trial balance must always be equal.

Definiton

According to M.S.Gosav (the substance of Accountancy) "Trail balance is a statement containing the balances of all ledger accounts, as at any given date, arranged in the form of debit and credit columns placed side by side and prepared with the object of checking the arthimetical accuracy of ledger postings".

Objectives of preparing the Trail balance

The preparation of trail balance has the following objectives:

i) The trail balance enables one to establish whether the posting and other accounting processes have been carried out without committing arithmetical errors. In other words, the trail balance helps to establish arithmetical accuracy of the books.

ii) Financial statements are normally prepared on the basis of agreed trial balance. Otherwise, the work may be cumbersone. Preparation of financial statements, therefore, is the second objective.

iii) The trial balance have to be seen only when details are required in respect of an account.

iv) Important conclusions can be derived by comparing the balances of two or more than two years with the help of trial balances of those years.

v) Through trial balance, books of accounts are tested and it is only after this test the final accounts are prepared. Just as before issuing a driving licence, a test is necessary and before taking a life insurance policy, a medical testis necessary, in the same way, test of books of accounts is necessary before preparation of final accounts, which is done through 'Trial balance'.

Methods of Preparation of Trial balance

The following are the methods of preparing the trial balance:

(i) Total Method: Under this method, the total of debits and credits of all accounts are shown in the trial balance respectively in the debit and credit side of the trial balance. The trial balance prepared under this method is known as gross trial balance.

(ii) Balance Method: Under this method, only balance of each account of ledger is recorded in trial balance. Some accounts may have debit balance and the others may have credit balance. All these debit and credit balances are recorded in it. This method is widely used.

Ruling of a trial balance

The following is the form of a trial balance

Method : 1-Total method

X's book

Trial balance as on .... 19 ....

S.No.	Name of Account	L.F.	Debit Total Amount	Credit Total amount
			Rs.	Rs.

Method: II – Balance Method

X's book

Trial balance as on .... 19 ....

S.No.	Name of Account	L.F.	Debit Total Amount	Credit Total amount
			Rs.	Rs.

Accounts of all assets, expenses, losses and drawings are debit balances. Accounts of incomes, gains, liabilities and capital are credit balances.

Schedule of debtors

When the goods are sold on credit basis, the buyer's account in the ledger is debited. For each buyer there is one ledger account. The trader would have sold the goods on credit to number of customers. As a result, there will be a number of customer's accounts. When we bring all the customer's account balances to the trial balance and write all individual names of customers, the trial balance will be too lengthy. Therefore, a list of debtors with their individual debit balances is prepared and totalled. Instead of writing the individual names of debtors, the total is written under the heading "Sundry debtors" in the trial balance. The list of debtors is termed as 'Schedule of debtors'.

Schedule of Creditors:

There are a number of suppliers from whom the businessman buys goods on credit basis. For each supplier, separate account is opened in the ledger. As in the case of debtors, a list of creditors with the balances due to them is prepared. Instead of writing the individual names of creditors, the total of the balances of creditors is written in the balance under the heading "Sundry Creditors".

The list of creditors is called "Schedule of Creditors".

If the trial balance tallies, it is an indication that the accounts are correctly written up. But it is not a conclusive proof. If the trial balance does not tally, efforts are made to make the trial balance tally. But if these efforts fail, then temporarily the difference of trial balance is placed to an account called 'Suspense account".

SELF EVALUATION QUESTIONS

4. Asset – equities, (True/false)
5. Daily recorders of business transaction ____________
6. Purchase return journal anther name is ___________
7. Arrangement of the item as balance sheet is known as ______

ANSWER

4. True
5. journal
6. Return outward back
7. marshalling

Illustration

Messrs. Rajkumar & Bros. started their business on 1st April 1995 with Rs.50,000 as their capital. Following were the transactions for one month.

1995		Rs.
April 1	Paid into bank	20,000
April 2	Purchased furniture from Modern furniture Ltd., on credit	3,000
April 6	Sold goods on credit to Sivakumar	3,500
April 8	Paid to Modern furniture Ltd., Cash	2,000
April 11	Purchased goods from Mohan	8,800
April 15	Paid wages in cash	200
April 16	Issued cheque to Mohan	7,000
April 20	Received from Sivakumar	1,500
April 21	Paid into bank	1,500
April 23	Cash sales	3,500
April 25	Cash purchases	1,800
April 27	Goods withdrawn for personal use	500
April 28	Cash withdrawn for personal use	750
April 29	Paid for stationery	100
April 30	Paid salaries by cheque	1,000

Give journal entries and prepare the ledger accounts and trial balance as on 30-4-1995.

Solution:

In the books of Messrs. Rajkumar & Bros. Journal Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
1-4-95	Cash A/c. Dr. To Messers. Rajkumar & Bros' capital A/c. [Being cash brought in for capital]		50000	10000
1-4-95	Bank A/c. Dr. To cash A/c. [Being amount deposited into bank]		20000	20000
2-4-95	Furniture A/c. Dr.		3000	

	To Modern Furniture Ltd., A/c. [Being furniture bought on credit]			3000
6-4-95	Sivakumar A/c. Dr. To Sales A/c. [Being goods sold on credit]		3500	3500
8-4-95	Modern Furniture A/c. Dr. To Sales A/c. [Being part payment made to Modern Furniture Ltd.]		2000	2000
11-4-95	Purchases A/c. Dr. To Mohan A/c. [Being goods purchased on credit]		8800	8000
15-4-95	Wages A/c. Dr. To cash A/c. [Being wages paid]		200	200
16-4-95	Mohan A/c. Dr. To Bank A/c. [Being payment made to Mohan by cheque]		7000	7000
20-4-95	Cash A/c. Dr. To Sivakumar A/c. [Being cash received]		1500	1500
21-4-95	Bank A/c. Dr. To Cash A/c. [Being amount deposited]		1500	1500
23-4-95	Cash A/c. Dr. To Sales A/c. [Being goods sold for credit]		3500	3500
25-4-95	Purchases A/c. Dr. To Cash A/c. [Being goods purchased for cash]		1800	1800
27-4-95	Drawings A/c. Dr. To Purchase A/c.		500	500

	[Being goods taken away for personal use]			
28-4-95	Drawings A/c. Dr. To cash A/c. [Being cash taken away for personal use]		750	750
29-4-95	Stationery A/c. Dr. To Cash A/c. [Being stationery purchased for cash]		100	100
30-4-95	Salary A/c. Dr. To Bank A/c. [Being salary paid by cheque]		1000	1000

FINAL ACCOUNTS

Introduction

The primary function of accounting is to accumulate accounting data in a manner that the amount of profit made or loss suffered during a period can be determined. The manner is which the amount of profit or loss has been arrived at is disclosed in the statement of accounts, prepared at the end of the accounting year. The various items of income and expenditure which arose during the accounting period are detailed out therein, grouped under significant heads. It it also accompained by a balance sheet, exhibiting assets and liabilities of the business as at the close of the period. In addition, for showing the nature of economic activity to which the account pertains, the revenue account as well as different sections in which it is set up are invariably headed as manufacturing trading and profit and loss account or simply as profit and loss account. These two statements etc., trading and profit and loss account and balance sheet are prepared to give the final results of the business. That is why both are collectively called final accounts.

Thus, preparation of final accounts is the step in the accounting cycle. In fact, final accounts include a number of accounts such as (i) Trading accounts (ii) Profit and loss account and (iii) Balance sheet. Though balance sheet is a statement, for all purposes, it is treated as one of the final accounts.

Once the 'Trial balance" is extracted and 'errors' rectified, a trader prepares the "Final accounts" so as to know the final results (i.e., net profit or loss) and financial position (i.e., assets and liabilities) of his business. Trading account and profit and loss account are prepared by transferring from the trial balance, all nominal accounts and accounts concerning goods by passing entries known as "closing entries". All remaining accounts viz., real and personal accounts pertaining to property, assets, debtors and creditors are just shown in a statement called balance sheet.

Grouping and Marshalling of assets and liabilities

A balance sheet is usually prepared in the form of a statement, with assets on the right-hand side and liabilities and capital on the left-hand side. The component items of a balance sheet should be arranged in an orderly manner and in a sequence that should be adhered to year by year. Such an arrangement of the items in a balance sheet is known as "Marshalling". There are two ways in which the assets and liabilities can be arranged in balance sheet. They are:

(a) Order o permanence: (b) order of liquidity.

The first method is commonly used by companies whereas the second one is popular among sole traders and partershio firms. However, in case of certain concerns, such as banking companies, insurance companies, railway companies, other joint stock companies etc., form of balance sheet is prescribed by the law.

(i) Proforma of balance sheet in the order of permanency

Balance sheet of .... as on ....

	Liabilities		Rs.	Assets	Rs.
	Capital	XXX		Fixed assets:	
Add	Net profit	XXX		Good will	XXX
Add	Interest on capital	XXX		Land & Buildings	XXX
		XXX		Loose & tools	XXX
Less	Drawings	XXX		Furniture & fixtures	XXX
Less	Interest n drawings	XXX		Vehicles	XXX
Less	Loss if any	XXX	XXX	Parents	XXX
				Trade marks	XXX
				Long term loans (Advances)	XXX
	Long term liabilities				
	Loan on mortgage	XXX		Investments:	
	Bank loan	XXX		Current assets:	
	Current liabilities			Closing stock	XXX
	Sundry creditors	XXX		Sundry debtors	XXX

	Bills payable	XXX		Bills receivable	XXX
	Bank overdraft	XXX		Prepaid expenses	XXX
	Creditors for outstanding expenses	XXX		Accrued incomes	XXX
	Income received in advance	XXX		Cash at bank	XXX
				Cash in hand	XXX
				Fictitious assets:	XXX
				Preliminary Expenses	XXX
				Advertising expenses	XXX
				Underwriting Commission	XXX
				Discount on issue of shares	XXX
				Discount on issue of debentures	XXX
			XXX		XXX

(ii) Proforma of balance sheet in the order of liquidity:

If the liquidly principle is followed then the sequence of presentation of items will be as under:

Liabilities	Rs.	Assets	Rs.
Current liabilities	XXX	Current assets	XXX
Fixed liabilities	XXX	Investments	XXX
Liabilities to owner	XXX	Fixed assets	XXX
		Fictitious	XXX
			XXX

Illustrations

Prepare Trading account of Archana for the year ending 31-12-96 from the following information:

	Rs.
Opening stock	80000
Purchases	860000
Freight inward	52000
Wages	24000
Sales	1440000
Purchase returns	10000
Sales returns	316000
Closing stock	100000
Import duty	30000

[Bharathodasan, B.Com., Nov. 2005: Periyar, BBA may 2004]

Solution:

Trading Account of Archana for the year ending 31-12-1996

		Rs.			Rs
To opening stock		80000	By sales	1440000	
To purchases	860000		Less: Sales returns	316000	1124000
Less: Purchase returns	10000	850000	By closing stocks		100000
To freight inward		52000			
To wages		24000			
To import duty		30000			
To gross profit c/d.		188000			
		1224000			12,24,000

Illustration

From the following balances extracted at the close of the year ended 31st Dec. 1996, prepared profit and Loss account of Mr. Raj as that date:

	Rs.		Rs.
Gross profit	55000	Repairs	500
Carriage on sales	500	Telephone expenses	520
Office rent	500	Interest (Dr)	480
General expenses	900	Fire insurance premium	900
Discount to customers	360	Bad debts	2100
Interest from Bank	200	Apprentice premium(Cr.)	1500
Travelling expenses	700	Printing & stationery	2500
Salaries	900	Trade expenses	300
Commission	300		

Solution:

Profit & loss account of Mr. Raj for the year ending 31-12-1996

	Rs.		Rs.
To carriage on sales	500	By gross profit b/d.	55000
To office rent	500	By bank interest	200
To general expenses	900	By apprentice premium	1500
To discount to customers	360		
To travelling expenses	700		
To salaries	900		
To commission	300		
To repairs	500		

To telephone expenses	520		
To interest paid	480		
To fire insurance premium	900		
To bad debts	2100		
To printing & Stationery	2500		
To trade expenses	300		
To net profit transferred			
To capital A/c.	45240		
	56700		56700

Questions

1. What do you understand by accounting concepts and conventions?
2. Briefly explain the basic accounting concepts and conventions.
3. What is the entity concept?
4. What do you understand by going concern concept?
5. Write short notes on:
    i. (i) Accounting period concept (ii) Cost concept
6. What do you mean by Materiality and Consistency? Explain by giving examples.
7. Write short notes on the conventions of
    a. (i) Conservatism and (ii) Full Disclosure
8. Explain the meaning of accounting equation.
9. Describe the rules governing the accounting equation.
10. Briefly describe the four 'stages' in the accounting cycle.
11. What is 'Journal' ' Explain its importance.
12. What is 'Ledger'? How is it maintained?
13. Explain the significace of 'Ledger'?
14. Explain the meaning of (a) Journalising (b) Posting (c) Balancing (d) Debiting (e) Creditint.
15. Distinguish between 'Journal' and 'ledger'?

16. What are 'Subsidiary books'?
17. Briefly describe the purpose and method of preparation of each subsidiary book.
18. Explain the procedure of 'Posting' from subsidiary books.
19. Write short notes on (a) Inward invoice (b) Outward proper' under the subsidiary book system?
20. What are the transactions usually recorded in 'Journal Proper' under the subsidiary book system?
21. Explain different kinds of 'Cash book' and their specific uses.
22. How do you prepare a 'Three columnar Cash book'? Explain its utility.
23. A 'Cash book' is a journal as well as a 'Ledger Account'. Explain.
24. What is 'Petty Cash book'? What are its advantages?
25. Explain the utility of Petty Cash Book under 'Imprest System' and with 'Analytical Columns'.
26. Write short Notes on : (a) Contra Entries. (b) Imprest system (c) Analytical Coloumns.
27. Briefly explain the purpose of preparation of final accounts.
28. Distinguish between balance sheet and trial balance
29. 'The accural concept is the basis for final accounts' explain.
30. When do you prepare a 'Manufacturing account?'
31. What do you understand by 'Liquidity order' and 'Permanency order' of preparing balance sheet?

Journal

1. Journals the following transactions in the books of Sri.T.N. of Coimbatore 1987:

   Oct. 1 Commenced business with Rs. 50,000

   3 Purchased goods for cash Rs. 10,000 at 5% trade discount.

   4 Paid carriage Rs.50

   8 Purchased machinery for Rs. 20,000

   10 Sold goods to Madan on account for Rs.15,000

   (Bharathiar, B.A.,Dec.1987)

2. Journalise the following transactions in Balan's books: 1985

   Jan 1 Balan started business by investing cash Rs. 50,000

   He bought goods of Rs.4000 and furniture of Rs.500

   2 Purchased building for Rs. 10,000

3 Purchased goods for cash Rs. 3000

4 Purchased goods on credit Rs.2,500

5 Paid cartage Rs.20

(Bharathiar, B.A.,Dec.1986)

3. Record the following transactions completed during the month of March 1999 in the general ledger.

Mar.	1 Paid rent for the month	Rs. 600
	2 Paid cash for office stationery	Rs. 60
	8 Purchased office equipment on account	Rs. 10,000
	13 Paid advartising expenses	Rs. 600
	15 Received cash from Kumar on account	Rs.8,000
	18 Piad maran on account	Rs.4,000
	25 Withdrew cash for personal use	Rs. 2,000
	29 Paid telephone bill	Rs.600
	30 Paid for repairs to typewriters	Rs.20,000
	31 Paid for repairs to typewriters	Rs.300
	31 Paid electricity bill for the month	Rs.400

[Hint: March 30: Debit Customer and credit fees]

4. Enter the following transactions of Sekar, a dealer in electrical goods, in the purchases book for the month of April 2000.

April	3	Purchased from General Suppliers Co. Ltd.,
		24 Transistor Radio sets at Rs. 200 each
		20 Electric Toasters at Rs.100 each
		6 Electric clocks at Rs. 200 each
		Less : Trade discount 20% on all items.
April	6	Purchased from Topaz Ltd.
		12 Electric Razors at Rs.120 each
		48 Battery torches at Rs.20 each
April	7	Purchased from Radio House:
		10 Colour T.V. at Rs. 6000 each
		4 Portable B/w. televisions at Rs.1500 each
April	19	Purchased 400 light bulbs at Rs. 5 each
		Less: Trade discount at 20%
		(Ans: Total of Purchases book Rs.76,400)

5. The rough book of M/s. Nathan & Co. contains the following: 2000

March	1	Purchased from Seeman & Co. on credit
		10 gross pencils @ Rs. 10 per gross
		2 gross registers @ Rs. 24 per dozen
		Less : Trade discount @ 10%
	2	Purchased for cash from the stationery mart:
		30 gross exercise books @ Rs.3 per dozen
	3	Purchased typewriter for office use from M/s.Modern Goods Co. on credit for Rs. 2000
	4	Purchased on credit from the paper Co.
		10 reams of white paper @ Rs.10 per ream
		20 reams of colour paper @ Rs.15 per ream
		Less : Trade discount @ 10%
	6	Purchased two dozens ink. pots @ Rs. 1.50 each from M/s. Krishna Bros. on credit.

Make out the purchases book of M/s. Nathan Co.

[Ans: Total of purchases book Rs.1,004.40]

[Hint: (1) A gross = 12 dozens.

(2) Ignore cash purchase on March 2 and Typewriter purchased]

6. Prepare a trading account of a trader for the year ending 31st December 1996 from the following data:

	Rs.
Opening stock (1-1-1996)	50,000
Goods purchased during 1996	2,80,000
Freight and packing on the above	20,000
Closing Stock (31-12-1996)	60,000
Sales	3,80,000
Packing expenses on Sales for distribution	12,000

[Ans: Gross profit – Rs. 90,000]

7. Prepare trading and profit and loss account from the information given below:

	Rs.		Rs.
Opening stock	3,600	Rent (Factory)	400

Purchases	18,260	Rent (Office)	500
Wages	3,620	Sales Returns	700
Closing Stock	4,420	Purchase Returns	900
Sales	32,000	General Expenses	900
Carriage on purchases	500	Discount to Customers	360
Carriage on sales7	400	Interest from Bank	200

[Ans: Gross profit – Rs. 10,240; Net Profit – Rs.8,280]

8. From the following balances of Arvind, prepare a Trading A/c., profit & Los A/c. and balance sheet as at 31st December 1995.

	Rs.		Rs.
Credit balances			546
Capital	72000	Postage	574
Creditors	17440	Bad debts	2590
Bills Payable	5054	Interest	834
Sales	156364	Insurance	20000
Loan	24000	Machinery	19890
Debit balances		Stock (1-1-95)	124184
Debtors	7770	Purchases	8600
Salaries	8000	Wages	8600
Discount	2000	Buildings	47560
		Furniture	32310

Value of goods on hand on 31.12.1995 Rs. 28,600

[Ans: Gross profit – Rs. 32,290; Net profit – Rs. 17,746; Balance sheet Total – Rs. 1,36,240]

9. The following balances were extracted from the books of Prasad on 31st March 1994.

	Rs.		Rs.
Capital	50000	Creditors	5000
Drawings	4000	Bad debts	1100
General Expenses	5000	Loan	15760
Buildings	22000	Sales	130720
Machinery	18680	Purchases	94000
Stock	32400	Motor car	4000
Power	4480	Reserve fund (Cr)	1800
Taxes & Insurance	2630	Commission(Cr)	2640
Wages	14400	Car expenses	3600
Debtors	12560	Bills payable	6700
Bank Overdraft	6600	Cash	160
Charity	210		

Stock on 31st March 1994 was valued at Rs.47,000. Prepare the final accounts for the year ended on 31st March 1994.

[Ans: Gross profit – Rs.32,440; Net profit – Rs. 22,540; Balance sheet total RS.1,04,400].

10. From the following Trial balance, prepare trading, Profit & Loss A/c. for the year ended 31.12.1981 and a Balance sheet as on that date:

Trial balance

	Rs.		Rs.
Purchases	11870	Capital	8000
Debtors	7580	Bad debts recovered	250
Return inwards	450	Creditors	1250
Bank deposit	2750	Return outwards	350
Rent	360	Bank overdraft	1570
Salaries	850	Sales	14690
Travelling expenses	300	Bills payable	1350
Cash	210		
Stock	2450		
Discount allowed	40		
Drawings	600		
	27,460		**27460**

Adjustments:

i) The closing stock on 31-12-81 was Rs.4200

ii) Write of Rs.80 as bad debts and create a reserve for bad debts at 5% on sundry debtors.

iii) Three months rent is outstanding.

[Madras, B.B.M.; March 1997]

[Ans: Gross proft – Rs.4,470]

Net profit – Rs. 2,595; Balance sheet Total – Rs.14,285

10.The following are the balances in the ledger of Mr.Sherif for the year ended 31^{st} March 1996.

	Rs.
Opening stock	
Raw materials	20000
Work in progress	3000
Finished goods	10800
Purchase of raw materials	50000
Sales	240000
Fuel and coal	1000
Wages	32000
Factory expenses	40000
Office expenses	30000
Depreciation on plant/machinery	3000
Closing stock:	
Raw materials	20000
Work in progres	4000
Finished goods	8000

Prepare manufacturing and trading account for the year ended 31^{st} March 1996.

NOTES

UNIT – II

BANK RECONCILIATION STATEMENT

MEANING

Need for Bank Reconciliation Statement

A bank gives to every account holder from time to time a copy of his account as it appears in the books of the bank. This statement showing all the deposits and withdrawals for a specified period is termed as 'pass book'. The 'Bank Balance' of a businessman is the balance appearing in the bank column of his cash book in which all the deposits and withdrawals are entered day by day. The cash book balance should generally be the same as shown by his bank pass book on any particular day. For every entry made by the businessman in his cash book, there must be a corresponding entry in the pass book (maintained by the banker) or vice versa. Thus, bank balance should be the same in both the books. However, it must be noted that the cash book and the pass book are maintained by two different parties and hence it is not certain that entry in one book will always have corresponding entry in the other. Naturally, if for a debit or credit entry in one book, there is no corresponding credit or debit entry in the other book, the balance will be two different figures in these two books or the two books do not agree.

In practice we find that on a given date the pass book and cash book rarely show the same balance. Theoretically, the two balances must be same. But because of time lag in recording the transactions and other reasons, the two balances are invariably different.

It is desirable for a business house to check periodically (preferably every month) the entries in the pass book with the entries in the bank column of the cash book and point out to the bankers the mistakes it comes across, so that those may be corrected. Any mistakes in the cash book should be corrected. A statement known as bank reconciliation statement is therefore prepared at periodical intervals with a view to indicate the items which cause disagreement between the balances as per the bank column of the cash'book and the bank pass book on any given date.

Causes for differences

The bank balance as per cash book may differ from the bank balance as per bank statement as on a particular date due to a variety of reasons as under:

I. Transaction entered in cash book but not in pass book as on the date of bank reconciliation statement:

(a) Cheques are issued but are not presented to bank for payment [cash book credited but pass book not debited].

(b) Cheques and bills are deposited in bank but not collected and credited in pass book [cash book debited but pass book not credited]

(c) Cheques or cash are debited in cash book but actually not sent to bank cash book debited but pass book not credited].

(d) Cheques are deposited but returned dishonoured by bank, but they are not adjusted in cash book yet [cash book debited but pass book not credited].

Similarly, cheques are issued but the bank returns them dishonoured [cash book credited but pass book not debited].

(e) Cash book is credited for issue of cheques but they are actually not issued or money not drawn [cash book credited but pass book not debited].

(f) Dividend, interest, deposits etc. debited in cash book more than once in error. [Excess debit in cash book but not credited in pass book]. Similarly, bank charges or withdrawals etc. are credited in cash book more than once, in error [excess credit in cash book but not debited in passbook].

II. Transactions entered in pass book but not in cash book as on the date of bank reconciliation statement

(a) Cash or cheque is directly deposited in bank by debtors or others and credited by bank but the depositor has no intimation of the same [pass book credited but cash book not debited].

(b) Bank has credited the pass book for interest on investments, for dividends on shares etc. collected by it but the depositor has no intimation of the same [pass book credited but cash book not debited].

(c) Bank has debited the pass book for direct payments [under standing instructions] on insurance premiums, interest on loans from others, electricity bills etc., but the depositor has no intimation of the same (pass book debited but cash book not credited]

(d) Bank debits the pass book for interest on overdraft or bank loan, for bank charges, commission, service charges, collection charges etc. [pass book debited but cash book not credited].

Similarly, bank credits pass book for interest on bank balance on fixed deposits etc. [pass book credited but cash book not debited].

(e) Cheques or bills discounted previously are dishonoured and or debited in pass book [pass book debited but cash book not credited].

(f) Bank has credited pass book for cheques deposited and collected; and pass book has debits for payment of cheques issued; but both have remained unrecorded in cash book [for deposits: pass book credited but cash book not debited; and for issues: pass book debited but cash book not credited].

(g) There may be erroneous debits in pass book for bank charges, interest and for cheques drawn by others [pass book debited but cash book not credited]. Similarly, there may be erroneous credits in pass book for interest on deposits etc. and for cheques etc., deposited by others [pass book credited but cash book not debited]. The various causes mentioned above necessitate the preparation of bank reconciliation statement which explains the specific reasons for the difference between the balances shown by the pass book and the cash book.

Method of preparation of bank reconciliation statement

1. Balance shown by the cash book and the pass book on a specified date are to be noted. Debit balance in the cash book and credit balance in the pass book indicate that the business has favourable balance in the bank. Similarly, credit balance in the cash book and debit balance in the pass book indicate that the business has unfavourable balance in the bank. It means bank has given 'overdraft' to the business.

2. All the debits and credits shown in the cash book must be compared with the entries in the pass book to identify any items omitted. Similarly, all the debits and credits in the pass book should be compared with the entries in the cash book to ascertain the items which were not recorded. Any items recorded in both the books but the amounts being different should be carefully noted to adjust the difference in the amounts. It is -preferable to make a list of all the differences.

3. The balance shown by the cash book or pass book can be taken as the 'Starting balance', each difference should be either added to or subtracted from the starting balance depending on the nature of the difference (see proforma B.R.S. I and II below).

4. When all the differences are adjusted, the balance must be the balance as per the other book. If cash book balance was the starting balance, the final balance must be the balance as per the pass book and vice versa.

Proforma of a bank reconciliation statement

The following statements indicate the effect of each 'difference' on cash book balance or pass book balance.

I. If we take cash book balance or overdraft as per pass book as the starting point:

Bank Reconciliation Statement as on ....

		Rs	Rs.
	Balance as per cash book		XXX
	or overdraft as per pass book		
Add:	i) Cheques issued/drawn but not presented	XXX	
	ii) Direct deposit made by customers into bank not recorded in cash book	XXX	
	iii) Divinded or other incomes collected by the bank not recorded in cash book	XXX	
	iv) Interest credited by the bank but not debited in cash book	XXX	XXX
			XXX
Less:	i) Cheques paid/deposited into bank but not credited	XXX	
	ii) Payments by the bank as per standing instruction, not entered in cash book	XXX	
	iii) Bank charges debited in pass book but not recorded in cash book	XXX	
	iv) Cheques deposited but dishourned, not recorded in cash book.	XXX	
	v) Cheques issued and recorded in cash book as deposited into bank but the same was not deposited into bank.	XXX	
	vi) Cheques issued but not recorded in cash book	XXX	

	vii) Interest on bank deposits recorded in cash book but not credited by the bank	XXX	XXX
	Balance as per pass book or overdraft as per cash book		XXX

II. If we take pass book balance or overdraft as per cash book as starting point:

Bank reconciliation statement as on ....

		Rs	Rs.
	Balance as per pass book		XXX
	or overdraft as per cash book		
Add:	i) Cheques paid/deposited in to bank but not credited.	XXX	
	ii) Payments made by the bank as per standing instruction, not entered in cash book.......	XXX	
	iii) Bank charges debited in pass book but not recorded in cash book	XXX	
	iv) Cheques deposited but dishonoured not recorded in cash book	XXX	
	v) Cheques issued and recorded in cash book as deposited in the bank but the same was not deposited into the bank	XXX	
	vi) Cheques issued but not recorded in cashbook	XXX	
	vii) Interest on bank deposits recorded in cash book but not credited, by the bank.	XXX	XXX
			XXX
Less:	i) Cheques issued/drawn but not presented		
	ii) Direct deposit made by customers	XXX	

	into bank, not recorded in cash book		
	iii) Dividends or other income collected by the bank but not recorded in cash book.	XXX	
	iv) Interest credited by the bank but not debited in cash book	XXX	XXX
	Balance as per cash book or overdraft as per pass book		XXX

Bank balance to be shown in balance sheet

When accounts are finalised at the end of an accounting year, cash at bank mist be shown in the balance sheet. For this purpose, neither cash book balance nor pass book balance can be taken as it is. The cash book should be adjusted appropriately and the adjusted cash book balance has to be shown in the balance sheet The cash book has to be adjusted in the light of differences observed in he context of preparation of bank reconciliation statement.

Adjustments in the Cash Book

(a) Incomes recorded in the pass book but not yet entered in the cash book like interest and dividend from investments directly collected by the bank, cheques and cash directly deposited by customers in the bank and not recorded in the cash book have to be entered in the cash book on the debit side. Corresponding credits to the respective accounts in the ledger must also be completed.

(b) Payments and expenses shown in the pass book but not yet recorded in the cash book should be entered on the credit side of the cash book. Corresponding debits to the accounts concerned must also be posted in the ledger. Examples of such items are bank charges, interest on overdraft, interest on loans, payments as per standing order etc.

(c) Any cheques or bills sent to bank for collection but not entered in the cash book, have to be debited in cash book. Similarly, bills and cheques dishonoured but not yet recorded must be credited in the cash book.

(d) All mistakes in the cash book relating to entering casting, balancing etc. must be rectified.

At this stage, all items causing difference between cash book and pass book ire recorded in the cash book except three specific items.

1. Cheques and bills deposited in the bank, but not yet credited in pass book;
2. Cheques issued, but not yet presented for payment;

3. Mistakes made in the pass book by the bankers.

These items are automatically adjusted in due course of time. So, they are ignored in the preparation of the adjusted cash book

Illustrations

L Reconciliation from favorable cash book balance

Illustration

From the under-mentioned particulars of Mr. M. Mohan prepare a Bank Reconciliation Statement as on 31st July 1994.

(i) Cheques paid into Bank on the 28th July 1994 but credited to Mohan's account in the first week of August 1994. K. Kalyan Rs. 1,000; J. Joy Rs. 800; R. Raghul Rs. 1,200.

(ii) The following cheques were issued by Mohan on 30th July 1994 but presented to bank for payment after the close of the year. D. David Rs. 1,200; H. Hari Rs. 1,000; L. Lal Rs. 800.

(iii) A cheque for Rs. 300 was credited direct to the account and was not passed through the cash book.

(iv) The bank balance as per cash book on 31st July 1994 amounted to Rs.30,000.

Solution:

Bank Reconciliation Statement of M.Mohan as on 31st July 1994			
		Rs.	Rs.
	Bank balance as per cash book		30000
Add:	i) Cheques issued but not presented for payment		
	D.David Rs. 1200		
	H.Hari Rs. 1000		
	L.Lal Rs. 800	3000	
	ii) Cheque credit direct to the account but not passed through the cash book	300	3300
Less:	Cheques paid in to bank but not credited in the pas book		33300
	K.Kalyan Rs. 1000		
	J.Joy Rs.800		

	R.Raghul Rs.1200	3000	3000
	Bank balance as per pass book		30300

IL Reconciliation from favorable pass book balance

Illustration

From the following particulars, prepare a bank reconciliation statement as at 31st December 1992 to find out the balance as per cash book of Ms. Akila.

(i) The following cheques were paid into bank in December 1992 but were credited by the bank in January 1993. Maninder-Rs. 1,400; Kalyani Rs. 1,600; Rajesh-Rs. 1,200

(ii) The following cheques were issued in December 1992 but were presented for payment in January 1993 Shalini - Rs. 1,000; Bhagat Rs. 900

(iii) The following charges were made by the bank which were not recorded in the cash-book.

Incidental charges for the half year ended 31-12-1992 Rs. 40 Collection charges for outstanding cheques Rs. 30.

(iv) The following payments made by the bank direct as per standing instructions were not entered in the cash book.

Insurance premium - Rs. 700; Subscription for commerce - Rs. 150

(v) A cheque for Rs. 1,000 which was received from a customer was entered in the bank column of cash book in December 1992.

(vi) A bill for Rs.2000 was retired by the bank under rebate of Rs.40 but the full amount of the bill was credited in bank column of the cash book.

The bank balances as per pass book was Rs. 31,600 on 31st December 1992.

Books of Ms.Akila

Bank reconciliation Statement as on 31.12.1992		
	Rs.	Rs.
Balance as per pass book		31600
Add: i) Cheques paid into bank but not yet cleared and credited:		
Maninder 1400		
Kalyani 1600		
Rajesh 1200	1200	
ii) Charges recorded in the pass book but not in the cash book:		
Incidental charges 40		
Collection charges 30	70	
iii) Payment made y the bank directly as per standing instructions, not recorded in the cash book:		
Insurance premium 700		
Subscription for commerce 150	850	
iv) Cheques entered in the cash book but omitted to be banked	1000	6120
		37720
Less: Cheques issued but not yet presented for payment		
Shalini : 1000		
Bhagat : 900	1900	
Rebate allowed for the bill retired but not entered in the cash book	40	1940
Balance as per cash book		35780

III. Reconciliation from Overdrawn cash book balance

Illustration

The bank overdraft of Rajini on 31-12-93 as per cash book is Rs.9,000. From the following particulars, prepare bank reconciliation statement:

		Rs.
i)	Unpresented cheque	3000
ii)	Uncleared cheque	1700
iii)	Bank interest debited in the pass book only	500
iv)	Bill collected and credited in the pass book only	800
v)	Cheque of Renu dishonoured	500
vi)	Cheques issued to Sekar entered in the Cash column of cash book	300

Solution:

Bank reconciliation Statement as on 31-12-93			
		Rs.	Rs.
	Bank overdraft as per cash book		9000
Add: i)	Uncleared cheque	1700	
ii)	Interest debited	500	
iii)	Dishonoured cheques	500	
iv)	Cheques omitted from the bank column	300	3000
			12000
Less : i)	Un presented cheques	300	
ii)	Bill collected	800	3800
	Bank Overdraft as per pass book		8200

SELF EVALUATION QUESTIONS

1. All the deposit and withdrawal for a specified period is termed as ______.
2. BRS ___________________________
3. Average due date is an _____________

ANSWER

1. pass book
2. Bank reconciliation statement
3. equated or mean

IV. Reconciliation from overdrawn pass book balance

Illustration

Prepare a bank reconciliation statement from the following data as on 30-11-1994:

(i) Balance as per pass book as on 3 0-11-1994 overdrawn Rs. 18,408.

(ii) Cheques drawn on 30-11-1994 but not cashed till 11 Dec. 1994 Rs 6,450; Rs.1,490; Rs. 1,852.

(iii) Bank overdraft interest charged on 28-11-1994 not entered in cash book Rs.3,220.

(iv) Cheques received on 29-11-94 entered in cash book, but not deposited into bank till 31-12-94 Rs. 22,644 and Rs. 3,460.

(v) Cheque received amounting to Rs.70 entered in the cash book twice.

(vi) Bills receivable due on 29-11-94 was sent to bank for collection on 28-11-94 and was entered in cash book forthwith but the proceeds were not credited in bank pass book till 3rd Dec. 1994 Rs.5,960.

(vii) A periodic payment by bank for Rs.160 under standing instruction not entered in cash book.

(viii) Cheque deposited on 30th Nov. 1994 dishonoured but the entry thereof was not made in the cash book Rs. 3,780.

Solution:

In the books of ....

Bank Reconciliation Statement as on 30th Nov. 1994

		Rs.	Rs.
	Overdraft balance as per pass book		18,408
Add:	Cheques drawn but not cashed		
	(Rs. 6450 + Rs.1490 + Rs.1852)	9792	9792
			28200
Less: i	Interest on bank overdraft not entered in cash book	3220	
ii	Cheque received and entered in the cash book as deposited into bank but actually not deposited till 3rd Dec.1994 (Rs.22644 + Rs.3460)	26104	
iii	Cheque received and entered in the cash book twice	70	
iv	Bill sent to bank for collection but not credited till 3rd Dec.1994	5960	
v	Periodic payment made by bank not entered in cash book	160	
vi	Cheque deposited dishonoured but not entered in cash book	3780	39294
	Bank balance as per cash book (Dr.)		11094

V. When both, pass book and cash book of a period are give

Illustration

Prepare a bank reconciliation statement as on 30th June 1993 from the bank pass book and cash book (Bank column only).

Cash book (Bank column only)

Date	Particulars	Amount	Date	Particulars	Amount
1993			1993		
June 1	To balance b/d.	23000	June 10	By Kalyani	1800
June 1	To Mani	1500	June 12	By Venkatesh	1700
June 5	To Sathish	2000	June 15	By Cash	4800
June 18	To Rathinam	1200	June 18	By Venu	1400
June 26	To Vijay	800	June 25	By Sekar	880
			June 28	By Abey Kuruvilla	1320
			June 30	By balance c/d.	16600
		28500			28500

AVERAGE DUE DATE

Meaning

Average due date is an 'equated' or 'mean' date on which a single payment of a consolidated amount can be made in lieu of several payments due on different dates.

In the normal course of business, a person may be required to pay several amounts to another person on different future dates. It is inconvenient for both of them to settle each amount due separately. Payment of the total amount due on the average due date protects both the debtor and creditor from 'loss of interest'.

The mathematical process involved in the computation of average due date is known as "Equation of Payments". In the process of single payment on Average Due Date, certain dues are paid after their actual due dates and some other dues are paid before their actual due dates. Thus, average due date is the 'arithmetic average' of various payments, giving proper weightage to the amount and period of the dues.

Actual payment of the total amount may be made on the average due date. Payment can also be postponed or preponed, based on compensation in the form of 'interest' for the period involved.

Practical uses of Average Due Date

a) In the settlement of running accounts between traders or traders and customers.

b) In the settlement of transactions between a principal and agent.

c) In settling a series of bills of exchange or post dated cheques.

d) In the calculation of interest on drawings of partners.

e) In the computation of interest on book debts realised piecemeal during dissolution of partnership Firms.

Basic types of Problems

Through average due date concept can be used in numerous situations, the following are the two basic types of problems.

a) Average due date for amounts lent in different instalments to be repaid in a single instalment.

b) Average due date for amounts lent in one instalment, repayable in several instalments.

a) Where amount is spent in different installments

The following steps are necessary to find the average due date:-

Steps:-

(i) Selecting one of the due dates as the 'base date'. Any one of the available due dates can be taken as base date. However, it is 'preferable' to choose the earliest of the due dates as 'base date'.

(ii) Calculation of the number of days from the base date to the due date of each transaction.

(iii) Multiplication of the amount of each transaction with the number of days from the base date, as shown in step (ii) to obtain products.

(iv) Adding the amounts of all payments and all products separately.

(v) Dividing the total of the products with the total of the payments to get a number [any fraction must be approximated to the nearest digit].

(vi) If the above number is positive, the average due date is ahead of the base date by that number of days. If however the above number is negative, [this is possible only when the base date is not the earliest of the due dates] the average due date is the date obtained by subtracting the above number of days from the base date.

$$\therefore \text{Average Due date} = \text{Base Date} \pm \frac{\text{Total of products}}{\text{Total of amounts}} \text{ days}$$

SELF EVALUATION QUESTIONS

4. Running statement of transaction between two parties is called __
5. Days are counted form the date of transaction is called _____
6. Days are counted herm the date of due date of transaction is called ________

ANSWER

4. account current
5. forward method
6. backward method

Days are counted herm the date of due date of transaction is called ________ (backward method)

Determination of Due Date

Due dates of transactions are essential for ascertaining number of days from base date of each transaction. The following guidelines are important for determination of due dates.

(i) In the case of running account between traders or other individuals, the date of a transaction is its due date, unless otherwise given.

(ii) In case of bills of exchange, bills payable 'on demand' or 'at sight' or 'on presentation', are due on the date they are presented for payment.

(iii) Bills of exchange payable at a predetermined time in future are due on the third day from the day they are payable. This is due to the customary 'three days of grace'.

(iv) Due date of a bill drawn in terms of days must be determined by actual count of days (adding grace days, if applicable).

(v) Due date of a bill drawn in terms of months must be computed in terms of months irrespective of actual number of days in each month.

(vi) If due date of a bill falls on a public holiday, the previous day becomes the day of due date.

(vii) Due date of bills payable days or months after sight should be computed from the date of acceptance, if given. Due date of bills payable after date should be computed from the date of drawing of the bill, if given.

(viii) While counting the number of days from base date for each transaction, the base date itself should be omitted.

Average due date as basis/or calculation of interest

I. Gain or loss on interest to any party can be avoided by making payment on the average due date. However, this date may be used as a 'bench mark' for several dealings.

(a) The debtor may seek extra time from the average due date for actual payment, agreeing to pay specified rate of interest.

(b) The debtor may plan to save 'interest' by agreeing to pay the aggregate sum before the due date.

(c) Both the parties may agree to settle the amount due with a new bill drawn on the average due date, adding interest for the period of the bill.

Interest is computed as follows:-

$$\text{Total amount X Agreed \% of interest x } \frac{\text{Agreed period}}{\text{1 year}}$$

$$\text{for example, Rs. 50000 x } \frac{15}{100} \text{ x } \frac{73}{365} = \text{RS. 1500}$$

II Interest on Drawings of Partners: Partners may withdraw money for personal needs on different dates during the year. Average due date for all the drawings can be calculated in the usual manner. When final accounts are prepared, interest on the total amount withdrawn from the average due date till the date of closing of accounts can be computed at the agreed rate of interest.

(b) Where the amount is lent in a single instalment

When a single amount is borrowed which is repayable in several instalments, Average due date can be calculated, through the following steps:

(i) Calculation of the number of days / months / years from the date of lending to the date of each instalment.

(ii) Ascertaining the aggregate of days / months / years as computed instep(i).

(iii) The aggregate found in step (ii) should be divided by the number of instalments payable for complete repayment of the sum borrowed.

(iv) The result of step (iii) should be added to the date of the loan to arrive at the Average due date.

Average Due Date = Date of Loan

$$\frac{\text{Total of Days / Months/Years of various instalments}}{\text{No. of instalments}} \quad +$$

(a) Where the amount is spent in different installments

Illustration

Kannan purchased goods from Raman, the due date for payment in cash being as follows:

	Rs.	
March 15	1000	Due 18th April
Apr. 21	1500	Due 24th May
Apr.27	500	Due 30th June
May 15	600	Due 18th July

Raman agreed to draw a bill for the total amount due on the average due date. Ascertain that date.

Computation of Average due date

Base date 18th April

Due date 1	Amount Rs. 2	No. of days from Base date 3	Product Rs. 4
18th April	1000	0	0
24th May	1500	36	54000
30th June	500	73	36500
18th July	600	91	54600

$$\text{Average due date} = \text{Base date} + \frac{\text{Total of products}}{\text{Total of amounts}}$$

$$= 18^{th}\text{ April} + \frac{145100}{3600}\text{ days}$$

$$= 18^{th}\text{ April} + 40\text{ days}$$

$\therefore$ Average Due date = May 28

Calculation of Interest:

Illustration

R owes S the following sums of money due from him on the dates stated:

Rs. 300 due on March 9, 1993

Rs. 1000 due on April 2. 1993

Rs. 4000 due on April 30, 1993

Rs. 100 due on June 1, 1993.

He wants to make the complete payment on 30-6-93. Calculate interest at 5% p.a. with the help of average due date method.

[Madras B.Com (ICE) Oct. 2000; BCS (ICE) Oct. 2000; Sep. 1995]

Solution:

Computation of Average due date

Base date 9-3-93

Due date 1	**Aount Rs. 2**	**No.of days from base date 3**	**Product Rs. 4 (2x3)**
9-3-93	300	0	0
2-4-93	1000	24	24000
30-4-93	4000	52	208000
1-6-93	100	84	8400
	5400		240400

$$\text{Average due date} = \text{Base date} + \frac{\text{Total of products}}{\text{Total of amounts}} \text{ days}$$

$$= 9.3.93 + \frac{240400}{5400} \text{ days}$$

$$= 9.3 + 45 \text{ days}$$

$\therefore$ Average Due Date = 23.4.93

Therefore, interest is chargeable from 23-4-93 to 30-6-93 i.e., 68 days.

Interest for 68 days = $5400 \times \frac{68}{365} \times \frac{8}{100}$

Interest payable = Rs. 50.30

When due dates fall on Gazatted government holidays:

Illustration

The following amounts are due to Ezil by Satya. Satya wants to pay off

(i) on 18-3-97 or (ii) 14-7-97.

Interest rate of 8% p.a. is taken into consideration.

Due dates	Rs.
10-1-97	1000
26-1-97 (Republic day)	2000
23-3-97	6000
18-8-97 (Sunday)	8000

Determine the amount to be paid in (i) and (ii)

Solution:

Computation of Average due date

Base date 10-1-97

Due date (Nominal) 1	**Due date (Actual) 2**	**No. of days front base date i.e., 10-1-97 3**	**Amount Rs. 4**	**Product Rs. 5**
10-1-97	10-1-97	0	1000	0
26-1-97	25-1-97	15	2000	30000
23-3-97	23-3-97	72	6000	432000
18-8-97	17-8-97	219	8000	1752000
			17000	2214000

$$\text{Average due date} = \text{Base date} + \frac{\text{Total of product}}{\text{Total amount}} \text{ (days)}$$

$$\text{Average due date} = 10\text{-}1\text{-}97 + \frac{22{,}14{,}000}{17000} \text{ (days)}$$

$$= 10\text{-}1\text{-}97 + 130 \text{ days}$$

$\therefore$ Average due date = 20-5-97

i) If the payment is made on 18-3-97, rebate will be allowed for expired time from 18-3-97 i.e., for 63 days. He has to pay he discounted value of the total amount.

$$\text{Discount} = 17000 \text{ X } \frac{8}{100} \text{ X } \frac{63}{365} \; 234.74$$

$\therefore$ Amount to be paid on18-3-97: 17,000-234.74

= Rs. 16,765, 26

ii) If the payment is deferred to 14.7.97, interest is to be paid from 20-5-97 to 14-7-97 (i.e., for 55 days)

$$\text{Interest} = 17000 \text{ X } \frac{8}{100} \text{ X } \frac{55}{365} \; 204.93$$

$\therefore$ Amount to be paid on 14-7-97 = Rs. 17,000 + 204.93

= Rs.17,204.93

When due dates of bill are given

Illustration

Find out the Average due date of the following bills accepted by a trader who wishes to settle them with one single payment.

Date of Bill	Amount of bill Rs.	Due date
1-4-90	800	6-6-90
30-4-90	1000	3-8-90
3-6-90	400	6-7-90
15-6-90	600	18-9-90

[Periyar B.B.A., May 2004]

Solution:

Calculation of Average due date

Base date 6-6-90

Due date	**Amount Rs.2**	No. of days from base date **3**	**Product Rs. 4 (2x3)**
6-6-90	800	0	0
3-8-90	1000	58	58000
6-7-90	400	30	12000
18-9-90	600	104	62400
			132400

$$\text{Average due date} = \text{Base date} + \frac{\text{Total of product}}{\text{Total of amounts}} \text{ days}$$

$$= 6\text{-}6\text{-}90 + \frac{1,32,400}{2800} \text{ days}$$

= 6-6-90 + 47 days

∴ Average due date = 23-7-90

Calculation of the due date of bills payable after so many months after date (or) sight:

Illustration

Ramesh drew upon Vinod several bills of exchange due for payment on different dates as under:

Date of Bill	Amount Rs.	Tenure of the Bill
1-6-88	1200	3 months
19-6-88	1600	2 months
10-7-88	2000	3 months
27-7-88	1500	3 months
7-8-98	1800	1 months
15-8-88	2400	2 months

Find out average due date on which payment may be made in one single amount.

Solution:

Computation of Average due date

Base date 22-8-88

Due date 1	Amount Rs. 2	No. of days from base date	Product Rs. 4 (2x3)
4-9-88	1200	13	15600
22-8-88	1600	0	0
13-10-88	2000	52	104000
30-10-88	1500	69	103500
10-9-88	1800	19	34200
18-10-88	2400	57	136800
	10500		394100

Total of product

Average due date = Base date + ________________________ days

Total of amounts

$$= 22\text{-}8\text{-}88 + \frac{3,94,100}{10500} \text{ days}$$

= 22-8-38 days

∴ Average due date = 29-9-88

Illustration

x sold goods to Y as detailed below:

Date of invoice	Value of goods sold Rs.
5-5-94	2000
12-5-94	1500
19-5-94	3000
26-5-94	2200
1-6-94	1500
3-6-94	1000

The payments were agreed to be made by bills payable 90 days from the respective dates of invoice. However, Y wanted to arrange for payment of all the bills to be made on a single date. Calculate the date on which such payment could be made without loss of interest to either party.

SELF EVALUATION QUESTIONS

7. Daily balance method is anther name ________________
8. An account of the transactions between two parties during a period is called ________
9. Average due date is known as ______________

ANSWER

7. periodical balance method
8. account current
9. equation of pay month

Solution:

Computation of Average Due date

Base date – 6-8-94

Due date (Date of invoice +90 days + 3days) 1	Amount Rs. 2	No. of days from Base date 3	Product Rs. 4
6-8-94	2000	0	0
13-8-94	1500	7	10500
20-8-94	3000	14	42000
27-8-94	2200	21	46200
2-9-94	1500	27	40500
4-9-94	1000	29	29000
	11200		168200

$$\text{Average due date} = \text{Base date} + \frac{\text{Total of products}}{\text{Total of amounts}} \text{ days}$$

$$= 6\text{-}8\text{-}94 + \frac{1,68,200}{11200} \text{ days}$$

$$= 6\text{-}8\text{-}94 + 15 \text{ days}$$

$\therefore$ Average due date = 21-8-94

Illustration

For goods sold,. Nagarajan drawn the following bills on Raj who accepts the same as per terms give under:

Amount of the bill Rs.	Date of drawing	Date of acceptance	Tenure
16000	6-1-95	9-1-95	3 months after date
18000	15-2-95	18-2-95	60 days

16000	21-2-95	21-2-95	2 Months
30000	14-3-95	17-3-95	30days after sight

On 18-3-95, it was agreed that the above bills will be withdrawn and the acceptor would pay the whole amount in one lump sum by a cheque, 15 days ahead of average due date and for this a rebate of Rs.1000 would be allowed.

Calculate the average due date, the amount and the due date of the cheque.

Solution:

Computation of Average Due date

Base date 9-4-95

Due date **1**	**Amount (Rs.)** **2**	**No. of days from base date** **3**	**Product Rs.** **4(2x3)**
[6-1-95 + months +3 days] = 9-4-95	16000	0	0
[15-2-95 + 60 days +3 days] = 19-4-95	18000	10	180000
[21-2-95 +2 months +3 days] = 24-4-95	16000	15	240000
[17-3-95 + 30 days +3 days] 19-4-95	30000	10	300000
	80000		720000

Average due date = Base date + $\frac{\text{Total of products}}{\text{Total of amounts}}$ days

$$= 9.4.95 + \frac{7,20,000}{80000} \text{ days}$$

	=	9.4.9.5 + 9 days
A.D.D.	=	18.4.95
Amount of cheque	=	Rs.80000 – 1000 = Rs. 79000
Due date of cheque 18.4.95-15 days	=	3.4.95

Note:

In case of bill after sight, the date of acceptance should be take for calculation on due date.

ACCOUNT CURRENT

Meaning

An account current is a running statement of transactions between two parties a given period of time and includes interest allowed or charged on various ;ms. It takes the form of an account. Particularly, when two parties have numerous transactions between themselves and settlement of each transaction not separately made, it becomes necessary. Firstly, to take into account the loss or gain on account of interest and secondly, to ensure that there is no dispute regarding the net amount due. For this purpose, a statement is prepared one party and sent to the other. Transactions between the two parties during particular period are recorded. Such a statement is called 'Account current". Thus, an account current is a copy of ledger account of the other party in the books of the party who sends it and contains an additional column on each side w calculating interest) besides the usual amount columns. An example is of manufacturer who sells goods frequently to a merchant on credit and receives payments from him in instalments at different intervals and charges interest on e amount which remains outstanding. Such a statement is generally rendered i) by one trader to another (ii) by a banker to his client (iii) by an agent to his principal (iv) by a consignee to consignor and (v) by one co-venturer to another.

While preparing the account current, the transactions are arranged date wise (chronologically) and the interest is charged or allowed at an agreed rate. The party to whom the account current is sent, is named first. Interest may be calculated for each transaction separately or only the net amount of the interest ay be entered. Usually, interest is calculated on the basis of number of days.

Heading of an Account Current

An account current being a copy of the ledger account of the opposite party, e sender writes the name of the opposite party at the beginning and writes his fin name at the end. For instance, when 'A' sends the account current to 'B' e heading of the statement will be 'B' in Account Current with 'A'. This would mean that a copy of 'B's A/c' is being sent to him (B) as it would appear the books of A.

Definition

An account current maybe defined as "an account of the transactions between two parties during a particular period, in which interest is calculated at agreed rate on each debit and credit item and the net balance of interest is eluded on the debit or credit side of the account in the amount column".

Procedure for calculating days of interest

There are three methods of calculating the number of days for account current purpose:

(i) Forward Method:- Under this method, the days are counted from the date of transaction (if there is no credit period) or from the due date of transaction (where a period of credit is granted or bill is used) to the closing date or date of settlement of account current. It includes product method and interest table method.

(ii) Backward or Epoque Method:- In this method, days are counted from the due date of transaction to the opening date of the account current. (This method is useful where the opening date of the account current is given).

(iii) Daily Balance Method or Periodical Balance Method:- This method is generally followed in banks. In this method, days are calculated from the due date of one transaction to the due date of the next transaction.

Points to remember regarding counting of days

(1) The date of the transaction is left out of calculation. For example, the number of days between 10th February and 28th February will be 18. 10th February will not be counted.

(2) In case of bills transactions, due date should be computed after adding 'grace days', wherever applicable.

(3) In the case of balance brought forward from the previous period, the first day of the new period will also be counted. Suppose, the opening balance on 1st January 1990 is Rs. 10,000. Up to 10th February 1990, the number of days will be 41 (January 31 + February 10). If a new transaction is entered, say, on 1st January, then this day will not b& counted.

(4) Where goods are bought or sold on 'some days credit' counting should be made from the due date of the transaction, after the period of credit is completed.

(5) Sometimes the date of the settlement of the transaction is different from the date of transaction itself. In that case the settlement date is to be considered.

Preparation of Account Current

There are four ways of preparing an account current. They are discussed in detail below.

(1) Product Method

In this method, separate columns for number of days, amount and products are to be opened on the both sides of the account The number of days in respect of each transaction to the closing date is ascertained. The number of days is multiplied by the amount of the transaction, in order to get the product.

The products are entered in a separate column on both sides of the account. Then the product column is balanced and interest is calculated for one day on the balance. It has to be entered in the amount column on the side which has the larger of the total products.

The logic behind this method is simple. Interest on Rs. 1,000 for 5 days will be the same as on Rs. 5,000 for one day.

The interest is ascertained by the formula:

$$\text{Interest} = \frac{\text{Balance of the products x Rate of interest}}{365 \times 100}$$

In case products are in terms of months,

$$\text{Interest} = \frac{\text{Balance of the products x Rate of interest}}{12 \times 100}$$

Red-ink Interest: Many a time an account current contains transactions the due dates of which fall after the settlement date i.e., the closing date of the I account current. For example, an account current is prepared for the half year ended 30th June 1990. X receives a bill of exchange from Y for Rs. 2,000 on 15th June due one month after date. The due date of the transaction is, therefore, 18th July 1990 i.e., 18 days after the closing date of the account current. In such a case, one of the following methods is adopted:

(i) The days of such transaction are calculated from - the settlement date to the due date of the transaction and put in the days column with (-) sign. The product of this is also marked with (-) sign. It is called Red-ink Interest because it is written in red ink in the books. Hence, the product of this type of transaction is to be deducted from the total of the products.

(ii) To avoid the confusion of red-ink figures in totalling the products, the products of such otherwise, red-ink transactions are written in blue ink on the opposite sides and are considered as usual.

Though the amounts of red-ink transactions are payable/receivable after the settlement date, these amounts are recorded within the account current. Therefore, interest for days beyond the settlement date is to be waived. Hence, the products of such transactions are deducted from the total of other products, the due dates of which are within the settlement date. The red-ink interest adjustments are not necessary in case of Epoque method.

(2) Interest Table Method / Forward Method

In this method, all the transactions are arranged in the form of an account. There are two additional columns on both sides of such an account.

(i) One column is meant to indicate the number of days counted from the due date of each transaction to the date of rendering the account. If no specific date is mentioned as the date on which payment is due, the date of transaction is presumed to be the due date.

(ii) The other column is meant for writing interest. Interest is calculated by tables, on each item separately. The interest columns on both sides of the account are then added and balanced. The balance is carried out into the principal (amount) column. This method is not very helpful since interest is to be calculated for each transaction separately.

(3) Daily Balance Method or Periodical Balance Method

This method is usually adopted in banks where the balance of an account is found after every transaction. In this case, the number of days written against each transaction are the days counted from its date or due date to the date of the Following transaction. In the case of the last transaction, the number of days are counted to the closing date of the period.

Each amount is multiplied with the number of days. If the amount represents a debit balance, the product is written in the 'Dr. product column' and if it represents a credit balance, the product is written in the ' Cr. product column'. The Dr. product and Cr. product columns are then totalled up. merest is calculated on each total at the given rate of interest and the net interest is ascertained. If the net interest is payable to the customer, it will appear as "By Interest A/c" under deposits and if it is due from the customer, t will appear as "To Interest A/c" under withdrawals.

4) Backward / Epoque Method

Under this method, the columns in the debit and credit sides of Account current are made in the same manner as in product method. Number of days are counted from the opening date of the statement to the due date of each transaction. Since the opening date is considered as base, no interest is charged on the opening balance but interest for the closing balance. Number of days are ascertained and then multiplied by the amount paid / received and the products are calculated. The products on each side are then totalled and the difference is ascertained. Interest is calculated at the agreed rate for the said difference for one day and the same is posted on the shorter side in the amount column.

Varying Rates of Interest

Some times both the parties agree to charge and to allow interest on debit and credit items at different rates of interest. In such a case, interest on the total of debit products is calculated at the rate of interest means for debit items and interest on the total of credit product is calculated at the rate meant for credit items. The difference between interest so arrived on debit and credit products should be entered in the amount column on the side in which products total is heavier.

Illustration

Interest calculation under product method

The following transactions took place between Ram and Krishna from 1-1-90 to 30-6-90.

1990		Rs.
Jan.1	Sold goods to Ram	2240
Jan.10	Received Ram's acceptance at 2Months	1000
Feb.15	Received cash from Ram	1200
Mar.2	Bought goods from Ram	5500
Mar.3	Accepted Ram's bill at 1Month	2000
Apr. 11	Paid cash to Ram	2000
Apr.30	Sold goods to Ram payable up to 31st May	2400
May 11	Bought goods from Ram	1500
May 31	Sold goods to Ram payable up to 10th June	2200
June 15	Bought goods from Ram	3000

Prepare the amount current to be sent by Krishna on 30th June 1990. The rate of interest is 5%.

[Madrs BCS Oct.1999; Periyar, BBA May 2006]

Solution:

Books of Krishna

Ram in Account current with Krishna as on 30-6-1990

Date	Particulars	Amount Rs.	Days	Products Rs.	Date 1990	Particulars	Amount Rs.	Days	Product Rs.
Jan.1	To sales	2240.00	180	403200	Jan.10	By R/r (due on March 13)	1000.00	109	109000
Mar.3	To B/P. (due on April 6)	2000.00	85	170000	Feb.15	By cash	1200.00	135	162000
Apr.11	To cash	2000.00	80	160000	Mar.2	By purchases	5500.00	120	75000
Apr.30	To sales (due on May 31)	2400.00	30	72000	May.11	By purchases	1500.00	50	45000
May31	To sales (due on June 10)	2200.00	20	44000	June 15	By purchases	3000.00	15	
June30	To balance of products			201800	June 30	By interest on bal. of products $\left(201800 \times \frac{5}{100} \times \frac{1}{365}\right)$	27.64		
June30	To Bal. c/d.	1387.64							
		12227.64		1051000			122247.64		1051000
					July 1	Bybalance b/d.	1387.64		

Illustration

Prepare account current for Nagesh in respect of the following transactions with Basha:-

1994		Rs.
Sep.16	Goods sold for Basha	400 (due 1st Oct.)
Oct.1	Cash received from Basha	180
Oct.21	Goods purchased from Basha	1000 (due 1st Dec.)
Nov.1	Paid to Basha	660
Dec.1	Paid to Basha	600

Dec.5	Goods purchased from Basha	1000 (due 1st Jan.)
Dec.10	Goods purchasd from Basha	440 (due 1st Jan.)
1995		
Jan.1	Paid to Basha	1200
Jan.9	Goods sold to Basha	40 (due 1st Feb.)

The account is to be prepared up to 1st Feb. calculate interest @ 6% p.a.

[Periyar, BBA May 2004; Bharathidasan B.com., April 2002]

Solution:

Basha in Account current with Nagesh as on 1-2-95

Date 1994	Particulars	Amount Rs.	Days	Products Rs.	Date 1994	Particulars	Amount Rs.	Days	Product Rs.
Sep.16	To sales A/c. (dueon Oct.1)	400.00	123	49200	Oct.1 Oct.21	By cash A/c. By purchase A/c. (due on 1st Dec.)	180.00 1000.00	123 62	22140 62000
Nov.1	To cash A/c.	660.00	92	60720	Dec.5	By purchase A/c. (due on 1st Jan)	1000.00	31	31000
Dec.1	To cash A/c.	600.00	62	37200	Dec.10	By purchases A/c. (due on 1st Jan.)	440.00	31	13640
1995									
Jan.1	To Cash A/c.	1200.00	31	37200					
Jan.9	To Sales A/c. (due on 1st Feb.)	40.00	0	0	1995 Feb.1	By balance c/d.	289.13	-	55540
Feb.1	To Interest $\left(55540 \times \frac{6}{100} \times \frac{1}{365}\right)$	9.13	-	-					
		2909.13	184320				2909.13	184320	

Illustration

Red-ink interest

Balaji had the following transactions with Ganesan.

1995		Rs.
Jan.20	Sold goods to Ganesan	400
Mar.2	Purchased goods from Ganesan	250
Mar.3	Accpted Ganesan's draft at 1Month due	200
Apr. 11	Cash paid to Ganesan	200
Apr. 30	Goods sold to Ganesan due end of may	400
May 11	Bought goods from Ganesan	100
June 11	Balaji drew a bill on Ganesan this day. Payable two months after date, and this was duly accepted by Ganesan	300

Prepare an account current to be rendered by Balaji to Ganesan as at 30th June, bringing interest into account at 20% p.a,

[Periyar, B.Com.,(CA) May 2006]

Solution:

Books of Balaji

Ganesan in Account Current with Balaji as on 30-6-95

Date 1995	Particulars	Amount Rs.	Days	Products Rs.	Date 1995	Particulars	Amount Rs.	Days	Product Rs.
Jan.20	To sales	400.00	161	64400	Mar.2	By purchase	250.00	120	30000
Mar.3	To B/P (due on Apr.6)	200.00	85	17000	mar.11	By purchase	300.00	50	15000
Apr.11	To cash	400.00	80	32000	June11	By B/R (due on Aug.14)	300.00	-45	-13500
Apr.30	To Sales (due on May 31)	100.00	30		June30	By balance of product	-	-	84900
June30	To Interest on bal. of product for 1 day @ 20% $\left(84900 \times \frac{20}{100} \times \frac{1}{365}\right)$	46.52				By bal. c/d.	296.52		-
		1146.52		116400			1146.52		116400
July1	To balance b/d.	296.52							

Illustration

Calculation of Interest under interest table method

On 1-1-90 Ramesh owed Rs. 6,000 to Umesh on account. During the six months ended 3006-690, the transaction were as follows in the books of Umesh

		Rs.
Jan.1	Goods sold to Ramesh	3000
Feb.1	Amount received from Ramesh	6000
Mar.1	Goods Sold to Ramesh	12000
Apr.1	Goods purchased from Ramesh	4500
May 1	Goods sold to Ramesh	15000
May 1	Cash received from Ramesh	6000

June 1	Goods purchased from Ramesh	7500
June 30	Cash received from Ramesh	3000

Prepare account current to be rendered to Ramesh on 30-6-90. Interest to be calculated at 18% p.a. in months.

Solution:

Books of Umesh

Ramesh in Account current with Umesh as on 30-6-90

Date 1990	Particulars	Months	Interest Rs.	Amount Rs.	Date	Particulars	Months	Interest Rs.	Amount Rs.
Jan.1	To bal. bd/. (6 6000 x 18% ____ 100)	6	540.00	6000	Feb.1	By cash (5 6000x18%____ 12)	5	450.00	6000
Jna.1	To sales	6	270.00	3000	Apr.1	By purchase	3	202.50	4500
Mar.1	To sales	4	720.00	12000	May.1	By cash	2	180.00	6000
May 1	To sales	2	450.00	15000	June 1	By purchase	1	122.50	7500
June30	To interest – (as per contra)	-	-	1035	June30	By cash	0	0	3000
					June30	By transfer to contra	-	1035.00	-
			1980.00	37035	June30	By balance c/d.	-	-	10035
July 1	To balance b/d.	-	10035					1980.00	37035

Illustration

Daily balance method

On 2-1-92 Gopal opened an account with Canara Bank depositing Rs.5000. His further deposits were: 20th Jan. Rs.2500; 20th March Rs.3000; 20th May Rs.3500;

His withdrawals were: Rs. 6000 on 20th February Rs. 5000 on 20th April and Rs.2500 on 20th June.

Prepare the account current to be rendered by the bank for the period 30th June 1992 charging interest at 5% p.a. on customer's debit balance and 2% p.a. on customer's credit balance.

[Periyar, B.Com., April 2001; Madras, B.Com., Spe. 1993]

Solution:

Gopal in Account Current with Canara Bank as on 30th June 1992

Date 1992	Particulars	Dr. withdrawls Rs	Cr. Deposits Rs.	Dr. or Cr.	Balance	Days	Dr. Product	Cr. Product
Jan.2	By cash	-	5000	Cr.	5000	18	-	90000
Jan.20	By cash	-	2500	Cr.	7500	31	-	232500
Feb.20	To cash	6000	-	Cr.	1500	29	-	43500
Mar.20	By cash	-	3000	Cr.	4500	31	-	139500
Apr.20	To cash	5000	-	Dr.	500	30	15000	-
May20	By cash	-	3500	Cr.	3000	31	-	93000
June20	To cash	2500	-	Cr.	500	10	-	5000
June30	By Interest	-	31	Cr.	531			
June30	To bal. c/d.	531	-	Cr.	531			
		14031	14031				15000	603500
July1	By bal. b/d.	-	531	Cr.	531			

Working Notes:

Interest Calculation

Interest on credit balances,

Interest @ 2% on 603500 for 1 day

$$603500 \times \frac{2}{100} \times \frac{1}{366} = 32.98$$

Less: Interest on debit balances

Interest @ 5% on 15000 for 1 day

$$15000 \times \frac{5}{100} \times \frac{1}{366} = 2.05$$

Net interest to be credited : 30.93 or 31 (approx)

Illustration

Epoque Method (Backward Method)

The following are a series of transactions between Anbu and Balu for the three months ending on 31-3-89. Calculated the amount of interest to be paid by one party to the other at 10% p.a. using epoque method.

Books of Anbu

		Rs.
1-1-89	Balu's opening balance (Dr.)	10000
10-1-89	Sold goods to Balu	20000
15-1-89	Cash received from Balu	20000
15-2-89	Sold goods to Balu	20000
1-3-89	Cash received from Balu	10000

Solution:

Books of Anbu

Balu in Account current with Anbu as on 31.03.89

Date	Particulars	Amount Rs.	Days	Product Rs.	Date	Particulars	Amount	Days	Product Rs.
1.1.89	To bal. b/d.	10000	-	-	15.1.89	By cash	20000	15	300000
10.1.89	To sales	20000	10	200000	1.3.89	By cash	10000	60	600000
15.2.89	To Sales	20000	46	920000	31.3.89	By balance	-	90	1800000
31.3.89	To balance of products			1580000	31.3.89	By bal. c/d. (Including (Interest)	20433	-	
31.3.89	To interest $1580000 \times 10\% \times \frac{1}{365}$	433							
		50433		2700000			50433		2700000

Note: Balance is found roughly in amount column but not written initially. For the rough balance, product is shown for full period. After entering interest, final balance is shown.

Illustration

Varying rates of Interest

From the following prepare an account current by Arivoli to Mohan for six months ended 30-6-90 charging interest on debits at 6% and on credits at 4% p.a.

1990		Rs.
Jan.1	Balance due from mohan	1200
Jan.10	Sold goods to Mohan	1040
Jan.17	Mohan returned goods	250
Feb.10	Mohan paid by cheque	800
Feb.14	Mohan accepted Arivoli's draft for one month	600
Apr.29	Goods sold to Mohan	1230
May 15	Received cash from Mohan	1400
June 5	Mohan accepted Arivoli's bill for 3 months	1000

[Bharathidasan, B.Com., April 1999]

Solution:

Books of Arivoli

Mohan in Account Current with Arivoli as on 30-6-90

Date 1990	Particulars	Amount Rs.	Days	Product Rs.	Date	Particulars	Amount	Days	Product Rs.
Jan.1	To bal. b/d.	1200.00	181	217200	Jan.17	By sales return	250.00	164	41000
Jan.10	To sales	1040.00	171	177840	Feb.10	By bank	800.00	140	112000
Apr.29	To Sales	1230.00	62	76260	Feb.14	By B/R (due on Mar.17)	600.00	105	63000
June30	To Interest	54.42			May 15	By cash	1400.00	46	64400
June30	To	525.58			June 5	By B/R	1000.00	-70	70000

	Balanc e c/d.					(due on Sep.8)			
		4050.00		471300			5050.00		210400

Interest on Total Product (Cr.) = $2,10,400 \times 4\% \times \frac{1}{365} = 23.05$

Interest on Total Product (Dr.) = $4,71,300 \times 6\% \times \frac{1}{365} = 77.47$

= 54.42

QUESTIONS

1. What is average due date? How is it computed?
2. What are the practical uses of average due date?
3. What is an account Current? Explain the different methods of computing interest.
4. What are the practical uses of Account current?

What is Red-ink interest? Why is it called so?

QUESTIONS

I. Reconciliation from favourable cash book balance

5. Prepare a bank reconciliation statement as on 31-12-93, from the following details:

	Rs
Balance as per cash book	7225
Cheque deposited into bank but not colleced	675
Cheque issued but not presented for payment	879
Bank charges debited in the pass book	20
Interest credited in the pass book	15

[Madras; B.Com., March 97]

[Ans: Bank balance as per pass book Rs. 7424]

6. From the following particulars find out the bank balance as per pass book of Mr.Murali as on December 31, 1995:
   a. The balance as per cash book on that date was Rs.23000.

b. Cheques issued but not cashed before that date amounted to Rs. 3500

c. Cheques paid into bank but not cleared before December 31 1995 amounted to Rs. 4300.

d. Interest on investments collected by the bank but not entered in the cash book amounted to RS. 550.

e. Local cheques paid into bank but not entered in the cash book Rs.600

f. Bank charges debited in the pass book Rs.50

[Ans: Bank balance as per pass book Rs. 23,300]

7. On March 31, 1995, the cash book of Prabhu showed a bank balance of Rs. 4850. While verifying with the pass book the following facts were noted.

   a. Cheques sent in for collection before March 31, 1995, and not credited by the bank amounted in all to Rs.845.

   b. Cheques issued before March 31, 1995, but not presented for payment amounted to Rs.885.

   c. The banker has charged as sum of Rs.100 towards incidental charges and credited interested Rs.250

   d. The banker has given a wrong credit for Rs.250

   e. Mr. Nathan has paid into bank directly a sum of Rs.300, on March 28, 1995, which has not been entered in the cash book.

   f. A cheque for Rs.200 sent for collection and returned unpaid has not been entered in the cash book.

   Prepare a bank reconciliation statement.

   [Madrs BCA//B.Sc.,(ICE) April 2001; B.Sc., Oct.1995]

   [Ans: Bank balance as per pass book Rs.2390]

8. The cash book of Anbu showed a balance of Rs.2500 on 23rd September1993. This did not agree with the pass book. From the following particulars ascertain the balance as per pass book.

   a. Cheque paid in but not cleared by bank before 23-9-1993 – Rs. 25

   b. Cheques issued in favour of customers but not presented prior to 23-9-1993 rs. 675.

   c. Commission charged by bank but not entered in cash book Rs.25

   d. Interest on Government securities collected and credited by bank not yet entered in cash book Rs.400

e. No record has been made in the cash book relating to a dishonour of a cheque for Rs.50.

a) Where the amount is spent in different instalments:

Due dates of transactions given;-

9. Ramesh purchased goods form Ravi on different dates. The date of each purchase and its due date is given below:

	Rs.		
7-1-93	1016	due on	12-2-93
20-1-93	366	due on	23-3-93
16-3-93	136	due on	19-5-93
19-4-93	828	due on	22-5-93

Ascertain the average due date.

[Madras, B.Com., Sep. 97]

[Ans: 31-3-93]

10. Anbu owes Sudhakar the following sums of money due on the dates stated.

Rs. 400	due on 5th	January 1990
Rs. 200	due on 20th	January 1900
Rs. 800	due on 4th	February 1990
Rs. 100	due on 26th	February 1990
Rs. 50	due on 10th	March 1990

find out average due date.

[Madras, BCS (ICE) Oct. 2002; B.Com., Sep. 97]

[Madrs, B.Sc., May 95]

[Ans: 28-1-90]

Calculation of interest:

11. Mr. A has purchased goods, the due dates of which are as follows:

Rs. 1000	due on 5th	July 1990
Rs. 1700	due on 10th	August 1990
Rs. 700	due on 25th	September 1990
Rs. 1300	due on 10th	November 1990

He wants to make the complete payment on Oct. 15, 1990. Calculate interest at 6% p.a. with the help of average due date method

[Ans: A.D.D.: 4-4-90; Interest Rs. 31.68]

12. Anand owes Sunil kumar Rs. 870 on 1st January 1987.

The following further transactions tool place between Anand and Sunil Kumar:

January 16 Anand buys goods Rs. 700

February 2 Anand receives cash Rs. 550

March 5 Anand buys goods Rs. 400

Anand pays the whole amount due on 31st March, together with interest at 10% per annum. Calculate the interest by the average due date method.

[Madurai, B.Com., Nov. 1987]

[Ans: A.D.D.22-1-87; Interest Rs. 46.95]

Product Method

13. From the information given below, prepare an 'Account current' to be rendered by Venu to Jani up to half-year ending 31-12-90. Interest is to be calucalted at 10% p.a.

1990		Rs.
Aug. 2	Goods sold to Jani	1800
Aug.20	Sight draft received from jani	900
Oct.10	Jani purchased goods on one month's credit	4000
Oct.25	Cash received from jani	3000
Nov.2	Goods returned by Jani	600
Nov.30	Cash sent to Jani	2000

[Ans: Interest: Rs. 49.78; Balance of account Rs. 3,349.78 Dr]

14. Make out an account current to be rendered by Madhan to Satishkumar for the half year ending 30th June 1997 in respect of the following transactions appearing in the books of Madhan, calculations to be made in terms of months.

1997		Rs.
1st January	Satishkumar owes Madhan	6000
1st March	Satiskumar remits cash	1800
1st April	Satiskumar buys goods from Madhan	2400
1st May	Satishkumar remits cash	3600

Interest is to be taken in to account @ 10% p.a.

[Ans: Interest RS. 240; Balance Rs. 3240 (Dr.)]

15. Krishnan had the following transaction with Gopal.

1990		Rs.
Jan.1	Opening balance due from Gopal	500
Feb.4	Sold goods to Gopal	1000
March 15	Purchased goods from Gopal	300
April 20	Received acceptance from Gopal for the bill dated April 15th payable one month after date	400
May 15	Paid cash to Gopal	300

Make up an account current to be rendered by Krishna to Gopal on 30th June 1990, calculating interest at 10% p.a.

[Madras B.Com., (ICE(May 2000)] [Annamalai, B.com., May 1996]

[Ans: Interest RS. 55.07; Balance Rs. 1,155.07]

16. From the following information prepare account current to be rendered by Mohan to Sundar up to 31-12-91. Interest to be calculated on the product system at the rate of 5% p.a.

		Rs.
July 2	Goods sold to Sundar	1200
July 10	Received sight draft from Sundar	600
Aug.1	Paid cash on behalf of Sundar	4200
Sep.1	Received goods from Sundar	4500
Oct.1	Supplied goods to Sundar	3000
Oct.15	Received cash from Sundar	2400
Nov.1	Received goods from Sundar	7800
Nov.1	Accepted bill for 1Month	3000
Dec.15	Remitted cash to Sundar	900

[Ans: Interest payable : Rs. 10.48; Credit balance Rs. 3,010.48]

17. Renuka is in account current with Shyyamala and the following transactions have taken place between them till April 15, 1992.

1992		Rs.

Jan.1	Balance due by Renuka	1700
Jan.15	Sold goods to Renuka	3000
Jan.25	Received cash from Renuka	1000
Feb.10	Received bill from Renuka	1600
Feb.20	Sold goods to Renuka due by 31st March 1992	5000
March 15	Purchased goods from Renuka	2000
March 31	Received cash from Renuka	2000
April 15	Sold Goods To Renuka Due By 30th April 1992	2600

18. From the following particulars, make out an account current to be rendered by Mani to Asha as on 30-6-93, charging interest at 20% p.a.

1993		Rs.
Jan.1	Balance due to Mani by Asha	1600
Jan.11	Goods sold by Mani to Asha	4400
Jan.20	Received bill accpted by Asha at two months for	5000
Feb.25	Cash received from Asha	2400
Mar.12	Bought goods of Asha	11000
Mar.13	Mani accepted Asha’s draft at 1 month for	4000
Apr.25	Cash paid to Asha	4000
Apr.30	Goods sold to Asha, due end of may	5000
May 21	Bought goods from Asha	2000
June 10	Sold goods to Asha due 20th June	4000
June 25	Bought goods from Asha	6000

19. The following were the transactions between Aruna and Natarajan from 1-7-90 to 31-12-90.

		Rs.
1-7-90	Balance owing to Aruna by Natarajan	1000
10-7-90	Aruna received from Natarajan an acceptance at two months for	5000

15-8-90	Aruna received cash from natarajan	4000
2-9-90	Aruna bought goods from Natarajan	20000
3-9-90	Aruna accepted Natarajan's draft at one month	15000
11-10-90	Aruna paid cash to Natarajan	5000
31-10-90	Aruna sold goods to Natarajan due end of November	8000
30-11-90	Natarajan bought goods from Aruna due 10th December	11000
15-12-90	Natarajan sent a cheque to Aruna for	16000

You are required to prepare an account current to be rendered by Aruna to Natarajan as at 31-12-90, taking into account interest at 5% p.a.

[Ans: Interst credited : Rs. 191.10; Balance of account: Rs. 5191.10 (Cr).]

20. Following dealings took place between Mohan and Raman between 1st April, 1995 and 30th June 1995. Rate of interest is 5% p.a.

1995		Rs.
April 1	Balance due from Raman	2000
April 2	Received cash from Raman	800
April 5	Purchased goods fro Raman	400
April 5	Sold goods to Raman (due on 15th April)	1000
May 6	Sold goods to Raman	600
May 12	Received cash from Raman	500
June 5	Purchased goods from Raman (Payment due on 10th June)	800
June 20	Received cash from Raman	200

[Peroyar, B.Com., April 2001; Madras, B.A., B.Sc., March 1997]

[Ans: Interest Rs.19.58; Balance; Rs.919.58 (Dr.)

Red-Ink Interest

21. Sasi had the following transactions with Radha.

1990		Rs.
Jan.1	Balance due from Radha	6000
Jan.15	Sold goods to Radha	7200
Feb.20	Bought goods of Radha	8800
Apr.20	Accpted Radha's draft dated 15th April at 3 months after date	8000
May 15	Bought goods of Radha (Payment due on 15th July)	2000
June 15	Goods invoiced to Radha	3200

Prepare an account current to be rendered by Sasi for the period to 30-6-90, charging interest at 8% p.a.

[Ans: Interest Rs. 234.78; Debit balance Rs. 13,834.78]

22. Mr. X is in account current with Mr. Y and the following transactions have taken place between January 1 and April 30.

1995		Rs.
Jan.1	Received goods from X due end of February	3067
Jan.19	Sold goods to Y due end of April	1269
Feb.3	Paid cash to Y	1300
Feb.12	Received goods from Y due end of March	4985
Feb.26	Accepted Y's draft at 2 Months	3500
Mar.21	Received cash from Y	1900
April 5	Received goods from Y due end on July	2763

[Bharathiyar, B.A., Nov.1987] [Ans: Interest Rs. 7.09; Balance: Rs. 6,653.9]

23. Suresh had the following transactions with Ramesh during the calendar year 1993.

1993		Rs.
Jan.1	Balance due from Ramesh	2000
Feb.16	Purchased goods from him	12000

Feb.28	Sold goods to him	20000
Mar.16	Received a cheque	6000
Apr. 20	Sold him goods [Invoice on May 3]	20000
June 16	Purchased goods from him [Received on July 16]	30000
Sep.23	Paid him cash	6000
Oct. 24	Accepted his bills for 3 months	10000
Nov.26	Received his acceptance for 2 months	16000

Prepare an account current of Ramesh completed up to 31-12-93 as will appear in the books of Suresh reckoning 5% interest on the balance due.

[Ans: Interest debited: Rs. 257.81; Balance of A/c. : Rs. 5742.19 (Cr.)]

[Hint: From computing number of days, the dates of invoice and goods received should be used]

24. The following are the particulars give to you, prepare account current to be sent by Arumugam to Sudhakar on 30th April 1991. Rate of inrerest is 5% p.a.

1991		Rs.
Jan.1	Balance owed by Shdhakar to Arumugam	1800
Jan.20	Sold goods to Sudhakar on credit	1200
Jan.25	Received cash from Sudhakar	1000
Feb.15	Accepted Sudhakar's draft for 2 Months	800
Feb.20	Paid cash to Sudhakar	1500
March 10	Purchased goods from Sudhakar	1700
March 26	Received cash from Sudhakar	400
April 5	Sold goods to Sudhakar	2900
April 15	Received Sudhakar's acceptance for one	600

	month	
April 20	Purchased goods from Sudhakar	900
April 25	Cash paid to Sudhakar	500

[Marthawada, B.Com., Oct. 1987] [Ans: Interest Rs. 45.23; Balance Rs. 4,145.23]

NOTES

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UNIT-III

BILL OF EXCHANGE

INTRODUCTION:

Business transactions are usually divided into two categories cash transactions and credit transactions Immediate payment takes place in case of cash transactions. But credit transactions involve payment after a certain period of time) In such cases it becomes necessary that the terms of payment be reduced to writing, so that there may be no possibility of misunderstanding between the parties and the amount may be paid punctually as promised. For Example : Mr. Raman of Chennai sells goods worth Rs. 1,000 to Mr. Kannan of Delhi to be paid for after three months. The seller would like to demand from the purchaser a document by which he may be able to enforce payment on the due date. This is done by Raman making an order upon Kannan to pay Rs. 1,000 after 3 months period. When Kannan signs the order as a token of his willingness, he becomes bound to pay the amount of Rs. 1,000 after 3 months. This order is known as a 'Bill of Exchange'.

Definition of Bill of Exchange

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

The following is a specimen of a Bill of exchange drawn in respect of goods sold by Mr. Raman of Chennai to Kannan of Delhi for a sum of Rs. 1,000 to be paid three months after the date of transaction :

Rs. 1,000 10-10-2000

Chennai

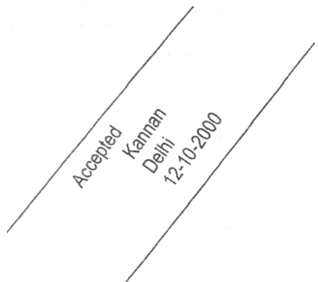
Three months after date pay to K.Kailash or order the sum of rupees one thousand only, for value received.

Revenue Stamp

To Kannan Raman

Delhi.

Mr. Raman has ordered Mr. Kannan to pay Rs. 1,000 to K. Kailash. If the order is acceptable to Mr. Kannan, he will sign across the bill as follows:



On such acceptance being written across the bill, it will really become a bill of exchange. Mr. Kannan is the acceptor; he will have to pay the amount to K. Kailashorhis order. K. Kailash is the payee and Raman is the drawer.

Features of Bill of Exchange

The Salient features of a bill of exchange are as follows :

i. It is a written document

ii. It is an unconditional order to pay

iii. It is signed by the drawer of the bill.

iv. It contains an order to pay a certain sum of money which' is generally given in both figures and words.

v. Amount is payable either on the due date of the bill or on demand.

vi. The amount is payable either to a definite person or to his order or to the bearer.

vii. It should be accepted for payment by the party on whom the order is made.

Parties to a Bill of Exchange

i. ***Draweror Maker :*** The person who writes out the bill of exchange is known as drawer. He signs his name in the right hand bottom comer of the bill.

ii. ***Drcnvee or Acceptor :*** The person upon whom the bill of exchange is drawn is called Drawee. He is the person who is ordered by the drawer to pay the amount of the bill.

iii. ***Payee :*** The person to whom the amount has to be paid is known as the payee. Sometimes the drawer requires the amount to be paid to himself in which case the drawer and the payee are the same person.

iv. ***Drawee in case of need :*** When in the bill or any instrument thereon the name of any person is given in addition to the drawee to be resorted to in case of need, such'person is called a 'drawee in case of need'.

Advantages of a Bill of Exchange

Bill of Exchange has become very popular for grant of credit in business circles due to the following advantages attached to this mode of granting credit.

i. By accepting a bill of exchange a person can purchase goods at a time when he has no cash with him. He can sell the goods and honor his acceptance on maturity.

ii. The seller gets a written acknowledgment of the debt from the purchaser, in which the date of payment is fixed. Bill of exchange thus ensures punctual payment from customers who are in the habit of delaying payments.

iii. A bill of exchange is a legal document and therefore its payment can easily be enforced in a court of law in the event of its being dishonored. Any complaint with regard to bad quality, excessive price, etc. of the goods would be meaningless at that stage.

iv. A bill of exchange is a negotiable instrument. The seller can discount it with his bank at any time he likes and thus convert it into cash at a minor loss.

v. A person can transfer his debts from his debtors to his creditors through the medium of bill of exchange. This avoids transfer and retransfer of funds from one place to another. Suppose a person in Delhi has bought goods from a merchant in Washington for 300 dollars and has, at the same time sold goods to another person in the same city for 300 dollars. He can draw a bill of exchange on his debtor in favour of his creditor for the amount due from him. Thus, his debtor will be saved the trouble and expense of sending money to India and he himself will not have to retransfer that sum to Washington, as his debtor will pay his creditor in that city.

vi. Bill of exchange contains information about the amount payable and the date of payment. As the amount and time of payment are known, planning of cash operations is facilitated.

vii. Accommodation bills enable businessmen to get funds from the market at cheap rates to meet their temporary financial requirements.

viii. Bills of exchange can be endorsed to other parties. Thus they serve almost the same purpose as cash.

ix. Recovery of debts is possible through Bills of exchange without having to remind the debtors.

Types of Bills of Exchange

From accounting point of view,

Bills of exchange are of two types (i) Trade Bills and (ii) Accommodation Bills.

i. *Trade bills:* Where a bill of exchange is drawn and accepted for a genuine trade transaction, it is called ‘Trade bill’. For example, ‘X’ sells goods worth Rs. 3,000 to ‘Y’. He draws a bill of exchange on ‘Y’ for the said amount and the same is accepted by **‘Y’.** This is a trade bill.

ii. *Accommodation Bills :* Where a bill of exchange is drawn and accepted for mutual help, It is known as 'Accommodation bill'. Actual sale and purchase of goods are absent in case of such bills. They represent a purely financial accommodation of the parties concerned. Usually Accommodation bills are discounted with banks and the proceeds are shared by the drawer and the drawee.

Promissory Notes

There is another method by which the promise made by the purchaser to pay for goods bought by him can be made definite and absolutely binding upon him. In this method, in the place of the seller drawing a bill of exchange on the purchaser, the purchaser himself makes a written promise to pay the amount to the seller. This document is called a 'promissory note', 'Pro. Note' or 'P/N'. According to section 4 of the negotiable instruments act, promissory note may be defined as "an instrument in writing (not being a bank note and a currency note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument". The specimen of a promissory note is as follows :

Rs. 3,000 8-10-2000

Chennai

Revenue Stamp

Two months after date I promise to pay Kumaran or order the sum of three thousand rupees with interest at six percent per annum, for value received.

Vel Murugan

Mr. Vel Murugan is the maker or a promisor; and Mr. Kumaran is the payee.

Thus, there are two parties to a promissory note, namely the maker and the payee. There is no acceptor. The maker is liable to pay the amount.

Features of Promissory Note

The salient features of a promissory note are as follows :

- ❖ It is a written document
- ❖ It contains an undertaking of promise to pay.
- ❖ It is signed by the maker or promisor
- ❖ Amount is payable either on demand or on the expiry of a fixed period.
- ❖ It contains a promise to pay a definite amount which is given in both Figures and words.
- ❖ The amount is payable either to a specified person or to his order. The person to whom the amount is payable is called, promisee or payee.

Distinction between Bill of exchange and promissory note

The following are the main points of difference between a bill of exchange and a promissory note :

	Basis	**Bill of exchange**	**Promissory note**
1.	No. of parties	There are three parties the drawer, the drawee and the payee.	There are two parties the promisor and the payee

2.	Drawer	The creditor is the drawer.	The debtor is the drawer.
3.	Promise and Order	It contains an order to pay.	It contains a promise to pay.
4.	Acceptance	It should be accepted by the drawee before it is binding upon him except in certain cases.	It is signed by the person liable to pay and as such, no acceptance is necessary.
5.	Liability	It's drawer is liable only when the drawee does not accept or pay the amount due.	Its maker is primarily liable.
6.	Noting & protesting	In case of dishonour, it would be better to get it noted for non payment.	In this case, noting is not necessary.
7.	Relationship	here, the drawer stands in immediate relationship with the acceptor and not to the payee.	In this case, the maker stands in an immediate relationship to the payee.
8.	Copies	in case of foregin bill, they are usually drawn in three copies	Here, only one copy is prepared whether it is foreign or local.
9.	Stamp	the bill payable on demand need not be stamped but otherwise stamps would be necessary	this has to be stamped in any case.

Accounting for Bill of Exchange

A bill of exchange has two aspects namely 'Bill Receivable' and 'Bill payable'. The same bill is treated as 'Bill Receivable' by the party entitled to receive payment and 'Bill payable' by the party liable to make payment. Generally, acceptor, of the bill makes payment on presentation of the bill on due date which is called 'Honouring of the bill'. For accounting purposes, bill of exchange and promissory notes are treated alike.

Recording Transactions relating to Bills

1. *Subsidiary Books system :* In this system which is followed by all Medium and large business firms, separate subsidiary books are opened, styled as 'Bills Receivable Book' and 'Bills Payable Book'. They are the books of original entry. In the ledger, 'Bills Receivable Account' and Bills payable Account'.
2. *Journal and Ledger system :* In this system which is adopted by small firms, sole Traders, etc. transactions relating to Bills are recorded in the Journal and then posted to Ledger along with all the usual business transactions.

A party who receives a bill of exchange **has four options :**

i. He may keep it till the date of maturity

ii. He may get it discounted with a bank and receive the amount less discount immediately;

iii. He may endorse it in favour of a creditor; or

iv. He may send the bill to Bank for collection,

(i) ***When Bill is retained by the drawer till due date :***

When goods are sold on credit basis, a bill is drawn by the seller to get written undertaking from the purchaser. The drawee (Purchaser) gives his acceptance by putting his signatures on the bill and returns the same to the drawer. On due date, drawer presents the bill for payment and drawee makes the payment. The following Journal entries are to be passed to record the above transactions :

SELF EVALUATION QUESTIONS

1. Business transaction are usually divided with ______________ categories.
2. Bill of exchange may be written document (true/false)
3. A bill of exchange may be _______________ instrument
4. Promissory note may be called as _______________

ANSWER

5. two
6. true
7. negotiable
8. promote

Illustration : (Bill sent to bank for collection and honoured at maturity)

On 1-5-99 Mohan gave his acceptance for three months bill of rs. 6,000 drawn by of Murali. Murali sent the bill to bank for collecting the amount on maturity. After maturity murali received intimation from the bank that the bank that the bill was duly honoured by mohan and bank charged Rs.20 for collection.

Show the entries in the books for murali and mohan

Date 1999	Particulars	L.F.	Dr. Rs.	Cr. Rs.
May 1	Bill Receivable A/c Dr To Mohan A/c [Being acceptance received]		6,000	 6,000
May 1	Bill for collection A/c Dr To Bills receiable A/c [Being acceptance received]		6,000	 6,000
May 4	Bank A/c Dr Bank charges Dr To bills for collection A/c. [Being collection of amount of the bill on maturity after deducting bank charges]		5,980 20	 6,000

Dishonour of Bills

Illusation

Gani sold to Mani for Rs.3,000 on credit on 1.04.1999 for this purpose, Gani drew bill on mani for Rs.3,000 for 3 months. Mani accepted the same and returned it to Gani. On maturity, the bill was dishonoured by Mani, Show the entries in the books of both the parties under each of the following circumstance:

i. If gani retained the bill till maturity.

ii. If gani discounted the bill by the bank at 18% p.a

iii. If gani endorsed the bill to his creditor anil;

iv. If gani sent the bill to the bank for collection.

Solution

In the books of gani (Drawer) journal entries

Date 1999	***Particulars***	**L.F.**	**Dr. Rs.**	**Cr. Rs.**
Apr 1	Mani A/c Dr To Sales A/c [Being goods sold on credit] [Being bill accepted by mani for three months]		3,000	 3,000
(i) Jul 4	Mani A/c. Dr To bills receivable A/c [Being acceptance of Mani dishonoured]		3,000	 3,000
(ii) Apr 1	Bank A/c Dr 3 Discount A/c 3,000 x 18% x Dr 12 To bills receivable A/c. [Being bill discounted with the banker at a discount of 18% p.a.]		2,865 135	 3,000
July 4	Mani A/c Dr To Bank A/c. To bills for collection A/c. [Being mani's acceptance discounted with the bank dishonoured on the due date]		3,000	 3,000
iii) Apr 1	Anil A/c Dr To bill receivable A/c [Being bill endorsed in favour of anil]		3,000	 3,000
July 4	Mani A/c Dr To anil A/c. [Being mani's acceptance endorsed		3,000	 3,000

	infavour of anil dishonoured]			
(iv) Apr. 1	Bills for collection A/c Dr To bills receivable A/c. [Being bill sent for collection to the bank]		3,000	3,000
July 4	Mani A/c Dr To bills for collection A/c [Being mani's acceptance sent to the bank for the collection dishonoured on the due date]		3,000	3,000
In the books of mani (Drawee) **Journal entries**				
Date 1999	**Particulars**	**L.F.**	**Dr. Rs.**	**Cr. Rs.**
Apr. 1	Purchase A/c Dr To Gani A/c [Being goods purchased on credit]		3,000	3,000
Apr. 1	Gani A/c Dr To bills payable after [Being bill accepted payable after 3 months]		3,000	3,000
I) July 4	Bills payable A/c Dr To gani A/c [Being bill dishonoured]		3,000	3,000

Note :* In case of (ii), (iii) and (iv) also the entries will be the same)

Illustration (Dishonour of Bill with noting charges)

On 1st June 1999, Murugan sells goods to Selvam for Rs.3,500 and draws three bills on him, the first for Rs.800 for One month, the second for Rs.1,200 for 2 months and the third for Rs.1,500 for 3 months. Selvam accepts and returns these bills to Murugan.

The first bills is retained by Murugan till the date of maturity. The second bill is endorsed by Murugan to his creditor Ramy on 3rd June 1999 and the third bill is sent to the bank for collection on 4th June 1999. On maturity all bills were dishonoured and noting charges paid were Rs.10, Rs. 20 and Rs.30 respectively.

You are required to pass journal entries in the books of Murugan, Selvam and Ramu.

Solution:

Date 1999	***Particulars***	**L.F.**	**Dr. Rs.**	**Cr. Rs.**
June 1	Selvam A/c Dr To Sales A/c [Being sales on credit]		3,500	 3,500
June 1	Bills receivable A/c. Dr To Selvam A/c [Being receipt of 3 bills for Rs.800, 1,200 and 1,500 respectively from Selvam]		3,500	 3,500
June 3	Ramu's A/c Dr To bills receivable A/c. [Being endorsement of 2nd bill payable after 2 months to creditor]		1,200	 1,200
June 4	Bills for collection A/c Dr To bills receivable A/c. [Being bill payable after 3 months sent for collection to the bank]		1,500	 1,500
June 4	Selvam A/c Dr To bills receivable A/c. To cash A/c. [Being retained bill dishonoured with noting charges]		810	 800 10
June 4	Selvam A/c Dr To Ramu's A/c. [Being endorsed bill dishonoured with noting charges paid by endorsee]		1,220	 1,220
Sept. 4	Selvam A/c Dr		1,530	

	To bills for collection A/c. To bank A/c. [Being bill sent to Bank for collection dishonoured with noting charges paid by Bank]			1,500 30

In the books of Selvam (Drawee)

Journal Entries

Date 1999	***Particulars***	**L.F.**	**Dr. Rs.**	**Cr. Rs.**
June 1	Purchases A/c Dr To Murugan A/c [Being credit purchase of goods]		3,500	 3,500
June 1	Murugan A/c. Dr To Bills payable A/c [Being acceptance of 3 Bills for 800, 1,200 and 1,500 respectively infavour of Murugan]		3,500	 3,500
July 4	Bills payable A/c Dr Noting charges A/c. Dr To murugan A/c. [Being one month bill dishonoured and the noting charges thereon]		800 10	 810
Aug.4	Bills payable A/c Dr Noting charges A/c. Dr To Murugan A/c. [Being 2 months bill dishonoured and the nothing charges thereon]		1,200 20	 1220
Sept.4	Bills payable A/c Dr Noting charges A/c. Dr. To murugan A/c. [Being 3 months bills dishonoured and the nothing charges thereon]		1,500 30	 1,530

In the books of Ramu (Endorsee)

Journal Entries

Date 1999	***Particulars***	**L.F.**	**Dr. Rs.**	**Cr. Rs.**
June 5	Bills receivable A/c. Dr To Murugan A/c [Being 2 months bill accepted by Selvam received from Murugan with his endorsement]		1,200	 1,200
Aug. 4	Murugan A/c Dr To bills receivable A/c. Dr To cash A/c. [Being bill endorsed by Murugan, drawn on Selvam dishonoured and cash paid thereon for noting charges]		1220	 1,200 20

Illustration (Renewal of Bill)

Kali owed to Venu Rs.12,000 on 1-1-1999. On the same date Venu drew upon Kali a bill for the amount at 2 months and Kali returned the bill duly accepted. Venu got the bill discounted at his bank at 6% p.a. Before the bill was due for payments Kali told Venu that he was not able to pay the full amount and requested Venu to accept Rs.4,500 immediately and draw upon him another bill for the remaining amount for tow months together with interest at 8% p.a. Venu agreed. The second bill was duly met. Give journal entries in the books for Venu and Kali.

In the books of Venu (Drawer)

Journal Entries

Date 1999	***Particulars***	**L.F.**	**Dr. Rs.**	**Cr. Rs.**
Jan.1	Bills receivable A/c Dr To Kali A/c [Being acceptance received from Kali]		12,000	 12,000
Jan.1	Bank A/c. Dr Discount A/c $\left(12,000 \times 6\% \times \frac{3}{12}\right)$ Dr		11,880 120	

	To bills receivable A/c. [Being discounting of the bill at 6% p.a.]			12,000
Mar.4	Kali A/c Dr To Bank A/c. [Being dishonour (renewal) of Kali's bill]		12,000	12,000
Mar.4	Cash A/c Dr To Kali A/c. [Being the amount received from Kali as per arrangement accepted]		4,500	4,500
Mar.4	Kali A/c Dr To Interest A/c $\left(7{,}500 \times 8\% \times \frac{2}{12}\right)$ [Being the interest due from Kali for 2 months]		100	100
Mar.4	Bills Receivable A/c. Dr. To Kali A/c. [Being new acceptance received from Kali for Rs.7,500 balance, plus Rs. 100 interest]		7,600	7,600
May 7	Cash A/c. Dr To bills receivable A/c. [Being the amount of the second bill received]		7,600	7,600

In the books of Kali (Drawee)

Journal Entries

Date 1999	***Particulars***	**L.F.**	**Dr. Rs.**	**Cr. Rs.**
Jan.1	Venu A/c. Dr. To bills payable A/c. [Being the acceptance of Venu's bill]		12,000	12,000

Mar.4	Bills payable A/c. Dr. To Venu A/c. [Being dishonour of B/P on the basis of Renewal agreement]		12,000	12,000
Mar.4	Venu A/c. Dr. To cash A/c. [Being the amount paid to Venu as per arrangement]		4,500	4,500
Mar.4	Interest A/c. Dr To Venu A/c. [Being the amount of interest due to Venu on Rs.7,500 for 2 months at 8%]		100	100
Mar.4	Venu A/c. Dr To bills payable A/c. [Being the new acceptance in favour of Venu as per arrangement]		7,600	7,600
Mar.7	Bills payable A/c. Dr To cash A/c. [Being the payment of bill date]		7,600	7,600

Illustration (Insolvency of drawee)

Sathish draws two bills of exchange on 1-1-1999 for Rs.6,000 and Rs.10,000 respectively. The bill of exchange for Rs.6,000 is for 2 months, while the bill for Rs.10,000 is for 3 months. These bills are accepted by Kannan to settle the amount he owed to Sathish. On 4th March, 1999, Kannan requests to renew the first bill with interest at 12% p.a. for a period of 2 months. Sathish agrees to this proposal. On 20th March 1999 Kannan retires the acceptance for Rs.10,000 interest rebate i.e., dicount being Rs.100.

Before the due date of the renewed bill, Kannan becomes insolvent and only 70 paise in a rupee was recovered from his estate. You are asked to show the journal entries in the books of Sathis and Kannan and also show Kannans' Account in Sathish's Ledger.

In the books of Sathish (Drawer)

Journal Entries

Date 1999	***Particulars***	**L.F.**	**Dr. Rs.**	**Cr. Rs.**
Jan.1	Bills receivable (No.1) A/c. Dr. Bills receivable (No.2) Dr. To Kannan A/c. [Being acceptance received from Kannan for two bills]		6,000 10,000	 16,000
March 4	Kannan A/c. Dr To bills receivable A/c. (No.1) [Being the entry passed on dishonour of acceptance since it is now renewed]		6,000	 6,000
Mar.4	Kannan A/C. Dr Discount A/C $\left(6{,}000 \text{ X } 12\% \text{X} \frac{2}{12}\right)$ Dr [Being the entry passed on dishonour of acceptance since it is now renewed]		120	 120
Mar.4	Bills Receivable (No.3) A/c. To kannan A/c. [Being the drawing of bill of exchange No.3 due for maturity on 7th May 1999 together with interest at 12% in lieu of the original acceptance of Kannan now renewed		6,120	 6,120
Mar.20	Cash A/c. Dr Rabate A/c. Dr To bills receivale A/c. (No.2) [Being the amount received on retirement of B/R No.2 before the due date]		9,900 100	 10,000

May 7	Kannan A/c. Dr To bills receivable A/c. [Being dishonour of Kannan's acceptance due to insolvency]		6,120	 6,120
May 7	Cash A/c. Dr Bad debts A/c. Dr To Kannan A/c. [Being the amount received from official assignee of Kannan at 70 paise in a rupee and balance 30% of debt. written off as bad]		4,284 1,836	 6,120

Dr	**Kannan's Account**				**Cr**
Date	Particulars	Rs.	Date	Particulars	Rs.
1-1-99	To balance b/d	16,000	1-1-99	By bills receivable (1)	6,000
4-3-99	To bills receivable (1)	6,000	1-1-99	By Bills receivable (2)	10,000
	(Dishonour on renewal)		4-3-99	By Bills receivable (3)	6,120
4-3-99	To interest	120	7-5-99	By cash (6x120x70%)	4,284
7-5-99	To bills receivable (3)	6,120	7-5-99	By bad debts (6,120x30%)	1,836
		28,240			28,240

In the books of Kannan (Drawee)

Journal Entries

Date 1999	***Particulars***	**L.F.**	**Dr. Rs.**	**Cr. Rs.**
Jan.1	Sathish A/c. Dr To bills payable A/c. (No.1) To bills payable A/c. (No.2) [Being the two bills accepted to settle Sathish's A/c.]		16,000	 6,000 10,000
Mar.4	Bills payable A/c. Dr To Sathish A/c. [Being reversal entry on dishonour of bill of exchange on its renewal]		6,000	 6,000
Mar.4	Interest A/c. Dr To Sathish A/c. [Being the interest on Rs.6000 at 12% for 2 months]		120	 120
Mar.4	Sathis A/c. Dr To bills payable A/c. [Being the new bill (No.3) accepted]		6,120	 6,120
Mar.20	Bills payable A/c. (No.2) To cash A/c. To Rebate A/c. [Being the amount paid on retirement of B/P No.2]		10,000	 9,900 100
May 7	Bills payable A/c. Dr To Sathish A/c. [being the bill dishourned due to insolvency]		6,120	 6,120
May 7	Sathish A/c. Dr To cash A/c. To deficiency A/c. [Being amount paid to Sathish at 70 paise in a rupee and balance 30% unpaid amount transferred to Deficiency A/c.]		6,120	 4,284 1,836

Accommodation Bills

Illustration (Accommodation of the drawer)

On 1st May 1999, Madhan accepted a two months for Rs.10,000 drawn on him by Mani for the latter's benefit. Mani discounted the bill on 4th May @ 12% p.a. and on the due date sent Madhan a cheque for Rs.10,000 in order to enable him to honour the bill. Madhan duly honoured his acceptance. Pass journal entries in the books of Mani and Madhan.

In the books of Mani

Journal Entries

Date **1999**	***Particulars***	**L.F.**	**Dr.** **Rs.**	**Cr.** **Rs.**
May 1	Bills receivable A/c Dr To Madhan A/c [Being acceptance for 2months given by Madhan for accomdation]		10,000	 10,000
May 4	Bank A/c. Dr Discount A/c $\left(10,000 \times 12\% \times \frac{2}{12}\right)$ Dr To bills receivable A/c. [Being bill discounted @ 12% p.a.]		9,800 200	 10,000
July 4	Madhan A/c Dr To Bank A/c. [Beingcheque sent to Madhan]		10,000	 10,000

In the books of Madhan

Journal Entries

Date **1999**	***Particulars***	**L.F.**	**Dr.** **Rs.**	**Cr.** **Rs.**
May 1	Mani's A/c Dr To Bills payable A/c [Being bill accepted payable after two months to accomodate Mani]		10,000	 10,000
July 4	Bank A/c. Dr To Mani A/c. [Being cheque received from Mani]		10,000	 10,000
July 4	Bills payable A/c Dr		10,000	

	To Bank A/c. [Being acceptance met on the date]			10,000

Illustration (Accommodation of the drawer and drawee)

For their accommodation, Pal draws a bill on Gani for Rs.8,000 for 3 months on 1-1-2001 accepts the bills and returns it to Pal, Pal discounts the bill with the bank for Rs. 7,900 and remits half the proceeds to Gani. Before maturity Pal remits the amount due to Gani and Gani honours the bill.

Show the entries in the books of Pal and Gani.

Solution:

In the books of Pal

Journal Entries

Date 1999	***Particulars***	**L.F.**	**Dr. Rs.**	**Cr. Rs.**
1-1-2001	Bills receivable A/c. Dr. To Gani A/c. [Being the bill accepted by Gani for 3 months for Mutual accommodation]		8,000	 8,000
1-1-2001	Bank A/c. Dr Discount A/c. Dr To bills receivable A/c. [Being the bill discounted]		7,900 100	 8,000
1-1-2001	Gani A/c Dr To Cash A/c. To discount A/c. [Being half of the proceeds remitted to Gani]		4,000	 3,950 50
1-1-2001	Gani A/c. Dr To cash A/c. [Being the remaining half remitted to gani on due date of honouring the accommodation bill]		4,000	 4,000

In the books of Gani

Journal Entries

Date **1999**	***Particulars***	**L.F.**	**Dr.** **Rs.**	**Cr.** **Rs.**
1-1-2001	Pal A/c. Dr. To Bills payable A/c. [Being the bill accepted payable after 3 months for mutual accommodation]		8,000	 8,000
1-1-2001	Cash A/c. Dr Discount A/c. Dr To pal A/c. [Being half of the proceeds received from Pal on the accommodation bill]		3,950 50	 4,000
4-4-2001	Cash A/c Dr To pal A/c. [Being remaining half received from Pal on due date to honour the B/P]		4,000	 4,000
4-4-2001	Bils payable A/c. Dr To cash A/c. [Being bill honoured at maturity]		8,000	 8,000

SELF EVALUATION QUESTIONS

5. When bill is presented on due date is called ________________
6. Bill of exchange may require __________________ parties
7. Promissory not may require __________ party

ANSWER

5. honouring of bill
6. three
7. two

Illustration (Accommodation Bills written on each other)

On 1-1-99, Ramya and Priya draw on each other at 2 Months for Rs.3,000 for their mutual accommodation. They discount each other's bill at 12% p.a. and on maturity, each party honours her own acceptance. Record the transactions in the Journals of Ramya and Priya.

Solution:

In the books of Ramya

Journal Entries

Date 1999	***Particulars***	**L.F.**	**Dr. Rs.**	**Cr. Rs.**
Jan 1	Bills receivable A/c Dr To Priya A/c [Being the acceptance received payable after 2 months]		3,000	 3,000
Jan 1	Priya A/c. Dr To bills payable A/c. [Being the acceptance given to Priya payable after 2 months]		3,000	 3,000
Jan 1	Bank A/c. Dr Discount A/c $\left(3{,}000 \times 12\% \times \frac{2}{12}\right)$ Dr To bills receivable A/c. [Being bill discounted @ 12% p.a.] for 2 months]		2,940 60	 3,000
March 4	Bills payable A/c Dr To Cash A/c. [Being acceptance met on the due date]		3,000	 3,000

In the books of Priya

Journal Entries

Date 1999	***Particulars***	**L.F.**	**Dr. Rs.**	**Cr. Rs.**
Jan 1	Ramya A/c Dr To Bills payable A/c [Being the acceptance given to Ramya payable after two months]		3,000	 3,000
Jan 1	Bills receivable A/c. Dr To Ramya A/c. [Being the acceptance received from Ramya payable after 2 months]		3,000	 3,000
Jan 1	Bank A/c. Dr Discount A/c Dr To bills receivable A/c. [Being bill discounted @ 12% p.a.] for 2 months]		2,940 60	 3,000
March 4	Bills payable A/c Dr To Cash A/c. [Being acceptance met on the due date]		3,000	 3,000

Illustration (Accommodation Bills drawn on each other – one party becoming insolvent)

On 1-1-99, Yasmin and Begun for their mutual accommodation drew on each other bills for Rs.5,000 each payable after three months. On 4-1-699, they discount with their bankers each other's bill @ 12% p.a. On due date, Yasmin meets her bill and Begum fails to meet her acceptance. Begum then accepts a bill of Rs.5,500(Including Rs.500 interest for renewal of bill) drawn by Yasmin on 4-3-99 payable after one month. Yasmin immediately gets the bill discounted for Rs.5,250. On 5-4-99 . Begum becomes insolvement and a final dividend of 40 paise in a rupee is received from her estate on 6-5-99. Pass journal entries in the books of Yasmin and Begum. Also show Begum's Account in Yasmin's ledger.

In the books of Yasmin

Journal Entries

Date 1999	***Particulars***	**L.F.**	**Dr. Rs.**	**Cr. Rs.**
Jan 1	Bills receivable A/c Dr To Begum A/c [Being acceptance received from Begum]		5,000	 5,000
Jan 1	Begum A/c. Dr To bills payable A/c. [Being acceptance given to Begum]		5,000	 5,000
Jan 4	Bank A/c. Dr Discount A/c $\left(5{,}000 \times 12\% \times \frac{3}{12}\right)$ Dr To bills receivable A/c. [Being bill discounted with bank]		4,850 150	 5,000
March 4	Bills payable A/c Dr To Cash A/c. [Being bill payable met on maturity		5,000	 5,000
March 4	Begum A/c Dr To bank A/c. [Being dishonour of the bill receivable accepted by Begum and discounted with Bank]		5,000	 5,000
March 4	Begum A/c Dr To Interest A/c. [Being interest receivable on renewal of bill]		500	 500
Mar.4	Bills receivable A/c. Dr To begum A/c. [Being new bill drawn on Begum]		5,500	 5,500

Mar.4	Bank A/c. Dr Discount A/c. Dr To bills receivable A/c. [Being the new bill discounted with bank]		5,250 250	 5,500
Apr.7	Begum A/c. Dr To Bank A/c. [Being the new bill disohourd on Begum's insolvency on 5-4-99]		5,500	 5,500
May 6	Cash A/c. (5,500 x 0.40) Dr Bad debts A/c. (5,500 x 0.600) Dr To begum A/c. [Being dividend of 40 paise in the rupee received, balance written off as bad debt]		2,200 3,300	 5,500

Ledger

Begum A/c.

Date	Particulars	Rs.	Date	Particulars	Rs.
1-1-99	To bills payable A/c.	5,000	1-1-99	By bills receivable A/c.	5,000
4-3-99	To bank A/c.	5,000	4-3-99	By bills receivable Ac/.	5,500
	(Dishonour of Bill)		6-5-99	By cash A/c.	2,200
4-3-99	To interest	500	6-5-99	By bad debts A/c.	3,300
7-4-99	To bank A/c. (Dishounour of bill)	5,500			
		16,000			16,000

In the books of Begum

Journal Entries

Date 1999	***Particulars***	**L.F.**	**Dr. Rs.**	**Cr. Rs.**
Jan 1	Yasmin A/c Dr To Bills payable A/c [Being acceptance given to Yasmin]		5,000	 5,000
Jan 1	Bills receivable A/c. Dr To Yasmin A/c. [Being acceptance give to Yasmin]		5,000	 5,000
Jan.4	Bank A/c. Dr. Discount A/c. Dr To bills receivable A/c [Being bill discounted with bank]		4,850 150	 5000
Mar.4	Bills payable A/c. Dr To Yasmin A/c. [Being the bill payable dishonoured]		5,000	 5,000
Mar.4	Interest A/c. Dr To Yasmin A/c. [Being interest payable on renewal of bill]		500	 500
Mar.4	Yasmin A/c. Dr To bills payable A/c. [Being new bill accepted for the amount of old bill and interest for renewal of bill]		5,500	 5,500
Apr.7	Bills payable A/c. Dr To Yasmin A/c. [Being new bill dishonoured due to insolved]		5,500	 5,500
May 6	Yasmin A/c. Dr To cash A/c. To Deficiency Dr [Being the amount paid to Yasmin 40% of the amount due]		5,500	 2,200 3,300

Illustration

Raka drew a bill on Baka for Rs.30,000 for mutual accommodation in the ratio of 2:1. Baka accepted the bill on 5-4-2001, payable on 8-8-2001. Raka discounted the bill with his Bank in Covai for Rs.29,100 and sent Baka's share immediately. Just before the due date they agreed that Baka should draw a Bill on Raka for Rs. 45,000 payable on 11-11-2001. It should be discounted by Baka on 7-8-2001 and pay of the first Bill out of the proceeds and any balance should be shared by them in their agreed ratio. The agreement was carried out, the discount on the new bill being Rs.1,500. On 10-11-2001, Raka informed Baka that he has become insolvement. Baka was forced to meet the bill from his own resources. On 1-12-2001. Baka received 50% of the amount due from Raka from his estate as final settlement.

Give Journal entries in the books of both the parties. Also show Raka's Account in Baka's Books.

Solution:

In the books of Raka

Journal Entries

Date 1999	***Particulars***	**L.F.**	**Dr. Rs.**	**Cr. Rs.**
5-4-91	Bills receivable A/c. Dr To Bank's A/c [Being bill received for Mutual Accommodation]		30,000	 30,000
5-4-91	Bank A/c. Dr Discount A/c To bills receivable A/c. [Being bill discounted for mutual Accommodation]		29,100 900	 30,000
5-4-91	Baka's A/c. Dr To cash A/c. To Discount A/c. 1 [Being ____ of the proceeds sent to Baka] 3		10,000	 9,700 300

7-8-01	Baka's A/c. Dr To bills payable A/c. [Being new Bill accepted in favour of Baka as per agreement]		45,000	 45,000
8-8-91	Cash A/c Dr Discount A/c. Dr To Baka's A/c. [Being $\frac{2}{3}$ of the proceeds of the discounted bill received, after meeting the first Bill]		9,000 1,000	 10,000
11-11-01	Bills payable A/c. Dr To Baka's A/c. [Being dishonour of Bill due for insolvency]		45,000	 45,000
1-12-2001	Bakas A/c. Dr To cash A/c. To deficiency A/c. [Being amount paid to Baka at 50% in settlement and the balance Transferred to deficiency]		30,000	 15,000 15,0000

In the books of Baka

Journal Entries

Date 1999	***Particulars***	**L.F.**	**Dr. Rs.**	**Cr. Rs.**
5-4-91	Raka's A/c Dr To bills payable A.c [Being bill accepted for Mutual accomodation]		30,000	 30,000
5-4-91	Cash A/c. Dr Discount A/c. Dr		9,700 300	

	To Raka's A/c. 1 [Being ___ of bill proceeds received] 3			10,000
7-8-01	Bills receivable A/c. Dr To Raka's A/c. [Being new bill received from Raka as per arrangement]	45,000		45,000
7-8-01	Bank A/c. Dr Discount A/c. Dr To bills receivable A/c. [Being new bill discounted]		43,500 1,500	45,000
8-8-01	Bills payable A/c. Dr To bank A/c. [Being old bill paid out of the proceeds of new bill]		30,000	30,000
8-8-01	Raka's A/c. Dr To cash A/c. [Being 2/3 proceeds of New Bill after payment proceeds of New bill after payment of Old bill sent to Raka]		10,000	9,000 1,00
11-11-01	Raka A/c Dr To bank A/c. [Being B/R dishonoured by Raka]		45,000	45,000
1-12-01	Cash A/c. Dr Bad Debts A/c. Dr To Raka's A/c. [Being cash received and Bad debt incurred on Raka's insolvency]		15,000 15,000	30,000

Raka's A/c

Date	Particulars	Rs.	Date	Particulars	Rs.
5-4-01	To bills payable	30,000	5-4-99	By cash	9,700
8-8-01	To cash	9,000		By discount	300
	To discount	1,000	7-8-01	By bills receivable	45,000
11-11-01	To bank A/c.	45,000	1-1201	By cash A/c	15,00
	(B.R.Dishonoured)			By deficienty A/c.	15,000

QUESTIONS

1. What is a 'Bill of Exchange'?
2. What are the differences between a bill of exchange and a promissory note?
3. Distinguish between a trade bill and an Accommodation bill.
4. Explain the meaning of the terms (i) 'Drawer' (ii) 'Drawee' (iii) 'Payee' and (iv)'Endorse' in the context of Bills of exchange.
5. What are the alternative courses of action possible when Drawe receives bill of exchange accepted by Drawee?
6. What do you understanding by 'Honouring' and 'Dishonouring' a Bill of exchange?
7. What is endoresement of Bill? What are the consequences when an endorsed bill is dishonoured?
8. What is renewal of a bill? What are the entries passed in the books of 'Drawer' and 'Drawee' on renewal of a bill.
9. What is retiring a bill under rebate?
10. What are the consequences of insolvency of drawee of a bill?

A) Bills Honoured on Due Dates:

11. Ram purchased goods form Narayan for Rs.2,000 on 15th December 1999. Narayan draws a bill on Ram for the same amount for 3months which was duly accepted by Ram.

    On due date Ram met the bill. Pass Journal entries in the books of both the parties.

    [Bharathiyar, B.Com., Nov.2001]

12. Sekar received on 74 May, 2001 a Bill at three months due from Raj for Rs.2000. Bill is duly paid on due date. Pass journal entries in the books of both the parties

    [Bharathiyar, B.Com., Nov.2001]

13. Amrit sells goods worth Rs.1,500 to Anand on 15th April, 1988. On the same date Anand accepts a bill for two months for the amount. Amrit discounts the bill immediately with bank @ 16% per annum. The bill is met on maturity.

    Give journal entries in the books of Amrit and also show the Bills receivable account.

    [Bharathiyar, B.B.M. Nov.1999]

    [Ans: Discount Rs.40]

14. From the following information, pass journal entries in the books of the drawer:

    a. 'A' draws a bill of exchange for Rs.10,000 and 'B' accepts the same.

    b. 'A' discounts the bill at 10% with bank.

    c. 'B' pays the amount to the bank to maturity date.

    [Bharathiyar, B.Com.,. Nov.2000]

    [Ans: Discount Rs.1000]

    Hint: In the absence of bill period, discount is 10% flat.

15. 'X' receives a bills receivable for Rs.5,000 from 'Y', 'X' endorses it to 'Z' Make journal entries in the books of 'X'.

    [Manonmaniam,, B.Com.,. April.2000]

16. On 1st January 1999, Ramesh owes Rajiv Rs.3,000 and he accepts a bill for Rs.2,900 for 2 months in full settlement of his account with Rajiv, Rajiv endorses the bill to his creditor, Arun on 3rd Jan.1999. The bill is met on the due date. Pass journal entries in the books of Ramesh.

    [Periyar, BBA May 2004; Bharathiyar, Nov.1999]

17. On 1-10-99, Sudha accepted a bill for Rs. 8,000 payable after three months, drawn by Rakha for credit sale of goods. On 2-11-199-, Sudha

makes the payment of the bill, receiving a rebate @ Rs.12% p.a. Pass journal entries in the books of Sudha and Rekha.

[Ans: Rebate : Rs. 166(For 63 days at 12% p.a.]

B) Renewal and Dishonour of Bills:

18. On 1-1-01 'A' drew a three months bill on 'B' for Rs. 10,000 and the accepted the same. On due date 'B' approached 'A' and requested him to cancel the bill and drew on him a new bill for Rs.10,500 for three months including interest. A agreed to this proposal.

    [Bharathiyar, B.Com., Nov.2001]

19. Jayaram having accepted a bill of for Rs.5,000 is unable to meet the same before the due date. He requests Ganesan the drawer to receive Rs.3200 in cash (Rs.200 being for interest) and to draw on him a new bill for Rs. 2000 for a further period of 3 months.

    Ganesan agrees to the proposal.

    Pass entreis in the books of both the parties.

    [Bharathiyar, B.Com., Nov.2001]

20. Rajeev accepted a bill for Rs.500 Unable to meet the same at the due date, he requests the drawer Rajesh to cancel the original bill and draw a new one for two months which is agreed by Rajesh, show the journal entries in the books of Rajesh if Rajeev pays Rs.125 in cash and the new bill is for Rs.400

    [Keral, B.Com.,Aug.1987]

    [Ans: Interest Rs. 25]

21. J's acceptance for Rs.350 renewed for three months. 'J' gave Rs.25 for interest. Our acceptance to 'K' Rs.400 renewed for 3 months with interest @ 5%. Pass journal entires.

    [Manonmanian, B.Com., April 2000]

    [Ans: Interest on acceptance to 'K' :Rs. 5]

22. Before the due date of the bill for Rs.300:

    a. Mohan, the acceptor, approaches us, pays Rs.100 and asks us to draw on him another bill for Rs.215, Rs.15 being interst and we agree to it.

    b. Mohan pays us Rs.15 for interest and we draw another bill for the full amount which he accepts.

    Pass necessary journal entries to record the above transations in the books fo the drawer.

    [Manonmanian, B.Com., Nov.200]

23. Journalise the following transactions:

    i. Our acceptance to M.Madhan for Rs.500 retired before due date, rebate allowed Rs.10.

    ii. Raj's acceptance for Rs.400 renewed for a further period of 3 months, interest charges at 5% per annum

    iii. Our acceptance to P.Suri for Rs.800 renewed for 3 months on the condition that Rs.200 is paid in cash immediately and the remaining balance to carry interest at 6% p.a.

    iv. Our bills payable drawn in the favour of Moorthy for Rs.500 returned unpaid due to lack of instructins to the Bank. Moorthy claims Rs.510 which we pay by cheque.

[C.A. Entrance, May 1974]

[Ans: (b) Interest : Rs. 5; (e) Interest Rs.9 (d) Interest Rs.10]

24. Amar sold goods to Babu for Rs.1000. Babu accepted a bill for Rs.1000 drawn by Amar. On the due date, babu approached Amar and requested him to cancel the original bill and the draw a new bill for Rs.1025 (including interest) which is agreed by Amar. On the due date, the second bill was honoured. Show the journal entries in the books of Amar.

[Bharathidasan, B.Com., April 1999]

25. On 1-1-99 Anand supplied goods to Ashok of the value of Rs. 9000 and settled the account by means of three bills of Rs.3000 each, due after two, three and four months reseptectively.

    A week later, Anand discounted the first bill at a discount of Rs.60. The other two bills were held till maturity. On the due date, the first two bills were met. On maturity of the thrid bill. However Ashok arranged to renew the bill by paying Rs. 1000 cash and giving Anand a fresh bill for four months to cover the balance together with 12% p.a. the necessary it for Rs.2000.

[Manonmanian, B.Com., Nov.2000]

Bharathiyar April 1999]

[Ans: Renewed Bill: Rs. 2,080 discount Rs.80]

26. Mr. 'R' accepted on 1st April, 1990 a bill for Rs.10000 drawn by Mr. 'S' at 3 months. Mr. 'S' immediately discounted the bill with his banker at 7% Mr. 'r' failed to meet the bill on the due date and an his request Mr. 'S' renewed the bill for 2 months by adding 12% interet to the amount of Mr. 'R's furnishing security. Mr. 'R' endorsed tow of his customers bills for Rs.7000 and Rs.5400 due on 20th Aug. and on the Sept. respectively, Mr. 'S' discounted all the three bills at 7% with the bankers. Ont he due date all bills were not.

Journals the above transactions in the bokks of ‘R’ and ‘S’

[Periyar B.Com., Nov.2000]

[Ans: Interest on renewed bill: Rs.200; Discount on bill give on July 4^{th} : Rs. 119, Rs.63, Rs. 70 respectively]

27. Mr. ‘K’ received from one of his customers a bill at three months for Rs. 8000 He discounted it one the same day at 10% per annum with his Bankers. Ont he date of maturity. the bill was dishourned. He incurred noting charges of Rs. 50. However, the customer paid him Rs.2000 in cash on he date of maturity and accepted a fresh bill at three months for the amouht due from him.

    Mr. ‘K’ gave the second bill to Mr. ‘R’ one of his creditors.

    Pass the necessary journal entries in the books of Mr. ‘K’.

[C.A. Inter, May 1973]

[Ans: Discount Rs. 200]

UNIT-IV

RECTIFICATION OF ERRORS

"To Err is human" is a familiar proverb. Errors or mistakes maybe committed in different stages of the accounting process. The errors have to be located and corrected at the earliest to ensure the correctness of accounts. If errors are not rectified, the profit disclosed by the profit and loss account cannot be relied upon. Similarly, the Balance sheet also becomes undependable.

Classification of errors

Numerous errors are usually committed in maintaining accounts. Appropriate classification of all the errors provides the necessary comprehension to rectify them. There are three ways in which the errors can be classified:

I. Nature of error as Basis:

Depending on the nature of error committed, errors can be classified as follows.

A. Errors of omission
B. Errors of commission
C. Errors of principle
D. Compensating errors

4. Errors of omission

This category includes omission of a transaction either in the journal or subsidiary books or in the ledger. The omission can be complete or partial.

(i) When a transaction is not at all recorded in journal for subsidiary books, it is complete omission. Similarly, when a transaction is not at all posted to the ledger, (both debit and credit) it is also complete omission.

(ii) When a part of a transaction is recorded and the remaining portion is omitted, it is partial omission. For example, cash received from a customer is entered in the cash book but not posted to the customer's account.

B. Errors of commission

'Commission' means doing something which should not have been done. His applies to all mistakes due to lack of concentration or carelessness.

The following **errors of commission are usually committed in subsidiary** Hooks.

1. Wrong entry: Entering wrong amount in a subsidiary book.
2. Entry in wrong book: Entering correct amount or wrong amount in a wrong subsidiary book.
3. Wrong casting: Subsidiary books are to be totalled periodically and posted to the ledger. The totalling of any particular subsidiary book may be wrong.

Wrong entry and entry in wrong book usually affect both the debit and dil So, mistake occurs in two different accounts. Wrong casting affects only ; account. There will not be any mistake in the personal account.

The following errors of commission are usually committed in ledger:

1. Errors of posting and 2. Errors of balancing.

Errors of posting may be:

Right amount in the right side of wrong account.

Right amount in the wrong side of correct account.

Wrong amount in the right side of correct account.

Wrong amount in the wrong side of correct account.

Wrong amount in the wrong side of wrong account.

Wrong amount in the right side of wrong account, etc.

Errors of balancing can occur in one or more accounts in the ledger while ascertaining the balance, either periodically or at the time of preparing trial balance.

C. Errors of principle

These mistakes occur due to improper application of principles of accounts. ERRORS OF PRINCIPLE may relate to different aspects.

1. Capital and revenue items: Purchase of assets maybe recorded in purchases book, treating capital expenditure like a revenue item. Similarly, sale of fixed assets may be shown in sales book. Expenditure on repairs may be debited to machinery account. Wages spent for erection of equipment may be debited to wages account.
2. Improper valuation: Valuation of investments and stocks against the recognised practices.
3. Erratic provisioning : Providing insufficient or excess provisions for depreciation, provision for doubtful debts, etc.

D. Compensating errors

Errors which neutralise each other are called compensating errors. The error

is usually in unrelated accounts but the amount will be the same. Thus, excess n in one account may be compensated by excess credit in another account.

II. Effect on Trial Balance as Basis:

If impact on Trial Balance is considered, we have two categories of errors:

l. Errors which are disclosed by trial balance: All errors of commission are usually disclosed by trial balance because the mistakes affect the agreement of trial balance. Errors of posting, casting, balancing, carrying forward etc., affect the balance of the accounts concerned. Errors of partial omission also affect the agreement of trial balance because either debit or credit is partially omitted.

2. Errors which are not disclosed by trial balance: Errors of principle result in equal debit and credit though technically the treatment is wrong. So, trial balance is not affected. Errors of complete omission ignore both debit and credit and thus have no effect on trial balance. Errors of duplication occurring when the same transaction is recorded twice. Compensating errors which balance each other etc., also do not affect the agreement of trial ' balance.

Posting to the correct side of wrong accounts, wrong amounts recorded in subsidiary books etc., also do not affect the agreement of trial balance.

III. Number of accounts affected as basis

From the point of view of rectification whether an error affects a single account or it affects two or more accounts is very important. On the basis of this criterion, errors are classified as follows:

1 Single sided errors or errors which affect one account.

2 Double sided errors or errors which affect two or more accounts.

Single sided errors include most of the errors of commission like errors of posting, casting, carry forward, balancing etc. They can be rectified by an explanatory note in the account concerned or by passing a journal entry using suspense account.

Double sided errors include errors of complete omission, errors of principle, posting to wrong account etc. Since these errors affect two or more accounts, they are usually rectified with the help of a journal entry. Only when it is not possible to pass a journal entry, 'explanatory note' can be written in the account concerned as rectification.

Rectification in different stages of accounting cycle

In book keeping, errors cannot be rectified by striking off the wrong amount or entry and introducing the right amount or entry.

'Neutralisation' and 'Restoration' are the principles used for rectification of errors. Appropriate entry is passed or suitable explanatory note is written in the account or accounts concerned to neutralise the effect of error and restore the correct position.

"Rectification of errors is done in three different stages, following different procedures. The stage in which rectification is done depends on identification or locating the error.

Stage I: Rectification before preparation of trial balance

If mistakes are located before preparing trial balance, they can be rectified with the help of explanatory notes in the affected account or by means of a journal entry. Suspense account is not at all opened.

Stage II: Rectification after preparing trial balance, but before finalising the accounts

Trial balance would not have tallied due to errors and the difference would have been placed to a 'Suspense Account'. So, wherever applicable, suspense it is used while passing entries for rectification.

Stage Ill: Rectification after preparing final accounts, generally in the subsequent accounting periods

Suspense account is used for rectification wherever applicable. However, errors affecting those accounts which appear in trading or profit and loss account must be rectified by using 'Profit and loss adjustment account' or 'Capital account". This becomes necessary because the affected accounts were previously closed by transferring them either to trading account or profit and loss account.

Basic Principle for rectification of errors

All errors, whatever may be their type or nature, result in one of the following four positions in one or more accounts.

(a) Excess Debit in one or more accounts: This must be rectified by 'crediting' the excess amount to the concerned account or accounts.

(b)]hort Debit in one or more accounts: This must be rectified by a further debit to the account or accounts involved.

(c) Excess credit in one or more accounts: This can be rectified by debiting the respective account with the excess amount involved.

(d) Short credit in one 01' more accounts: This can be rectified by a further credit to the account or accounts involved.

SUSPENSE ACCOUNT

Need for suspense account

Locating and rectifying errors in accounts is a continuing process. It takes throughout the year. However, at the end of the accounting year, trial balance is prepared as a prelude for Final accounts. If the trial balance does not tally, difference is ascertained and effort is made to locate the errors. However, preparation of final accounts cannot be delayed beyond a reasonable period. So, any unaccounted difference in trial balance is placed to a suspense account. completing the final accounts, mistakes can be located and rectified gradually.

The balance in suspense account is the net effect of all the errors which affect the trial balance. If debits are short and credits are in excess in the trial balance, the difference is placed to suspense account as a debit balance. It appears on the assets side of the balance sheet. Similarly, if credit is short and debit is in excess in the trial balance suspense account will be a credit balance and will be shown on the liabilities side of the balance sheet. Thus suspense account helps in tallying the balance sheet.

Whenever mistakes are located entries are passed debiting or crediting the suspense account. When all the errors are rectified, suspense account is automatically closed.

If rectification involves debiting and crediting two accounts with the same amount, then the rectification entry will not involve the suspense account. This is possible in double sided errors.

In all single sided errors, rectifications involve the suspense account because the, error had affected only one account.

EFFECT OF RECTIFICATION ON NET PROFIT

If errors are located immediately after finalising the accounts it is possible to correct the net profit in the light of the rectification of errors. Even otherwise, it is useful to ascertain the effect of rectification on the net profit.

The following are the guidelines for assessing the effect of rectification on the gross profit and net profits.

1. If trading account debit side items like purchases, wages and carriage are debited in a rectification entry, the gross profit decreases and net profit also reduced by the same amount. Similarly, if the above items are

credited in a rectification entry the gross profit and net profit will go up to the extent of the credit so given.

2. If trading account credit side items like sales and closing stock are debited in a rectification entry, gross profit and net profit are reduced to that extent. Similarly, if these items are credited, gross profit and net profit will go up to that extent.
3. If profit and loss account debit side items like salaries, rent, depreciation etc. are debited in a rectification entry the net profit decreases to that extent. If they are credited, net profit increases to that extent.
4. If profit and loss account credit side items like discount received, interest received are debited in a rectification entry net profit reduces to that extent. Similarly, if these items are credited net profit goes up to that extent.

Rectification of errors during a subsequent period

If errors are located during subsequent accounting years, the following aspects should be noted for the purpose of rectification.

1. As per the requirement, personal accounts and real accounts can be debited and credited in the rectification entries Similarly, suspense account can also be debited or credited as the case may be.
2. It is not possible to debit or credit accounts, which are usually closed by transferring to trading account or profit and loss account because those accounts were already closed for the year in which the error was committed. If the nominal accounts or the goods accounts are debited or credited as a part of rectification, the subsequent years accounts in which rectification is made, will be unnecessarily affected.
3. Profit and loss adjustment account or capital account of the owners can be directly debited or credited for the purpose of rectification, after assessing the impact of rectification on the profit.

The same guidelines given above for 'effect of rectification on net profit' are applicable to assess the effect of rectification on net profit

If profit decreases because of rectification of errors, the profit and loss adjustment account or capital account must be debited. Similarly, when profit increases because of rectification, the profit and loss adjustment account or capital account must be credited (refer illustrations 15 and 16).

ONE - SIDED ERRORS

1. Errors of Totalling or Casting

Illustration

Rectify the following errors:

(a) Purchases Book is over cast by Rs. 300 (for the month of March).

(b) Sales book has been under cast by Rs. 200.

(c) Purchase Returns Book has been over cast by Rs. 75.

(d) Sales Returns Book has been under cast by Rs. 50.

Solution:

Explanation:

S.No.	Nature of mistake	Effect of mistake	Rectification
(a)	Over casting of Purchases Book	Excess Debit	Credit the Purchases A/c
(b)	Under casting of Sales Book	Under Credit	Credit Sales A/c
(c)	Over easting of Purchases returns Book	Excess Credit	Debit Purchase Returns A/c
(d)	Under casting of Sales Returns of Sales Returns Book	Under Debit	Give a further debit to Sales Returns A/c

Rectification : To rectify the errors :

(a) Credit purchases A/c with Rs. 300.

(b) Credit Sales A/c with Rs. 200.

(c) Debit purchase Returns A/c with Rs. 75.

(d) Debit Sales Returns A/c with Rs. 50.

II. Errors of Carry Forward

Illustration

(i) Purchases book is carried forward Rs. 350 less.

(ii) Sales Book total is carried forward Rs. 500 more.

(iii) A total of Rs. 758 in the Purchases Book has been carried forward as Rs. 857.

(iv) The total of the Sales Book Rs. 755 on page 20 was carried forward to page 21 as Rs. 557.

(v) Purchase Returns Book was carried forward as Rs. 5,120 instead of Rs. 1,520

Solution :

Explanation :

S.No	Nature of Mistake	Effect of mistake	Rectification
(i)	Carrying forward lower amount in Purchases book	Under debit	Give further debit to Purchases A/c
(ii)	Carrying forward higher amount in Sales Book	Excess Credit	Debit Sales A/c
(iii)	Carrying forward higher amount in Purchases Book	Excess debit	Credit Purchases A/c
(iv)	Carrying forward lower amount in Purchases Book	Under credit	Give further credit to Sales A/c
(v)	Carrying forward higher amount in Purchase Returns Book	Excess Credit	Debit Purchase Returns A/c.

Rectification :

(i) Debit Purchases A/c with Rs. 350

(ii) Debit Sales A/c with Rs. 500

(iii) Credit Purchases A/c with Rs. 99

(iv) Credit Sales A/c with Rs. 198

(v) Debit Purchase Returns A/c with Rs. 3,600

HI. Errors of Posting

Illustration

Rectify the following errors :

(i) Purchases from Akila for Rs. 1,500 has been posted to the debit side of her account.

(ii) Sales to Vijay for Rs. 1,520 has been posted to his credit as Rs. 1,250.

(iii) Purchases from Chandra for Rs: 750 has been omitted to be posted to the personal A/c.

(iv) Sales to Kandan for Rs. 780 has been,posted to his account as Rs.870.

Solution :

(i) Purchases from Akila should have been posted to the credit of Akila's A/c, but it has been debited.

Hence :

Credit Akila's A/c with double the amount i.e., Rs. 3,000.

(ii) Sales to Vijay must find itself on the debit side of Vijay's account but his account is credited with Rs. 1,250.

Hence :

Debit Vijay's A/c with Rs.1,250 + Rs.1,520 i.e., Rs. 2,770.

(iii) This is an omission to post to the Personal A/c. Note that posting must be to the credit of Chandra's A/c.

Hence :

Post Rs. 750 to the credit of Chandra's A/c.

(iv) Here Kandan's A/c has been debited with a wrong amount i.e., with excess amount. To rectify this error, the excess amount must be credited to his account..

Hence :

Credit Kandan's A/c with Rs. 90.

Comprehensive Illustrations for One sided Errors

Illustration

How would you rectify the following errors in the books ofKamal & Co.?

(i) A payment of Rs. 1,500 for salaries (to Sundar) has been posted twice to Salaries Account.

(ii) The total of the Purchases Book has been under cast by Rs. 300.

(iii) The total of Bills Receivable Book Rs. 1,000 has been posted to the credit of Bills Receivable Account.

(iv) The Returns Inward Book has been under cast by Rs. 75.

(v) A sum or Rs. 400 written off as depreciation on Machinery has not been credited to the Machinery Account.

(vi) Discount allowed to Ramya Rs. 125 has not been entered into discount column of the Cash book but it has been posted to his Personal Account.

(vii) An amount of Rs. 252 for a credit sale to Harish, although correctly entered in the Sales Book, has been posted as Rs. 225.

Solution :

(i) The excess debit will be removed by a credit in the Salaries Account by the entry: "By **double posting on .... by Rs. 1,500".**

(ii) The Purchase account should receive another debit ofRs.300 since it was debited short previously.

"To under casting of purchases book for the month of...... Rs. 300"

(iii) Rs. 1,000 should have been debited to the Bills Receivable Account and not credited. To correct the mistake, the Bills Receivable Account should be debited by Rs. 2,000 by the entry:

"To Wrong posting of Bills Receivable received on .... Rs. 2,000"

(iv) Due to this error, the Returns Inward Account has been posted short by Rs. 125. The rectifying entry will be:

"To under casting of Returns Inward Book for the month of.......... Rs. 75"

(v) The omission of the credit to the Machinery Account will be rectified by the entry.

"By Omission of posting on .... Rs. 400"

(vi) Due to this error, the Discount Account has been debited short by Rs.125. The required entry is :

"To Omission of discount allowed to Ramya on .... Rs. 125"

(vii) Due to this error, Harish has been debited short by Rs. 27. The correct entry is:

"To difference in amount posted on .... Rs. 27"

Illustration

Rectify the following errors:

(i) Sales to Sridhar Rs. 152, posted to his account as Rs. 125.

(ii) Purchased goods from Manohar Rs. 550, credited as Rs. 505.

(iii) Received Bills Receivable from Seenu Rs. 1,000, posted as Rs. 100.

(iv) Purchased furniture from Raghu Rs 404 on credit debited as

Rs.440.

(v) Discount allowed Rs. 64 to Anbu credited to his account as Rs. 46

(vi) Discount received Rs.37 from Babu posted to his account as Rs.39.

(vii) Purchased furniture on cash for Rs. 2,000 was not posted.

Solution :

(i) Debit Sridhar's A/c by Rs. 27.

(ii) Credit Manohar's A/c by Rs. 45.

(iii) Credit Seenu's A/c by Rs. 900. Bills Receivable A/c is correct.

(iv) Credit furniture A/c by Rs. 36 being excess debit given to furniture A/c. Raghu's A/c is correct.

(v) Credit Anbu's A/c by Rs. 18.

(vi) Credit Babu's A/c by Rs. 2.

(vii) Debit furniture A/c by Rs. 2,000. Cash A/c is correct as there is no mistake in recording this transaction.

Double - sided Errors

Illustration 6

The following errors were found in the books of Prabhakar & Sons. Give the necessary entries to correct them:

(a) Salary of Rs, 1,000 paid to a Mohan due to him has been debited to his personal account.

(b) Rs. 1,500 paid in cash for a typewriter was charged to office expenses account.

(c) Rs. 5,000 paid for furniture purchased has been charged to purchases account.

(d) Repairs made were debited to Building Account for Rs. 250.

(e) An amount ofRs. 500 withdrawn by the proprietor for his personal use has been debited to trade expenses account.

(f) Rs. 200 received from Shanthy & Co., has been wrongly entered as from Shajahan & **Co.,**

Solution : Books of Prabhakar & Sons

Errors	Particulars	L.F.	Debit Rs.	Credit Rs.
(a)	Salaries A/c Dr. To Mohan A/c (Correction of wrong debit to Mhon's personal A/c for salaries paid)		1,000	 1,000
(b)	Typewriter A/c Dr. To office experness A/c (Correction of wrong debit to office expenses A/c for puchase of typewriter)		1,500	 1,500
(c)	Furmiture A/c Dr. To Purchase A/c (Correction of wrong debit to building Account for repairs made)		5,000	 5,000
(d)	Repairs A/c Dr. To Building A/c (Correction of wrong debit to building Account for repairs made)		250	 250
(e)	Drawings A/c Dr. To Trade expense A/c (Correction of wrong debit trade Expenses A/c for each withdrawn by the proprietor for his personal use)		500	 5000
(f)	Shajahan & Co. A/c Dr. To Shanthi & Co. A/c (Correction of wrong credit to Shajahan & Co. instead of Shanthi & Co.)		200	 200

Illustration

Give journal entries to rectify the following errors:

(i) A purchase of goods from Deva amounting to Rs. 250 has been wrongly passed through the sales book.

(ii) A credit sale of goods Rs. 300 to Raja has been wrongly passed through the purchases book.

(iii) Sold old furniture for Rs. 1,500, passed through the sales book.

(iv) Paid wages for the construction of Building debited to wages account Rs. 10,000.

(v) A cheque for Rs. 500 received from Madan was dishonoured and had been posted to the debit of sales returns account.

(vi) Paid Rs. 1,000 for the installation of Machinery debited to wages account.

(vii) On 31st Dec 1996 goods of the value ofRs. 500 were returned by S. Singh and were taken into stock on the same date, but no entry was passed in the books.

Solution :

Rectifying Journal Entries

Errors	Particulars	L.F.	Debit Rs.	Credit Rs.
(i)	Purchase A/c Dr. Sales A/c Dr. To Deva A/c (Correction or wrong entry sales book of a purchase of goods from Deva)		250 250	 500
(ii)	Raja A/c Dr. To Purchase A/c To Sales A/c (Correction of wrong entry in purchases book of a credit sale of goods to Raja)		600	 300 300
(iii)	Sales A/c Dr. To Furniture A/c (Correction of wrong credit to sales account for sale of old furniture)		1,500	 1,500
(iv)	Building A/c Dr. To Wages A/c		10,000	 10,000

	(Correction of wrong debit to wages account for wages debit to wages account for wages paid for construction of building)			
(v)	Madan A/c Dr. To Sales Returns A/c (Correction of wrong debit to sales returns account for dishonour of cheque received from Madan)		500	 500
(vi)	Machinery A/c Dr. To Wages A/c (Correction of wrong debit to wages account for wages paid for installation of machinery)		1,000	 1,000
(vii)	Sales Return A/c Dr. To. S. Singh A/c (Entry of goods returned by him and taken into stock omitted from records).		500	 500

SUSPENSE ACCOUNT

Illustration

A Trial Balance is prepared and the book keeper finds that it disagrees, there being an excess debit of Rs. 1,270. The time in hand to trace the errors being, short, he places the difference to the credit of a newly opened account called Suspense Account.

He subsequently discovers the following errors. Pass rectifying journal entries with a view to close the Suspense Account. Show also the Suspense Account.

(i) The Day Book is totalled Rs. 50 short.

(ii) Payment of trade expenses Rs. 275 entered on the payment side of the cash book is omitted to be posted.

(iii) Commission Rs. 125 paid, has been posted twice to commission account.

(iv) A sale to A. Gopal for Rs. 195 though correctly entered in the Day Book is debited to A. Gopal Account as Rs. 465.

(v) Goods bought from L, Lal for Rs. 500 though correctly entered in the invoice book is debited to L. Lal's personal account instead of being credited to him.

(vi) Discount column on the receipts side of cash book, totalling Rs. 615 has been added up to showRs. 715.

Solution :

Rectifying Journal Entries

Errors	Particulars	L.F.	Debit Rs.	Credit Rs.
(i)	Suspense A/c Dr. To Sales A/c (Rectifying under credit to sales A/c)		50	50
(ii)	Trade Expenses A/c Dr. To Suspense A/c (Rectifying omission to debit trade expenses account)		275	275
(iii)	Suspense A/c Dr. To Commission A/c (Rectifying double posting to commission A/c)		125	125
(iv)	Suspense A/c Dr. To A. Gopal A/c (Rectifying excess debit to Gopal's A/c)		270	270
(v)	Suspense A/c Dr. To L. Lal A/c (Rectifying wrong debit, instead of credit of Rs. 500 to L. Lal's A/c)		1,000	1,000
(vi)	Suspense A/c Dr. To Discount A/c (Rectifying over debit given to discount account through error in totalling).		100	100

Suspense Account

	Rs.		Rs.
To A Gopal	270	By Balance b/d	1,270
To Sales A/c	50	By Trade expenses A/c	275
To L. Lal A/c	1,000		
To Commission A/c	125		
To Discount A/c	100		
	1,545		**1,545**

Illustration

Correct the following errors found in the books of Mr. Dhandapani. The Trial Balance was out by Rs. 986, excess credit. The difference has been posted to a suspense account.

(i) A Sale of Rs. 400 to Bobby & Co., was wrongly credited to their account.

(ii) A purchase of Rs. 134 had been posted to the creditor's account as Rs. 120.

(iii) The total of returns inward book for December had been cast Rs. 200 short.

(iv) A cheque for Rs 400 received from Sandhya had been dishonoured and was posted to the debit of "Allowance Account".

Solution :

In the Books of Dhandapani

Rectifying Journal Entries

Errors	**Particulars**	**L.F.**	**Debit Rs.**	**Credit Rs.**
(i)	Bobby & Co A/c Dr. To Suspense A/c (Being the correction of the mistake by which the account of Bobby & Co. was credit by Rs. 400 instead of being debited).		800	 800
(ii)	Suspense A/c Dr. To Creditor's A/c(Personal A/c) (Being the mistake in creding the creditor's account less by Rs. 14 now corrected)		14	 14
(iii)	Return Inward A/c Dr. To Suspense A/c (Being the mistake of totalling the return Inward Book corrected)		200	 200
(iv)	Sandhya A/c To Allowances A/c (Being the cheque of Sandhya dishonoured previously debited to Allowances A/c)		400	 400

Suspense Account

1996	To Difference in Trial	Rs.	1996		Rs.
Dec. 31	Balance	986	Dec. 31	By Bobby & Co. A/c	800
	To Creditors A/c	14		By Returns Inward A/c	200
		1,000			**1,000**

SELF EVALUATION QUESTIONS

1. Omission of a transaction either is the journal or ledger are called ____________
2. Commission which should and have been done _________
3. Improper application of principles of accounts ____________

ANSWER

1. error of omission
2. error of commission
3. error of principle

Illustration

A book-keeper failed to balance his trial balance, the credit side exceeding debit side by Rs. 1,750. This amount was entered in a suspense account. Later the following errors were discovered:

(i) Goods worth Rs. 6,200 sold to Rahim were correctly entered in the Sales Book, but posted to Rahun's account as Rs. 2,600.

(ii) A credit balance of Rs.7,550 of Rent Receivable account was shown as Rs. 5,700.

(iii) The total of Returns outward book amounting to Rs.2,000 was not posted to ledger.

(iv) Goods worth Rs. 1,000 purchased from Prema were wrongly entered in the sales book. The account of Prema was correctly credited.

(v) The Sales book was under cast by Rs. 1,000.

(vi) The total of the credit side of Dravid's account was over cast by Rs. 1,000.

Give the journal entries to rectify the above errors and prepare the suspense account.

Solution :

Rectifying Journal Entries

Errors	**Particulars**	**L.F.**	**Debit Rs.**	**Credit Rs.**
(i)	Rahim A/c Dr. To Suspense A/c (Being goods sold for Rs. 6,200 were correctly entered in sales book,		3,600	 3,600

	but wrongly posted to Rahim's account as Rs. 2,600, now corrected)			
(ii)	Suspense A/c Dr. To Rent Receivable A/c (Being the total of returns outward book was not shown as Rs. 5,700 now corrected)		1,850	 1,850
(iii)	Suspense A/c Dr. To Returns outward A/c (Being the total of returns outward book was not posted to ledger, now rectified)		2,000	 2,000
(iv)	Purchase A/c Dr. To Suspense A/c (Being correction of wrong entry in sales book of a purchase of goods from Prema. The account of Prema was correctly credited)		1,000 1,000	2,000
(v)	Suspense A/c To Sales A/c (Being the sales book which was under cast, now corrected).		1,000	 1,000
(vI)	Dravid A/c To Suspense A/c (Being the credit side of Dravid's A/c which was over cast, now corrected).		1,000	 1,000

Suspense Account

	Rs.		Rs.
To Difference in Trial Balance	1,750	By Rahim A/c	3,600
To Rent Receivable A/c	1,850	By Purchase A/c	1,000
To Returns Outward A/c	2,000	By Sales A/c	1,000
To Sales A/c	1,000	By Dravid A/c	1,000
	6,600		**6,600**

Preparation of Suspense A/c and ascertaining the effect on profit

Illustration

Rectify the following errors. Calculate the difference in the Trial Balance Prepare Suspense account and find out the effect of these errors on net profit.

(i) An item of Rs. 300 relating to prepaid rent account was omitted to be brought forward.

(ii) Purchased goods from Marayan Rs. 600. passed through sales book.

(iii) Received a Bill of exchange from Anand for Rs. 1,000 and passed it through sales book.

(iv) Rs. 1,000 paid to Mala against our acceptance was debited to Malar account.

(v) Bill received from Jolly for repairs done to T.V. Rs. 300 and T.V. supplied for Rs. 1,900 was entered in the purchases book as Rs. 2,000.

(vi) Received final dividend of Rs. 400 from Ajay whose account had already been written off as bad debt. was credited to his newly opened account and was included in the list of creditors.

(Punjab, B.Com., 1970 Adapted)

Solution :

Rectifying Journal Entries

Errors	**Particulars**	**L.F.**	**Debit Rs.**	**Credit Rs.**
(i)	Prepaid Rent A/c Dr. To Suspense A/c (Being the balance of prepaid rent A/c omitted to be brought forward, now corrected)		300	300
(ii)	Purchase A/c Dr. To Narayan A/c (Being purchase of goods wrongly entered in sales book, now corrected).		600 600	1,200
(iii)	Bills Receivable A/c Dr. To Anand A/c Dr. (Being bill received from Anand, wrongly entered in the sales book, now corrected)		1,000 1,000	2,000
(iv)	Bills Payable A/c Dr. To Malar's A/c (Being payment made for acceptance wrongly debited to Malar A/c, now rectified)		1,000	1,000
(v)	T.V. A/c Dr. Repairs A/c To Purchases A/c To Suspense A/c (Being the bill of the puchase of T.V. and repairs wrongly entered in the invoice book, now corrected)		1,900 300	2,000 200
(vi)	Creditors A/c		400	

	Dr. To Bad debts recovered A/c (Being the amount of bad debts recovered, wrongly credited to Ajay, now corrected).			400

Suspense Account

	Rs.		Rs.
To Difference in Trial Balance	500	By Prepaid Rent A/c	300
		By Sundries A/c	200
	500		**500**

Effect of errors on the profit

Memorandum Profit & Loss Account

	Rs.		Rs.
To Purchase A/c	600	By Bad debts recovered A/c	400
To Sales A/c	600	By Purchases A/c	2,000
To Sales A/c	1,000	By Net loss	400
To Prepaid rent A/c	300		
To Repairs	300		
	2,800		**2,800**

Due to the above errors, the profit of last year must have been increased by Rs. 400.

Illustration

An accountant could not tally the Trial balance. The difference was temporarily placed to suspense account for preparing the final accounts. The following errors were later discovered.

(i) Commission of Rs. 50 paid, was posted twice once to discount account and once to commission account.

(ii) The sales book was under cast by Rs. 100.

(iii) A sale of Rs. 278 to Raja though correctly entered in Sales book, was posted wrongly to his account as Rs. 386.

(iv) A Purchases from Nataraj of Rs. 184, though coorectly entered in purchases book, was wrongly debited to his personal account.

(v) Discount column of the receipt side of the cash book was wrongly added as Rs. 280 instead of Rs. 240.

(vi) Entertainment expenses Rs. 190, though entered in the cash book, were omitted to be posted in the ledger.

You are required to :

(i) Pass the necessary rectifying entries

(ii) Prepare Suspense Account and

(iii) State the effect of the rectification on the profit. What would be the correct profit if the profit originally arrived at was Rs. 20,000?.

(I.I.B. Part 1 Oct. 1976 Adapted)

Solution :

Rectifying Journal Entries

Errors	**Particulars**	**L.F.**	**Debit Rs.**	**Credit Rs.**
(i)	Suspense A/c Dr. To Discount A/c (Being amount wrongly debited to discount account, now rectified)		50	 50
(ii)	Suspense A/c Dr. To Sales A/c (Being Sales book under cast by Rs. 100 now rectified) .		100	 100
(iii)	Suspense A/c Dr. To Raja A/c (Being wrong posting of sale of Rs. 278 to Raja as Rs. 386, now recetified)		108	 108
(iv)	Suspense A/c To Nataraj A/c Dr. (Being purchase of Rs. 184 from Nataraj wrongly debited to his personal account, now rectified)		368	 368
(v)	Discount A/c Dr. To suspense A/c (Being amount of excess credit in discount account, now rectified)		40	 40
(vi)	Entertainment expenses A/c Dr. To Suspense A/c		190	 190

	(Being rectification of amount not debited to entertainment account in ledger)			

Suspense Account

To Discount A/c	Rs. 50	By Balance b/d (Bal.fig)	Rs. 396
To Sales A/c	100	By Discount A/c	396
To Raja A/c	108	By Entertainment expenses A/c	190
	626		**626**

The profit and loss account will be affected as follows.

(i) Discount is decreased by Rs. 50. This will increase the profit

(ii) Sales is increased by Rs. 100. This will increase the net profit.

(iii) No effect on profit.

(iv) No effect on profit

(v) Discount is increase by s. 40. This will decrease the profit.

(vi) Entertainment expense are increased by Rs. 190. This will decrease the profit.

Effect of Errors on Profit

	Balance of Profit		**Rs.** **20,000**
Add : (i)		50	
(ii)		100	150
			20,150
Less : (v)		40	
		190	230
		Correct Profit	**19,920**

Illustration

pass rectifying entries for the following and point their effect on profit or loss:

(i) An amount of Rs. 600 withdrawn by the proprietor for his personal use, is posted to travelling expenses account.

(ii) A customer's cheque of Rs. 300 received through Sankaran was credited to Sankaran's Account.

(iii) Rs. 900 spent in the extension of plant & machinery are posted to wages account.

(iv) Rs. 1,120 were spent in the repair of a machine but this amount is posted in machinery account.

(v) Goods of Rs. 400 were returned by Mohinder, these goods were included in stock but no record for it was made in the books of account.

(vi) Gowri Shankar's cheque of Rs. 500 was dishonoured, its amount was posted to allowance account.

(vii) Rs. 6,000 spent in extension of factory building were charged to Repairs Account.

SELF EVALUATION QUESTIONS

4. Suspense account is used for rectification (true /false)
5. ___________and _________________ due the principles used for rectification us of error
6. Single sided errors or errors which affect one account (True /false)

ANSWER

4. True
5. neutralization or restoration
6. True

QUESTIONS

1. Explain different types of errors with appropriate examples.
2. 'Some errors affect the agreement of the trial balance and some others do not Explain.
3. Write short notes on :

(a) Error of principle

(b) Compensating error

(c) Error of casting and posting.

4. What is suspense account? Why is it opened?

5. How do you ascertain the effect of rectification of errors on net profit?

Rectification of errors without suspense A/c

6. Rectification the following errors which are discovered in the books of Srinivasagalu & Co.

(a) The return outward book is over cast by Rs. 150.

(b) Received Rs. 200 from Shyam debited to his account.

(c) The puechase book was under cast by Rs. 1,000.

(d) A payment of Rs. 500 for salaries to Raju has been posting was done to Madan's A/c

(e) Rs. 150 received from Madan was entered on the debit side of the cash book. No posting was done to Madan's A/c.

7. The following errors affecting the accounts for the year 1995 were detected in the books of Balu & Co., Madras.

(f) Rent of proprietor's residence Rs. 1,000 was debited to Rent A/c

(g) Sale of old fumiture for 2,000 treated as sale of goods.

(h) Cash received from Ganesh Rs. 300 was credited to Gajapathy.

Pass rectifying journal entries. State the nature of each of theses mistakes.

8. The following errors were detected in the accounts of Siva & Sons for the year ended 30th June 1992.

(i) A builder's bill for Rs. 2,700 for erection of a small shed was debited to repairs account.

(j) A cheque for Rs. 300 received from Ram was dishonoured and debited to allowances account.

(k) Goods to the value of Rs. 150 returned by Chandran were included in stock but to entry was made in the books.

(l) Repairs to plant amounting to Rs. 567 had been chargd to plan & Machinery account.

(m) Wages paid to firm's own worker to make certain additions to machinery amounting to Rs. 550 were were posted to wages account.

(n) A sum of Rs. 100 drawn by the proprietor was debited to travelling expenses account.

Pass necessary journal entries to rectify theses errors.

[Mqadras, B,Com., March 1993]

9. Rectify the following errors without using a suspense account.

(o) Purchase of fumiture Rs. 2,500 passed through purchase dy book.

(p) Goods worth Rs. 1,000 used by the proprietor not recorded in the books.

(q) Credit sales to Ramu Rs. 1,500 wrongly credited to his account.

(r) payment to Gopal Rs. 450 posted to his account as Rs. 540.

[Madras, B.Sc, Oct 1996]

10. Rectify the following errors.

(s) Rs. 2,000 paid on account of salary to the cashier Ganesh, stands debited to his personal account.

(t) An amount of Rs. 500 withdrawn by the proprietor for his personal use has been debited to trade expenses A/c.

(u) Rs. 700 received from M. Ravi has been crdited to S. Ravi.

(v) A purchases of goods from Kali amounting to Rs. 600 has been wrongly entered through the sales book.

(w) A credit sale of Rs. 2,000 to Jankiram has been wrongly passed through the purchases book.

11. Pass Journal entries to rectify the following errors.

a. Wages paid for the construction of a room, debited to wages account Rs. 890.

b. Purchased goods for the personal use of the proprietor Rs. 300 debited to purchases account.

c. Material of the value of Rs. 800 was used in the manufacturing of some parts of machinery in the factory itself. No record was made.

d. Paid repairing charges on the purchase of an old machinery Rs. 250, debited to general expenses account.

e. Paid rent to landlord Rs. 2,400 debited to Landlord's account as Rs. 2,004.

f. Sold old furmiture for Rs. 150, passed through sales book.

[Madras, B.Com, March 1997]

12. Rectify the following errors.

a. Repairs made were debited to building account Rs. 1,000.

b. Sugumar returned goods worth Rs. 2,000. No entry was passed in the books to this effect.

c. Rs. 3,000 paid to kavitha as salary for the month of December was debited to her effect.

d. Rs. 5,200 paid for the purchase of a typewriter was charged to office expenses account.

e. A cheque for Rs. 600 received from S. Lal having been dishonoured was wrongly debited to K.Lal's A/c.

13. Rectify the following errors without using a suspense account.

    a. Purchases of Rs. 500 from Gopal wrongly entered in the book.

    b. Goods taken by the proprietor Rs. 1,000 debited to his personal account.

    c. Salaries paid to Ramesh Rs. 1,500 debited to his personal account.

    d. Discount Rs. 50 allowed to Sundar had been credited to discount account.

    e. Crdit sales to Ramu Rs. 1,500 wrongly posted to the credit of his account.

[Madras, B.Com., May 1995]

14. Correct the following errors without using suspense account.

    a. Sales returns following errors without using suspense account.

    b. Sales book over cast by Rs. 500

    c. The total of discount column on the debit side of the cash book Rs. 75 not posted into discount A/c.

    d. Repairs to Machinery Rs. 630 debited to Machinary A/c.

    e. Purchases from Parthiram Rs. 1,500 passed through sales book.

[Madras, B.Com., March 1993]

15. The under mentioned errors were made by the counting house staff of a firm during the year ended 30th June 1990.

    a. On 15th May 1990, a clerk of the firm was paid Rs. 6000 for his arrears of salary and discharged. This amount was debited to his personal account.

    b. On 15th June 1990, goods of the value of Rs. 3,500 were returned by a customer and were taken onto stock, but the returns were not entered in the books.

    c. On 10th April 1990, goods of the value of Rs. 750 were puchased for cash but the amount was entered in the discount column of the cash book.

d. On 18th February 1990, a contractor's bill for the extension of a godown amounting to Rs. 2,500 was debited in the journal to repairs account and posted to that account.

   By means of what entries would you rectify the above errors?

16. Rectify the following errors.

   a. The returns outward book was under cast by Rs. 55.

   b. A purchase from Rajan for Rs. 555 was entered in the invoice book as Rs. 55.55.

   c. Interest received from Gopalan Rs. 25 for loan given to him is credited to Goplan's account instead on loan A/c.

   d. A sale of lod furniture amounting to Rs. 7

   e. 5 had been crdited to sales A/c.

[Madras, B.Com., Sept 1997]

17. Correct the following errors.

   a. A welding machine purchased for Rs. 5,600 from the Oxygen Co., Ltd., has been entered in the purchase day book.

   b. The total for the returns outwards book is Rs. 100 short.

   c. A sale of Rs. 175 of M/s Gupta & Mukkerjee has been entered in the sales book as Rs. 157.

   d. A purchase of Rs. 215 from M/s Guha & Roy has been posted to the debit of their account.

   e. Licence fee for Proprietor's gun, Rs. 30 has been debited to General expenses A/c.

   f. A sale of Rs. for old furniture has been passed through the sales book.

   g. Rs. 375 paid for wages to workmen for making show cases had been charged to wages A/c.

   h. A sale of Rs. 200 to Singhi & Co., was credited to their account.

[Madras, B.Com., Sept 1996]

18. Pass journal entries to rectify the following errors.

   a. A cheque of Rs. 750 received for loss of stock by fire had been deposited in the proprietor's private bank A/c.

   b. An item of purchase of Rs. 151 was entered in the purchases books as Rs. 15 and posted to the supplier's account as Rs. 51.

   c. A sales return of Rs. 500 was not entered in the financial accounts though it was duly taken in the stock book.

d. An amount of Rs. 300 was received in full settlement from a customer after he was allowed a discount column and discount allowed was entered in the amount column.

e. Bills receivable from Mr. A. of. Rs. 1,000 was posted to the credit of bills payable account and also credited to the account of Mr. A.

[Madras, B.Sc, May 1995]

19. Not all of the following journal entries are correct. Give correct entries, wherever necessary.

		Rs.	**Rs.**
(i)	Discount A/c Dr.	250	
	To M/s. Ram & Co. (Discount allowed to M/s. Ram & Co. on their setting the account).		250
(ii)	Purchases A/c Dr.	1,000	
	To M/s. krishana & Co.		1,000
	(Being the purchase of office furniture from M/s. Krishna & Co).		
(iii)	S. Weifa & Co. A/c Dr.	2,500	
	To purchases A/c		2,500
	(Being the purchases of goods from S.Weifa & Co on credit).		
(iv)	G.Bobby A/c Dr.	1,400	
	To Bank A/c		1,400
	(Being the payment to G.Bobby her salary for the month).		
(v)	Prem & Co. A/c Dr.	1,650	
	To Furniture A/c		1,650
	(Sale of old furniture on credit to M/s. Prem & Co).		
(vi)	Cash A/c Dr.	1,320	
	To Sales A/c		1,320
	(Being the cash sales for the day as per cash memo from .... to ..).		

20. Rectify the following errors.

   a. An amount of Rs. 1,500 paid to Chards for repairs was entered in his personal account.

   b. An amount of Rs. 4,500 received from Mani was was credited to Manivannan's

   c. Salaries amounting to Rs. 1,900 were omitted to be posted to salaries account.

   d. Dues to Robert Rs. 5,000 were settled by paying Rs. 4,900 and the entry had been made as

		Rs.	Rs.
Robert A/c	Dr.		4,900
To Cash A/c			4,900

21. Rectify the following errors.

   a. An amount of Rs. 200 withdrawn by the proprietor for his personal use has been debited to Trade expense Account.

   b. A purchase of goods from Mathi of Rs. 300 has been wrongly entered in the sales book.

   c. Rs. 50 received from Boopathi has been credited to Pathi's account.

   d. Rs. 1500 paid salary to cashier stands debited to his personal A/c

   e. Extension of building amounting to Rs. 10,000 has been debited to Repairs account.

   f. An account of Rs. 100 received as interest was credited to commission account.

   g. Sales book total of Rs. 878 was wrongly totalled as Rs. 788.

   h. Typewriter purchased for as. Rs. 1500 was wrongly debited to purchase A/c.

(Madras, B.Com., Sept 1997]

22. How will you rectify the following errors?

   a. Sale of goods to the value of Rs. 600 to Raja has been debited to Raghvan.

   b. A Purchase of goods from Gnanvel amounting to Rs. 2500 has been wrongly entered in the sales book.

   c. A purchase of goods from Arun amounting to Rs. 1500 has been debited to his account.

   d. A payment of Rs. 600 in respect of salary paid to the manager has been debited to his personal account.

e. The total of the discount column, on the debit side of the cash book has been added short by Rs. 40.

[Madras, B.Com, March 1994]

23. Pass journal entries necessary to rectify the following errors ;

a. A cheque of Rs. 750 received for loss if stock by fire had been deposited in the proprietor's personal account.

b. An item of purchase of Rs. 151 was entered in the purchase book as Rs. 15 and posted to the supplier's account as Rs. 51.

c. A sales rturn of Rs. 500 was not entered in the books though it was duly included in the stock.

{Madras, B.Com, March 1988]

24. Pass journal entries necessary to rectify the following errors.

a. An amount of Rs. 15,000 withdrawn by the proprietor for his personal use has been debited to trade expense A/c.

b. A purchases of goods from Sohalal amounting to Rs. 8,650 has been wrongly entered through the sales book.

c. A credit sale of Rs. 950 to Jayaraj has been wrongly passed through the purchases book.

Rectification of erros with suspense A/c

25. Pass journal entries to rectify the following errors. Assume that there exists a suspense account.

a. The total of sales book was under cast by Rs. 2,000

b. The purchase of Machinery Rs. 3,000 was entered in the purchases book

c. A sale of Rs. 45 to Selvendran was posted in his account as Rs. 54.

d. The total of purchase return was over cast by Rs. 200.

e. The total of sales book Rs. 1;122 was wrongly posted in the ledger as Rs. 1,222.

(Madras, B.Com, May 1997)

[Ans : Opening Balance of Suspense A/c : Rs. 1,709 (Cr.)]

UNIT-V

BANK ACCOUNTS

INTRODUCTION

"Bank" is a comprehensive term for a number of institutions carrying on certain kinds of financial business. In a narrow sense, it may be defined as the place for keeping money and valuables safely, the money being paid out on the customer's order, i.e., cheques. The Banking Regulation Act 1949 defines banking as "accepting", for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise". Therefore any company which engages itself in the manufacture of goods or carries on any trade and accepts deposits of money from the public for financing its business activities will not be treated as doing business of banking. Till 1949, there was no special legislation to regulate banking companies but since that year the Banking Regulation Act applies to corporate entities carrying on the business of banking in India. Such Companies are also subject to the Companies Act 1956. All the nationalised banks are also governed by the Banking Regulation Act but regulations regarding appointment of directors and disposal of profits etc., do not apply to them.

Business of Banking Companies

A bank deals in money. It buys and sells money in the same way as a trader buys goods for resale at a profit. It buys money from depositors and sells it to borrowers. Section 6 of the Banking Regulation Act contains a detailed list of the forms of business a banking company may carry on, in addition to its banking business. These forms of business are:

(i) Borrowing, raising or taking up of money;

(ii) Lending or advancing money;

(iii) Drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundis, promissory notes and other instruments;

(iv) Granting and issuing of letters of credit, traveller's cheques and circular notes;

(v) Buying, selling and dealing in bullion,

(vi) Buying and selling, on commission, underwriting and dealing in stock, shares, debentures, bonds, etc.

(vii) Receiving of all kinds of scrips or valuables on deposit or for safe custody;

(viii) Providing of safe deposit vaults;

(ix) Collecting and transmitting of money and securities;

(x) Carrying on and transacting every kind of guarantee and indemnity business;

(xi) Undertaking and executing trusts;

(xii) Undertaking the administration of estates as executor, trustee or otherwise;

(xiii) Contracting for public and private loans and negotiating and issuing the same;

(xiv) The acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purpose of the company;

(xv) Selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into accounts or otherwise dealing with all or any part of the property and rights of the company;

(xvi) Acquiring and undertaking the whole or any part of the business of any person or company when such business is of a nature enumerated or described in this sub-section.

(xvii) Doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company;

(xviii) Any other form of business which the Central Government may, by notification in the 'Official Gazette", specify as a form of business in which it is for a banking company to engage.

In this chapter, we are mainly concerned with the technique of preparing the final accounts of the banking companies;

Legal Requirements

The important provisions relating to final accounts of a banking company are follows:

(1) Prescribed form: As per Section 29 to 33 of the Banking Regulation Act,: every banking company is required to prepare a balance sheet in accordance with form A set out in the Third Schedule and a Profit and Loss Account in conformity with form 15 of the same schedule. The formats have been revised w.e.f. 1st April 1991. In other words, the final accounts for the year ending 31st March 1992 and onwards are to be prepared in the new formats.

(2) Accounting Year: On account of the amended provision of the Income Tax Act 1961 requiring every company to close its accounts on 31st March each year, w.e.f financial year ending 31st March 1989, now a banking company also closes its accounts on 31st March each year.

(3) Prohibition of Trading: According to Sec. 8, a banking company cannot directly or indirectly deal in the business of buying or selling or bartering of goods, except in connection with the realisation of security given to or held by it or engage in any trade or buy, sell or barter goods for others otherwise than in connection with bills of exchange received for collection or negotiation or for the administration of estates as executor, trustee or otherwise.

(4) Non - banking, assets: A banking company may have to take possession of sets charged in its favour on account of the failure of a debtor to repay the loan in time. According to Sec. 9, a banking company cannot hold any immovable property however acquired, except for its own use, for any period exceeding seven years from the date of acquisition thereof. Gain or loss on sale of such an asset has to be shown separately in the Profit & Loss Account of the banking company.

(5) Share capital: In order to ensure that no banking company commences or carries on business with a weak and vulnerable capital structure, Section 11 lays down the following minimum limits of paid up capital and reserves to be complied with by a banking company which wishes to commence or carry on business in a the case of a banking company incorporated outside India:

		Types of Banking	**Aggregate value of paid up capital and reserves**
1		In the case of banking company incorporated outside India:	
	a	If it has a place or places of business in the city of Bombay or Calcutta or both	20lakhs
	b	If it has places of business elsewhere	15lakhs
2		In the case of a banking company incorporated in India:	
	a	If it has places of business in more than one State and if it has a place or places of business in Bombay or Calcutta or both.	10lakhs
	b	If it has place of business in more than one state but not in Bombay or Calcutta.	5lakhs

	c	If it has all its places of business in one State none of which is situated in the city of Bombay or Calcutta - for the principal place of business plus	10lakhs
		i) in respect of each of its other places of business situated in the same district plus	10,000
		ii) in respect of each place of business situated elsewhere in the state otherwise than in the same district Subject to an overall limit of 5 lakhs	25,000
	d	If it has one place of business and that also not in Bombay or Calcutta	50,000
	e	If it has all its places of business in one State or more which is or are situated in the city of Bombay or Calcutta plus	5lakhs
		in respect of each place of business situated outside the city of Bombay or Calcutta as the case may be	25,000
		Subject to an overall limit of	10lakhs

The above requirements apply to those banks which were established before 1962. The Banking Companies (Amendment) Act 1962 raised the minimum amount of the value of the paid up capital to Rs.5 lakhs for any Indian bank commencing business after the commencement of that Act.

(6) Reserve Fund: Every banking company incorporated in India is required under section 17(1) of the Act to create a Reserve Fund and to transfer to such fund, before any dividend is declared, a sum equal to not less than 20% of the profit, as disclosed in the Profit and Loss Account. Such reserve is termed as “Statutory reserve". This Section does not apply to banking companies incorporated outside India. The Central Government may, on the recommendation of the reserve Bank, exempt a banking company from this restriction if the aggregate amount of reserves and share premium amount is not less than the paid up capital of the banking company.

(7) Payment of Dividend: Section 15 prohibits payment of dividend by any banking company until all of its capitalised expenses have been completely written off. These capitalised expenses include preliminary expenses,

organisation expenses, share-selling commission, brokerage, amounts of losses incurred and any other expenditure which is not represented by tangible assets. Payment of dividend out of the profits is considered inappropriate when capitalised expenses are outstanding.

A Banking company may, however, pay dividends on its shares without writing of the following:

i) Depreciation in the value of its investments in approved securities where such depreciation has not actually been capitalised or otherwise accounted for as loss.

ii) Depreciation in the value of its investments in shares, debentures or bonds (other than approved securities) in any case where adequate provision for such depreciation has been made to the satisfaction of the auditors of the banking company.

iii) Bad debts, if any, where adequate provision has been made to the satisfaction of the auditors of the banking company (Section 15).

(8) Payment of commission, Brokerage, etc;. According to Sec. 13, a banking company cannot pay out directly or indirectly any commission, brokerage, discount or remuneration in any form in respect of any shares issued by it, exceeding 2½ % of the paid up value of the shares.

(9) Shares on Uncalled Capital: Under Sec. 14, a banking company cannot creat any charge on unpaid capital and any such charge is invalid

(10) Under Sec. 14A, banking company cannot create a floating charge on the undertaking or any property of the bank except with the written permission of the Reserve Bank of India certifying that the charge will not be detrimental to the interest of the depositors.

(10) Subsidiary companies: In order to prevent the banking company from carrying on trading activities indirectly by acquiring controlling interest, it has been provided that a banking company can form a subsidiary company only for one or more of the following purposes:

(i) The undertaking and executing of trust;

(ii) The undertaking of the administration of estates as executor, trustee or otherwise;

(iii) The carrying on business of banking exclusively outside India, with the prior permission of the Reserve Bank.

(iv) Such other purposes as are incidental to banking business (Section 19)

(11) Cash Reserves: Under Sec. 18 every banking company (not being a, Scheduled bank) shall maintain a cash reserve with itself or with the Reservel Bank or the State Bank of India or any other bank notified by the Central' Government in this behalf a sum equal to at least 3% of its time and demand liabilities in India.

Under Sec. 42, a Scheduled bank is also required to maintain with the Reserve Bank, an average daily balance of 3% of its total time and demand liabilities in India. The Reserve Bank has the power to increase this percentage upto 20% by a notification in the official gazette (At present CRR is 10%w.e./January 16,1997).

(12) Statutory Liquidity Ratio: According to Sec. 24 (2A) of the Banking Regulation Act, every banking company in India whether scheduled or non-scheduled, is required to maintain in India in cash, gold, or unencumbered approved securities an amount which is not less than 25% of the total of its demand and time liabilities in India. This is known as "Statutory Liquidity Ratio". The Reserve Bank has the power to increase this ratio upto 40%. It now stands at 33.75% w.e.f Sep. 17,1994(;.e., reduced from 34.75% in two stages). The Reserve Bank has decided to gradually reduce it to 25% over a three-year period.

(13) Loans and Advances: Section 20 of the Banking Regulation Act imposes certain restrictions on the loans granted by banks to persons connected with their management. This section as amended by the Amending Act of 1968 is as follows:

(a) No banking company can grant loans and advances on the security of its own shares;

(b) The banking company should not enter into any commitment for giving any loan or advance to: any of its directors;

  (i) to a firm in which any of its directors is interested as partner, manager

  (ii) employee or guarantor. (iii) To any company of which any of the directors of the banking company is a director, manager, guarantor or

  (iii) To any individual with whom any of its directors is a partner or a guarantor.

(14) Limits as to Investments in Shares and Debentures: Reserve Bank of India has removed limits on investments made by the banks in the equity and debentures issue? of 17 financial institutions. These include IDBI, IFCI, ICICI, EXIM Bank of India, IRBI, NABARD, NHB, UTI, LIC, GIC, RCTFC, TDICI, Tourism Finance Corporation of India, etc.

The above restrictions on granting of loans and advances were introduced by an amendment in 1968 in the Banking Regulation Act.

SELF EVALUATION EQUATIONS

1. Banking regulation act 1949 defines banking as ______________________
2. Payment of commission brokerage etc, not exceding _________ paid value
3. Reserve fund not less than ____________ of the profit as disclosed in the profit loss account.

ANSWER

1. accepting
2. 2 ½ %
3. 20%

PREPARATION OF PROFIT AND LOSS ACCOUNT

Banks are required to prepare final accounts for each financial year. i.e., their books are closed each year on 31 st March. But for internal purpose, banks usually close their books on 30th September called half yearly closing. The Profit & Loss Account of a banking company has to be prepared in Form 'B' of Schedule III, attached to the Banking Regulation Act 1949. Form 'B' is given below:

Form 'b'

Third Schedule

Form of profit and loss account

Profit and loss account for the year ended 31st march 19......

	Schedule No.	**Year ended on 31.3 (current year Rs.)**	**Year ended on 31.3..... (Previous year Rs.)**
I. Income		XXX	
Interest Carried	13	XXX	
Other income	14		
Total			
II. Expenditure			
Interest expended		XXX	
Operating expenses	15	XXX	
Provisions and contingencies	16	XXX	
Total			
III. Profit / Loss:			
Net profit/Loss (-) for the		XX	

year			
Profit/Loss(-) brought forward		XX	
Total			
IV. Appropriations			
Transfer to statutory reserves		XXX	
Transfer to other reserves		XXX	
Transfer to Govt. proposed dividend		XXX	
Balance carried over to balance sheet		XXX	
Total			

Schedules to be annexed with profit and Loss account Schedule 13; Interest Earned

	Year ended on 31.3..... (Current year) Rs.	**Year ended 31.3........ (Previous year) Rs.**
I. Interest/Discount on Advances/Bills	xxx	
II. Income on investments	xxx	
III. Interest on balances with RBI and other Inter-bank funds	xxx	
IV. Others	xxx	
Total		

Schedule 14: Other Income

		Year ended on 31.3..... (Current year) Rs.	**Year ended 31.3........ (Previous year) Rs.**
I. Commission, Exchange and Brokerage	XXX		
II. Profit on sale of investments	XXX		
Less: Loss on sale of invetsments	XXX	XXX	

III. Profit on revaluation of Investments	XXX		
Less: Loss on revaluation of investments	XXX	XXX	
IV: Profit on sale of Land/Building and other assets	XXX		
Less: Loss on sale of Land, Building and other assets.	XXX	XXX	
V. Profit on exchange transactions	XXX		
Less : Loss on exchange transactions	XXX		
VI. Income earned by way of dividends etc. from subsidiaries /companies and or joint venture abroad/in India		XXX	
VII. Miscellaneous income		XXX	
Total			

Note: Under items II to, loss figure may be shown in brackets

Schedule 15: Interest Expended

		Year ended on 31.3..... (Current year) Rs.	**Year ended 31.3........ (Previous year) Rs.**
I. Interest on Deposits	XXX		
II. Interest on RBI/Inter Bank borrowings	XXX		
Others	XXX	XXX	

Schedule 16: Operating Expenses

	Year ended on 31.3..... (Current year) Rs.	**Year ended 31.3........ (Previous year) Rs.**
I. Payments to and provisions for employees	XXX	XXX
II. Rent, taxes and lighting	XXX	XXX
III. Printing and Stationery	XXX	XXX
IV. Advertisement and Publicity	XXX	XXX
V. Depreciation on bank's property	XXX	XXX
VI. Director's fees, allowances and expenses	XXX	XXX
VII. Auditor's Fees, allowance and expenses	XXX	XXX
VIII. Law charges	XXX	XXX
IX. Postage, telegrams, telephone, etc.	XXX	XXX
X. Repairs and maintenance	XXX	XXX
XI. Insurance	XXX	XXX
XII. Other/Expenditure	XXX	XXX
Total		

GUIDELINES OF RBI FOR PROFIT AND LOSS ACCOUNT

I. Interest Earned (Schedule 13)

(a) Interest/Discount on advances/bills: It includes interest and discount on all types of loans and advances like cash credits, demand loans, over-drafts, export loans, loans, domestic and foreign bills purchased and discounted (including those rediscounted), over due interest and also interest subsidy, if any, relating to such advances/bills.

(b) Income on Investments: It includes all income derived from the investment portfolio by way of interest and dividend.

(c) Interest on Balances with RBI and other inter bank funds: It includes interest on balances with Reserve Bank and other banks, call loans, money market placements, etc.

(d) Others: It includes any other interest/discount income not included in the above heads.

II. Other Income (Schedule-14)

a) Commission, exchange and brokerage: It includes all remuneration on services such as commission on collections, commission/exchange on remittances and transfers, commission on letters of credit, letting out of lockers and guarantees, commission, on Government business, commission on other permitted agency business including consultancy and other services, brokerage, etc., on securities. It does not include foreign exchange income.

b) Profit on sale of investments: Less: Loss on sale of investments.

c) Profit on revaluation of investments: Less: Loss on revaluation of investments: It includes Profit/Loss on sale of securities, furniture, land & buildings, motor vehicles, gold, silver, etc. If the net position is a loss, the amount should be shown as a deduction. The net profit/loss on revaluation of assets may also be shown under this item.

d) Profit on sale of land, building and other assets: Less loss on sale of land, buildings and other assets.

e) Profit on exchange transactions : Less: Loss on exchange transactions: It includes Profit/Loss on dealing in foreign exchange, all income earned by way of foreign exchange, commission and charges on foreign exchange transactions excluding interest which will be shown under interest. Only the net position should be shown. If the net position is a loss, it is to be shown as a deduction.

f) Income earned by way of dividends, etc. from subsidiaries, companies, joint ventures abroad/in India,

g) Miscellaneous income: In includes recoveries from constituents for godown rents, income from bank's properties, security charges, insurance etc., and any other miscellaneous income. In case any item under this head exceeds one percentage of the total income, particulars may be given in the notes.

SELF EVALUATION EQUATIONS

4. S.L.R expands
5. Capitalized expenses are
6. No bank9ng company can grant loan and advance in the security of its __________

ANSWER

4. statutory liquidity ratio
5. preliminary expenses, organization expenses
6. own share

III Interest Expended

(a) Interest on deposits: It includes interest paid on all types of deposits including deposits from banks and other institutions.

(b) Interest on RBI/Inter bank borrowings: It includes discount/interest on all borrowings and refinance from Reserve Bank of India and other banks.

(c) Others: It includes discount/interest on all borrowings/refinance from financial institutions. All other payments like interest on participation certificate, penal interest paid, etc., may also be included here.

IV. Operating Expenses

a) Payment to and provisions for employees: It includes staff salaries/wages, allowances, bonus, other staff benefits like provident fund, pension, gratuity, leave fare concessions, staff welfare, medical allowances to staff, etc.

b) Rent, taxes, and lighting: It includes rent paid by the banks on buildings and other municipal and other taxes paid (excluding income tax and interest tax), electricity and other similar charges and levies. House rent allowance and other similar payment to staff should appear under the head "payment to and provisions for employees".

c) Printing and Stationer}': It includes books and forms and stationery used by the bank and other printing charges which are not incurred by way of publicity expenditure.

d) Advertisement and publicity: It includes expenditure incurred by the bank for advertisement and publicity purposes including printing charges of publicity matter.

e) Depreciation on Bank's property: It includes depreciation on bank's own. property, motor cars and other vehicles, furniture, electric fittings, vaults, lifts, leasehold properties, non-banking assets, etc.

f) Director 's fees, allowances and expenses: It includes sitting fees and all other items of expenditure incurred on behalf of directors. The daily allowance, hotel charges, conveyance charges, etc., which though in the nature of reimbursement of expenses incurred may be included under this head. Similar expenses of local committee members may also be included under this head.

g) Auditor's fees and expenses (including branch auditor's fees and expenses): It includes the fees paid to the statutory auditors and branch auditors for professional services rendered and all expenses for performing their duties, eventhough they may be in the nature of reimbursement of expenses. If external auditors have been appointed by banks themselves for internal inspections and audits and other services the expenses incurred in that context including fees may not be included under this head but shown under "other expenditure".

h) Law charges: All legal expenses and reimbursement of expenses incurred in connection with legal service are to be included here.

i) Postage, telegrams, telephones, etc.: It includes all postal charges like stamps, telegrams, telephones, teleprinter, etc.

j) Repairs and maintenance: It includes repairs to bank property, their maintenance charges etc.

k) Insurance: It includes insurance charges on bank's property, insurance premia paid to deposit insurance and Credit Guarantee Corporation, etc. to the extent they are not recovered from the concerned parties.

l) Other expenditure: All expenses other than those not included in any of the other heads like licence fees, donations, subscriptions to papers, periodicals, entertainment expenses, travel expenses, etc., may be included under this head. In case any particular item under this head exceeds one percentage of the total income particulars may be given in the notes.

V. Provisions and contingencies

It includes all provisions made for bad and doubtful debts, provision for taxation, provision for diminution in the value of investments, transfers to contingencies and other similar items.

BALANCE SHEET

The Balance Sheet of a banking company has to be prepared in Form 'A' of Schedule III attached to the Banking Regulation Act 1949. Form 'A' is reproduced as follows:

Form a

Form at balance sheet

Balance sheet of .... (here enter name of the banking company) as on 31.3. (Year)

	Schedule No.	As on 31.3.... (current year) Rs.	As on 31.3.... (previous year) Rs.
Capital and Liabilities			
Capital	1		
Reserves and surplus	2		
Deposits	3		
Borrowings	4		
Other liabilities and provisions	5		
Total			
Assets			
Cash and balance with RBI	6		
Balance with banks and money at call and short notice	7		
Investments	8		
Advances	9		
Fixed assets	10		
Other assets	11		
Total			
Contingent liabilities	12		
Bills for collection			

Schedule 1: Capital

	As on 31.3.... (current year) Rs.	**As on 31.3.... (previous year) Rs.**
I. For Nationalised banks		
Capital (fully owned by Central Govt.)		
Total		
For banks incorporated outside India Capital		
i) (The amount bought in by banks by way of start-up capital as prescribed by RBI should be shown under this head?		
ii) Amount of deposit with the RBI under section 11(2) of the Banking Regulation Act. 1949		
Total		
iii) For other banks		
Authorised capital (shares of Rs............... each)		
Issued capital (shares of Rs. .... cash)		
Subscribed capital (shares of Rs.......... cash)		
Called up capital (shares of Rs............... cash)		
Less: Calls unpaid		
Add: Forfeited shares		

Schedule 2: Reserves and surplus

		As on 31.3.... (currentye ar) Rs.	**As on 31.3.... (previous year) Rs.**
i)	Statutory reserves		
	Opening balance		
	Additions during the year		
	Deductions during the year		
ii)	Capital reserve		
	Opening balance		
	Additions during the year		
	Deductions during the year		
iii)	Share premium		
	Opening balance		
	Additions during the year		
	Deductions during the year		
iv)	Revenue and other reserves		
	Opening balance		
	Additions during the year		
	Deductions during the year		
	Balance in profit and loss account		
	Total (i, ii, iii, iv & v)		

Schedule 3: Deposits

		As on 31.3.... (currentyear) Rs.	As on 31.3.... (previousyear) Rs.
A.	I. Demand deposits		
	i) From banks		
	ii) From others		
	II. Savings bank deposits		
	III. Term deposits		
	i) From banks		
	ii) From others		
	Total (I, II and III)		
B.	Deposits of branches in India		
	Deposits of branches outside India		
	Total		

Schedule 4: Borrowings

		As on 31.3.... (currentyear) Rs.	As on 31.3.... (previous year) Rs.
I.	Borrowing in India		
	i) Reserve bank of India		
	ii) Other banks		
	iii) Other institutions and agencies		
II.	Borrowing outside India		
	Total (I and II)		
	Secured borrowings included in I and II above – Rs.		

Schedule 5: Liabilities and Provision

		As on 31.3.... (currentyear) Rs.	As on 31.3.... (previousyear) Rs.
I.	Bills payables		
II.	Inter-office adjustments (net)		
III.	Interest accrued		
IV.	Others (Including provisions)		
	Total		

Schedule 6: Cash and Balances with Reserve Bank of India

		As on 31.3.... (currentyear) Rs.	As on 31.3.... (previousyear) Rs.
I.	Cash in hand		
	(Including foreign currency notes)		
II	Balances with Reserve Bank of India		
	i) In current account		
	ii) In other accounts		
	Total (I and II)		

Schedule 7: Balances with banks and money at call and short notice

		As on 31.3.... (currentyear) Rs.	As on 31.3.... (previous year) Rs.
I.	In India		
	i) Balance with banks		
	a) In current accounts		

	b) In other deposit accounts		
	ii) Money at call and short notice		
	a) With banks		
	b) With other institutions		
	Total (I and II)		
II.	Outside India		
	i) In current accounts		
	ii) In other deposit accounts		
	iii) Money at call and short notice		
	Total (I, II & III)		
	Grand Total		
	(I and II)		

Schedule 8: Investments

		As on 31.3.... (currenty ear) Rs.	**As on 31.3.... (previousy ear) Rs.**
I)	Investments in India in		
	i) Government in India in		
	ii) Other approved securities		
	iii) Shares		
	iv) Debentures and books		
	v) Subsidiaries and/or joint ventures		
	vi) Other investments (to be specified)		
	Total		
II.	Investments outside India in		
	i) Government securities		

	(Including local authorities)		
	ii) Subsidiaries and/or joint venture abroad		
	iii) Other investments (to be specified)		
	Total		
	Grand Total		
	Grand Total (I and II)		

Schedule 9: Investments

		As on 31.3.... (currentyear) Rs.	As on 31.3.... (previousyear) Rs.
A.	i) Bills purchased and discounted		
	ii) Cash credits overdrafts and loans repayable on demand		
	iii) Term loans		
	Total		
B.	i) Secured by tangible assets		
	ii) Covered by Bank/Government guarantees		
	iii) Unsecured		
	Total		
C.	I. Advances in India		
	i) Priority sectors		
	ii) Public sector		
	iii) Banks		
	iv) Others		
	Total		
	II. Advance outside india		
	i) Due from banks		
	ii) Due from others		
	a) Bills purchased and discounted		
	b) Syndicated loans		
	c) Others		
	Total		
	Grand Total (I and II)		

Schedule 10: FIXED ASSETS

		As on 31.3.... (currentyear) Rs.	As on 31.3.... (previousyear) Rs.
I.	Premises		
	At cost on 31st March of the preceding year		
	Additions during the year		
	Deductions during the year		
	Depreciations to date		
II.	Other Fixed Assets (Including furniture and fixtures)		
	At cost as on 31st March at the preceding year		
	Additions during the year		
	Deductions during the year		
	Depreciation to date		
	Total (I and II)		

Schedule 11: OTHER ASSETS

		As on 31.3.... (currentyear) Rs.	As on 31.3.... (previousyear) Rs.
I.	Inter-office adjustments (net)		
II.	Interest accrued		
III.	Tax paid in advance/tax deducted at source		
IV.	Stationary and stamps		
V.	Non-banking assets acquired in satisfaction of claims		
VI.	Others		
	Total		
	(a) In case there is any unadjusted		

	balance of loss, the same may be shown under this item with appropriate foot note.		

Schedule 12: CONTINGENT LIABILITIES

		Year ending As on 31.3.... (currentyear) Rs.	**Year ending on 31.3.... (previousyear) Rs.**
I.	Claims against the bank not		
II.	Liabilities for party paid investments		
III.	Liabilities on account of outstanding forward exchange contracts		
IV.	Guarantees given on behalf of constituents		
	a) India		
	b) Out side India		
V.	Accepted endrosements and other obligations		
VI.	Other items for which the bank is contingently liable		
	Total		

Non-performing assets (N.P.A.) – Provisions for doubtful debts

Illustration 1

On 31st March 1998, Bharat Commercial Bank Ltd., finds its advances classified as follows:

Standard assets	1491300
Sub-standard assets	92800
Doubtful assets (secured)	
: Doubtful for one year	25660
: Doubtful for one year to 3 years	15640
: Doubtful for more than 3 Years	6580
Loss assets	10350

Calculated the amount of provision to be made by the bank against the above mentioned advances.

Solution:

		Amount (Rs.)	% required as provision	Provision (Rs.)
Standard assets		1491300	0	-
Sub-standard assets		92800	10	9280
Doubtful assets:	Up to one year	25660	20	5132
	One year to 3 Years	15640	30	4692
	More than 3 years	6580	50	3290
Loss assets		10350	100	10350
Total provision required				32744

Note: If the doubtful assets were unsecured, 100% provision has to be made.

Interest Doubtful Debts

Illustration

While closing the books of a bank on 31st Dec.1989, you find in the loan ledger as unsecured balance of Rs. 2 lakhs in the amount of a merchant whose financial condition is reported to you as bad. Interest on the same amount amounted to Rs.20,000 during the year. During the year 1990, the bank accepted 75 paise in the rupee on account of the debt upto 31st Dec. 1989. Give journal and ledger to record these transactions under alternative accounting policies.

[Madras, M.Com., April 1998]

Note: The term 'Alternative accounting policies' includes different methods of treating interest on doubtful debts. There are three methods, all of which are employed below to show the distinction in accounting treatment.

Solution:

i) Interest Suspense Method

Books of Bank

Date	Particulars	L.F	Dr.	Cr.
			Rs.	Rs.
31.12.89	Merchant’s Loan A/c.		20000	
	To Interest suspense A/c.			20000
	[Being interest on doubtful debt]			
?.?.90	Cash A/c.		165000	
	To Merchant’s Loan A/c.			165000
	[Being 75 paise per rupee recovered on merchant’s loan]			
?.?.90	Interest suspense A/c.		20000	
	To interest A/c.			15000
	To Merchants loan A/c. [Being the amount collected out of interest on doubtful and the balance transferred to loan account]			5000
?.?.90	Bad debts A/c.		50000	
	To merchant’s loan A/c.			50000
	[Being uncollected portion of loan written off as bad]			

Merchant’s loan A/c.

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
31.12.89	To balance b/d.	200000	31.12.89	By balance c/d.	220000
21.12.89	To interest suspense A/c.	20000			

		2200000			220000
01.01.90	To balance b/d.	220000	?	By cash	165000
				By Int. suspense A/c.	5000
				By bad debts A/c.	50000
		220000			220000

Dr	Interest Suspense A/c.				Cr.
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
31.12.89	To balance c/d.	20000	31.12.89	By Merchant's	
				Loan A/c.	20000
		20000			20000
?	To interest A/c.	15000	1.1.90	By balance b/d.	20000
	To merchant's Loan A/c.	5000			
		20000			20000

ii) Cash basis

Journal Entries

Date	Particulars	L.F	Dr.	Cr.
			Rs.	Rs.
1989	No entry			
1990	a) Cash A/c. Dr.		165000	
	To Interest A/c.			15000
	To Merchant's Loan A/c.			150000

	[Being the amount received from the amount –75% of the interest due and of the amount of the advanced]			
	b) Bad debts A/c. Dr.		50000	
	To merchant's Loan A/c.			50000
	[Being the balance amount due from the merchant written off as irrecoverable]			

Note: Interest Rs.15000 will be added to interest and discount in schedule. 13.

Dr	**Merchant's Loan A/c.**				**Cr.**
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
31.12.89	To balance b/d.	200000	31.12.89	By balance c/d.	200000
		200000			200000
1.1.90	To balance b/d.	200000	31.12.89	By cash	150000
				By bad debts A/c.	50000
		200000			200000

Dr	Interest A/c.				Cr.
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
	To balance c/d.	15000	1990	By cash	15000
		15000			15000
			?	By balance b/d.	15000

Dr	Bad debts A/c.				Cr.
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1990	To merchant's loan A/c.	50000	?	By balance c/d.	50000
		50000			50000
	To balance b/d.	50000			

iii) Accrual basis with full provision for bad debts

Journal Entries

Date	Particulars	L.F	Dr.	Cr.
			Rs.	Rs.
1989	a) Merchant's Loan A/c. Dr.		20000	
	To Interest A/c.			20000
	[Being interest due from .... on the loan]			
	b) Interest and Discount A/c. Dr.		220000	
	To provision for bad and doubtful debts [Being provision made for loan and interest thereon being doubtful]			220000
1990	Cash A/c Dr.		165000	
	Bad debts A/c. Dr.		55000	
	To merchant's loan A/c. [Being amount received from the merchant balance being road debts]			220000

Note: Bad debts provision will be reduced by Rs.165000 for the year 1990, as that amount was recovered]

Dr	Merchant's Loan A/c.				Cr.
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
31.12.89	To balance b/d.	200000	31.12.89	By balance c/d.	220000
31.12.89	To interest A/c.	20000			
					220000
	To balance b/d.	220000	?	By cash	165000
			?	By bad debts A/c.	55000
		220000			220000

Dr	Provision for Bad and Doubtful debts A/c.				Cr.
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
31.12.89	To balance c/d.	220000	31.12.89	By Int. & Discount A/c.	220000
			1.1.90	By balance b/d.	220000
	To bad debts	55000			
	To balance c/d.	165000			
		220000			220000
			?	By balance b/d.	165000

Dr	Interest Suspense A/c.				Cr.
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1990	To merchant's Loan A/c.	55000	1990	By provision for Bad and Doubtful debts A/c.	55000
		55000			55000

Rebate on bills discounted

Illustration

On 31st March, 1998 a bank held the following bills, discounted by it earlier;

	Date of bill 1998	Term of bill (months)	Discounted @ % p.a.	Amount of bill Rs.
i	January 17	4	17	730000
ii	February 7	3	18	1460000
iii	March9	3	17.5	364000

You are required to calculate the rebate on bills discounted. Also show the necessary journal entry for the rebate.

Solution:

Date of bill 1998	Date of Maturity 1998	No. of days away from 31.3.98	Discount Rate	Amount of bill Rs.	Discount for days after 31.3.98
January 17	May 20	50	17%	730000	17000
February 7	May 10	40	18%	1460000	28800
March 9	June 12	73	17.5%	364000	12740
	Closing rebate on bills				58540

Date	Particulars	L.F	Dr	Cr.
31.3.98	Discount received A/c. Dr. To rebate on bills discounted A/c. [Adjustment made for discount not yet earned on discount bills]		58540	58540

Working Notes:

Rs.

i) Discount on Rs. 7,30,000 for 50 days

$$@\ 17\%\ \text{p.a.} = 730000 \times \frac{17}{100} \times \frac{50}{365} = 17000$$

ii) Discount on Rs. 14,60,000 for 40 days

$$@\ 18\%\ \text{p.a.} = 1460000 \times \frac{18}{100} \times \frac{40}{365} = 28800$$

iii) Discount on Rs. 3,64,000 for 73 days

$$@\ 17.5\%\ \text{p.a.} = 364000 \times \frac{17.5}{100} \times \frac{73}{365} = 12740$$

Illustration

The trial balance of the Nedungadi Bank Ltd., as on 30th June 1984 shows the following balances.

	Rs.
Interest and discount	4540600
Rebate on bills discounted (1.7.83)	4750
Bills discounted and purchased	337400

The unexpired discount as on 30.06.84 is estimated to be Rs. 5560. Draft necessary adjusting entries and calculate the amount of interest and discount to be credited to Profit and Loss account.

Solution

Books of Nedungadi Bank Ltd.,

Journal (adjustment)

	Particulars	**L.F**	**Dr.**	**Cr.**
			Rs.	Rs.
	Rebate on bills discounted A/c. Dr.		4750	
	To Discount A/c [Being transfer of opening unexpired discount to discount account]			4750
	Discount A/c. Dr.		5560	
	To Rebate on bills discounted [Being closing unexpired discount out of the current year's discount]			5560

(b) Calculation of amount of interest and discount to be credited to Profit & Loss account:

	Rs.
Interest and Discount given	45,40,600
Add: Opening balance of rebate on bills discounted	4,750
	45,45,350
Less: Closing balance of rebate on bills discounted	5,560
Interest and discount to be credited to Profit and Loss A/c. (schedule 13)	45,39,790

Illustration

As on 31st December 1985, the books of the Hercules bank, include among others, the following balances

	Rs.
Rebate on bills discounted (1.1.1985)	3,20,000
Discount received	46,00,000
Bills discounted and purchased	3,15,47,000

Throughout 1985, the banks rate for discounting has been 18%.

On investigation and analysis, the average due date for the bills discounted and purchased is calculated as 15th February, 1986.

Show the calculation of the amount to be credited to the banks Profit and Loss A/c. under discount earned for the year 1985. Show also the journal entries required to adjust the above mentioned accounts.

Solution:

Unexpired discount or rebate on bills on 31.12.85

Rs.

$$3,15,47,000 \times \frac{18}{100} \times \frac{45}{365} \text{ (i.e.,) } 7,00,084$$

Amount to be credited to Profit & Loss A/c.

has been ascertained as follows:

		Rs.
	Balance in discount received A/c.	46,00,000
Add:	Balance in rebate account as of 1.185 transferred	3,20,000
		49,20,000
Less:	Rebate on bills (31.1.85)	7,00,084
	Amount to be transferred to Profit and Loss A/c.	42,19,916

Journal entries

Date	**Particulars**	**L.F**	**Dr.**	**Cr.**
			Rs.	Rs.
1985	Rebate on bills discounted A/c. Dr.		3,20,000	
Dec.31	To discount received A/c. [Being transfer of opening balance in the rabate A/c.]			3,20,000
Dec.31	Discount received A/c. Dr.		7,00,084	
	To rebate on bills discounted A/c.			7,00,084

	[Being provision for unexpired discount as on 31.12.85]			
Dec.31	Discount received A/c. Dr.		42,19,916	
	To profit and Loss A/c. [Being transfer of discount net after adjustments]			42,19,916

Illustration

On 1.1.90, the rebate on bills discounted account of a bank showed a credit balance of Rs.1,00,000. On 31.12.90, the discount account showed a credit balance of Rs.15,00,000 before adjusting unexpired discount. The bills discounted outstanding on 31.12.90 were Rs.2 crores with average maturity date of January 31, 1991 and they were all discounted at 12% p.a.

Write adjustment entries and relevant ledger accounts to record these items and also show how these items will appear in the final account of the bank.

Working Note:

Rebate on bills discounted on 31.12.90

$$2{,}00{,}00{,}000 \times \frac{12}{100} \times \frac{1}{12} = \text{Rs. } 2{,}00{,}000$$

Solution:

Journal Entries

Date	Particulars	L.F	Dr.	Cr.
			Rs.	Rs.
31.12.90	Rebate on bills discounted A/c. Dr.		1,00,000	
	To discount A/c. [Being opening balance of rebate transferred to discount A/c.]			1,00,000
31.12.90	Discount A/c. Dr.		2,00,000	
	To rebate on bills discounted [Being unexpired discount on			2,00,000

	31.12.90 taken into A/c.]				

Dr	Discount A/c.				Cr.
Date	Particulars	Rs.	Date	Particulars	Rs.
31.12.90	To Rebate on bills discounted (closing)	2,00,000	31.12.90	By balance b/d.	15,00,000
31.12.90	To Profit & Loss A/c.	14,00,000	31.12.90	By rebate on bills discounted (opening)	1,00,000
		16,00,000			16,00,000

Dr	Rebate on bills Discounted A/c.				Cr.
Date	Particulars	Rs.	Date	Particulars	Rs.
31.12.90	To discount A/c.	1,00,000	1.1.90	By balance b/d.	1,00,000
		1,00,000			1,00,000
31.12.90	To balance c/d.	2,00,000	31.12.90	By discount A/c.	2,00,000
		2,00,000			2,00,000
			1.1.91	By balance b/d.	2,00,000

Treatments in final accounts

i) In schedule 13 (i.e., interest earned) prepared for Profit and Loss account, opening rebate on bills discounted is added and closing rebate on bills discounted is subtracted.

ii) In balance sheet liabilities side under schedule 5 (i.e., other liabilities and provisions) closing rebate on bills discounted is shown as a separate item.

Preparation of Loss Account

Illustration

From the following particulars, prepare a Profit and Loss A/c. of New bank Ltd., for the year ended 31.12.1996.

	Rs.		Rs.
Interest on loans	2,60,000	Interest on cash credits	2,25,000
Interest on fixed assets	2,80,000	Rent and taxes	20,000

Rebate on bills discounted	50,000	Interest on overdrafts	56,000
Commission charges to customers	9,000	Director's and Auditor's fees	4,500
Establishments expenses	56,000	Interest on savings bank accounts	70,000
Discount on bills discounted	2,00,000	Postage and telegrams	1,500
Interest on current accounts	45,000	Sundry charges	1,800
Printing and advertisements	3,000		

[Calicut, B.Com., Oct.1987]

Solution:

New bank Ltd.

Profit and Loss Account for the year ended 31.12.96

		Schedule No.	**Year ended 31.12.96 (Current year) Rs.**	**Year ended 31.12.95 (Previous year) Rs.**
I	Income			
	Interest earned	13	7,41,000	
	Other income	14	9,000	
	Total		7,50,000	
II.	Expenditure			
	Interest expended			
	Operating expenses	15	3,95,000	
	Provisions and contingencies	16	86,800	
	Total		4,81,800	

III.	Profit/Loss:			
	Net profit for year (I-II)		2,68,200	
	Profit brought forward		-	
	Total		2,68,200	
IV.	Appropriations			
	Transfer to statutory reserve (20% of 2,68,00)		53,640	
	Transfer to other reserves		-	
	Transfer to Government/proposed dividend	-		
	Balance carried over to balance sheet		2,14,560	
			2,68,200	

Working Notes:

Schedule 13: Interest earned

	Rs.
Interest on Loans	2,60,000
Discount on bills discounted	2,00,000
Interest on cash credits	2,25,000
Interest on over draft	56,000
Total	7,41,000

Note: Rebate on bills is the closing rebate and it will be shown in schedule 5 in balance sheet.

Schedule 14: Other Income

	Rs.
Commission charges to customers	9,000

Total	9000

Schedule 15: Interest earned

	Rs.
Interest on fixed deposits	2,80,000
Interest on current accounts	45,000
Interest on savings	70,000
Total	3,95,000

Schedule 16: Operating expenses

	Rs.
Establishment expenses	56,000
Printing and Advertisements	3,000
Rent and rates	20,000
Director's and Auditor's fees	4,500
Postage & Telegrams	1,500
Sundry charges	1,800
Total	86,800

Provisions and Contingencies

Nil

Nil

Illustration

From the following information relating to Lakshmi Bank Ltd., prepare the profit and Loss A/c. for the year ended 31st December, 1987.

	Rs		Rs.
Rent received	72,000	Salaries and allowances	2,18,800
Exchange and commission	32,800	Postage	5,600
Interest on fixed deposits	11,00,000	Sundry charges	4,000
Interest on savings bank A/c.s	2,72,000	Director's & Auditor's fees	16,800
Interest on overdrafts	2,16,000	Printing	8,000
Discount on bills discounted	7,80,000	Law charges	3,600
Interest on current accounts	1,68,000	Locker rent	1,400
Interest on cash credits	8,92,000	Transfer fees	2,800
Depreciation on bank property	20,000	Interest on lons	10,36,000

(Osmania, B.Com., Nov.1988)

Solution:

The Lakshmi Bank and

Profit and Loss account

For the year ended 31st December 1987

		Schedule No.	Year ended 31st Dec.87 Rs.
I.	Income		
	Interest earned	13	29,24,000
	Other income	14	1,09,000
	Total		30,33,000
II.	Expenditure		
	Interest expended	15	15,40,000
	Operating expenses	16	2,76,800
	Provisional and contingencies		-
			18,16,800

III	Profit/Loss		
	Net profit for the year (I - II)		12,16,200
	Profit brought forward		-
			12,16,200
IV	Appropriations		
	Transfer to statutory reserve (20% of net profit)		2,43,240
	Transfer to other reserves		-
	Transfer to Government/proposed dividend		-
	Balance carried over to Balance sheet		9,72,960
			12,16,200

Working Notes:

Schedule 13: Interest earned

	Rs.
Interest on overdrafts	2,16,000
Discount on bills discounted	7,80,000
Interest on cash credits	8,92,000
Interest on loans	10,36,000
	29,24,000

Schedule 14: Other Income

	Rs.
Locker rent	1,400
Transfer fees	2,800
Exchange and commission	32,800
Rent	72,000
	1,09,000

Schedule 15: Interest Expended

	Rs.
Interest on fixed deposits	11,00,000
Interest on savings bank accounts	2,72,000
Interest on current A/c.	1,68,000
	15,40,000

Schedule 16: Operating Expenses

	Rs.
Depreciation on bank property	20,000
Salaries and allowances	2,18,800
Postage	5,600
Sundry charges	4,000
Director’s and Auditor’s fees	16,800
Printing	8,000
Law charges	3,600
	2,76,800

Preparation of balance sheet

Illustration

On 31st December 1986. The following balances stood in the books of Asian Bank Ltd., after preparation of its profit and Loss account.

Share capital	Rs.
Issued and subscribed	40,00,000
Reserve fund (under section 17}	62,00,000
Fixed deposits	4,26,00,000
Savings bank deposits	1,90,00,000
Current account	2,32,00,000

Money at call and short notice	18,00,000
Investments	2,50,00,000
Profit and Loss account (cr) 1st Jan. 1996	13,50,000
Dividend for 1985	4,00,000
Premises	29,50,000
Cash in hand	3,80,000
Cash with RBI	1,00,00,000
Cash with other banks	60,00,000
Bills discounted and purchased	38,00,000
Loans, cash credits and over drafts	5,10,00,000
Bills payable	70,000
Unclaimed dividend	60,000
Rebate on bills discounted	50,000
Short loans (borrowing from other banks)	47,50,000
Furniture	11,64,000
Other assets	3,36,00
Net profit for 1986	15,50,000

Prepare balance sheet of the banks as on 31st December 1986.

[Marathawada, B.Com., Nov.1987]

Solution:

Asian Bank Ltd

Balance Sheet as on 31.12.1986

	Schedule No.	**As on 31.12.86 Rs.**
Capital and Liabilities		
Capital	1	40,00,000

Reserves & Surplus	2	87,00,000
Deposits	3	8,48,00,000
Borrowings	4	47,50,000
Other Liabilities & Provisions	5	1,80,000
		10,24,30,000
Assets:		
Cash and balance with RBI	6	1,03,80,000
Balance with Banks & Money at call and Short Notice	7	78,00,000
Investments	8	2,50,00,000
Advances	9	5,48,00,000
Fixed assets	10	41,14,000
Other assets	11	3,36,000
		10,24,30,000
Contingent Liabilities	12	Nil
Bills for collection	-	Nil

Working Notes:

Schedule 1: Capital

	Rs.
Issued and subscribed share capital	40,00,000

	Schedule 2 : Reserves and Surplus		Rs.
	Reserve fund		62,00,000
	Profit and loss A/c. (1.1.86)	13,50,000	
Less:	Dividend for 1985	4,00,000	
		9,50,000	
Add:	Net profit for 1986 after deducting statutory reserve [15,50,000 x 20%]	12,40,000	21,90,000
	Statutory reserve		3,10,000
			87,00,000
	Schedule 3: Deposits		

	Fixed deposits		4,26,00,000
	Savings bank deposits		1,96,00,000
	Current accounts		2,32,00,000
			8,48,00,000
	Schedule 4: Borrowings		
	Short loans		47,50,000
	Schedule 5: Other Liabilities and Provisions		
	Bills payable		70,000
	Unclaimed dividend		60,000
	Rebate on bills discounted		50,000
			1,80,000
	Schedule 6 : Cash and balances with RBI		
	Cash in hand		3,80,000
	Cash with RBI		1,00,00,000
			1,03,80,00
	Schedule 7 : Balance with banks and Money at call and short notice		
	Money at call and short notice		18,00,000
	Cash with other banks		60,00,000
			78,00,000
	Schedule 8 : Investments		
	Investments		2,50,00,000
	Schedule 9 : Investments		
	Bills discounted and purchased		38,00,000
	Loans, cash credits and overdrafts		5,10,00,000
			5,48,00,000
	Schedule 10 : Investments		
	Premises		29,50,000
	Furniture		11,64,000
			41,14,000
	Schedule 11 : Other assets		
	Other assets		3,36,000
	Schedule 12 : Contingent Liabilities		
			Nil

Illustration 16

From the following particulars of XY Bank Ltd., having its own premises, prepare the balance sheet in the prescribed from as on 31st December, 1995.

	Rupees (in thousands)
Authorized capital	4000
Subscribed capital 4,00,000 shares of Rs.10 each Rs.5 paid	2000
Investments	7000
Bills discounted (in India)	15000
Profit and Loss (Cr)	850
Endorsement on bills for collection	100
Liability of customers for acceptances	5000
Money at call and short notice	9000
Cash in hand	2000
Cash with RBI	4000
Reserve	3000
Cash with State Bank	4000
Letters of credit issued	500
Telegraphic transfers payable	800
Bank drafts payable	1200
Short loans	40
Rebate on bills discounted	10
Acceptances for customers	5000
Loans and Advances	10000
Cash credits	10000

Overdrafts	1000
Bills purchased (payable outside India)	1000
Current and deposit accounts	56000
Investment fluctuation fund	100
Bills for collection	100

Note: Prepare a trail balance and determine the balancing figure which constitutes the value of premises.

[Madras, B.B.M., Oct. 1998] [C.S.Inter, Dec. 1985]

Solution:

Trial Balance

Debit balances	Rs.	Credit balances	Rs.
Investments	7000	Subscribed capital	2000
Bills discounted	15000	Profit and Loss A/c.	850
Endorsement on bills for collection	100	Endorsement on bills for collection	100
Liability of customers for acceptances	5000	Acceptances for customers	5000
Money at call and short notice	9000	Reserves	3000
Cash in hand	2000	Letters of credit issued	500
Cash with RBI	4000	Telegraphic transfers payable	800
Cash with SBI	4000	B.D. payable	1200
Letters of credit issued	500	Short loans	40
Loans and advances	10000	Rebate on bills discounted	10
Cash credits	10000	Current deposit account	56000
Overdrafts	1000	Investment fluctuation fund	100
Bills purchased	1000		
Premises (bal.fig)	1000		
	69600		69600

XY Bank Ltd.

Balance sheet as on Rs.(in ’000)

	Schedule No.	As on 31.12.95 Rs.
Capital and liabilities		
Capital	1	2000
Reserves and surplus	2	3950
Deposits	3	56000
Borrowings	4	40
Other liabilities and provisions	5	2010
		64000
Assets:		
Cash and balance with RBI	6	6000
Balance with banks and money at call and short notice	7	13000
Investments	8	7000
Advances	9	37000
Fixed assets	10	1000
Others assets	11	Nil
		64000
Contingent liabilities	12	5600
Bills for collection	-	Nil

Working Notes:

Schedule 1 : Capital	(Rs. in’ 000)
Authorised, issued and subscribed capital 4,00,000 shares of Rs. 10 each	4000
Called up and paid up capital 4,00,000 shares of Rs. 5 called and paid	2000
Schedule 2: Reserves and Surplus	(Rs. ’ 000)
Reserves	3000
Profit and Loss A/c.	850
Investment fluctuation fund	100
	3950
Schedule 3: Deposits	
Current and Deposit accounts	56000
Schedule 4: Borrowings	
Short loans	40
Schedule 5: Other Liabilities and Provisions	
Telegraphic transfers payable	800
Bank drafts payable	1200
Rebate on bills discounted	10
	2010
Schedule 6: Cash and Balance with RBI	
Cash with RBI	4000
Cash in hand	2000
	6000
Schedule 7: Balance with banks and money at call	
Money at call and short notice	9000

Cash with SBI	4000
	13000
Schedule 8: Investments	
Investments	7000
Schedule 9: Advances	
Loans and Advances	10000
Bills discounted	15000
Cash credits	10000
Overdrafts	1000
Bills purchased	1000
	37000
Schedule 10: Fixed Assets	
Premises	1000
Schedule 11: Other Assets	
	Nil
Schedule 12: Contingent Liabilities	
Endorsement on bills for collection	100
Liability for customers acceptances	5000
Letters of credit issued	500
	5600

Note: The contra items were shown on both sides of the balance sheet in the old form. After 1992, only one figure is taken as contingent liability and the contra item is ignored.

QUESTIONS

Preparation of Profit and Loss Account

1. From the following particulars, prepare the Profit and Loss account of Chennai Bank Ltd., for the year ending 31st March 1992.

	Rs.
Interest on deposits	32,00,000
Commission (Cr)	1,00,000
Interest on loans	24,90,000
Sundry charges (Dr)	1,00,000
Rent and taxes	2,00,000
Establishments	5,00,000
Discount on bills discounted	14,90,000
Interest on overdrafts	16,00,000
Interest on cash credits	23,20,000
Auditor's fees	35,000
Director's fees	16,000
Bad debts to be written off.	3,00,000

[Madras, B.Com., Sep.1997; Oct.1994]

[Ans: Net profit for the year Rs.36,49,000]

Balance carried to Balance Sheet Rs.29,19,200]

2. Prepare the Profit and Loss Account for the year ended 31.12.1992 of Kasinathan Bank Ltd., from the following particulars.

	(Rs.' 000s)
Interest on Loans	250
Interest on savings accounts	150
Interest on cash credits	160
Interest on fixed deposits	190
Interest on Overdraft	50

Amount charged against current accounts	20
Rebate on bills discounted	19
Salaries and allowances	120
Discount	40
Rent, tax, insurance etc.	5
Dearness allowances	35
Commission, brokerage and exchange	15
Managing director's salary	15
Contribution to provided fund	10

[Madras, B.Com., March 1995, March 1994, Sep.1992]

[Ans: Net profit for the year Rs.10,000]

Balance carried to balance sheet Rs.8000]

[Hint: Rebate on bills discounted is to be taken as closing rebate already adjusted]

3. In respect of the integrated Bank Ltd., incorporated under the Indian Companies Act, 1913, the following are the balances as on 31st December 1994, pertaining to the revenue account of the bank. The board of directors decide to make a provision of Rs.2,32,100 for Bad and doubtful debts and Rs.20,00,000 for taxation. Draw up the profit and Loss account of the bank for the year ended 31st December 1994 in the statutory form.

Particulars	Rs.	Particulars	Rs.
Interest paid on deposits	7270605	Interest received	11090155
Interest paid or borrowings	1005100	Commission received	2227344
Printing and Stationery	250122	Brokerage	310292
Postage and telegrams	142152	Discount	6010111
Salaries other than managing director's	3289224	Exchange	832230
Managing director's salary	26000	Miscellaneous receipts	256280

Allowances to employees			
Other than the managing director	1988887		
Allowances to Managing director	14125		
Rent	480605		
Stamps	20029		
Advertisement	147120		
Lighting, etc.	49595		
Taxes	105090		
Rates	155398		
Provident fund contribution	207202		
Director's remuneration and allowance	35532		
Local committee fees and allowance	20405		
Insurance	50405		
Law charges	34879		
Audit fees	20000		
Depreciation written off on bank property	30115		
Repair to bank property	2222		
Loss on the sale of govt. securities	102254		
Miscellaneous expenses	684314		

[Madras, B.A., March 1997]

[Ans: Net profit for the year – Rs. 23,62,932; Balance carried to Balance sheet Rs.18,90,346]

4. The following are the balances of Cholan Bank Ltd., for the year ended 31.3.1992.

	Rs.
Interest on Loans	518000
Interest on fixed deposits	550000
Commission received	16000
Salaries and allowances	108000
Discount on bills discounted	292000
Rebate on bills discounted	98000
Interest on cash credits	446000
Interest on current accounts	84000
Rent and taxes	36000
Interest on overdrafts	308000
Director's fees	6000
Auditor's fees	2000
Interest on savings bank deposits	136000
Postage and telegrams	3000
Printing and Stationery	6000
Locker rent	2000
Transfer fees	1000
Depreciation on banks properties	10000
Sundry charges	4000

Other Information:

i) Provision for bad debts to be made Rs.80,000

ii) Provision for income tax required Rs.3,00,000

From the above information, prepare the Profit and Loss account of the bank for the year ended 31.3.92

[Ans: Net profit for the year – Rs. 2,58,000; Balance carried to Balance sheet - Rs.206400]

[Hints: i) Interest on current accounts is an expenditure

ii) Rebate on bills discounted is closing rebate which is already adjusted in discount on bills.

iii) Locker rent and transfer fees are incomes. Sundry charges is an expense]

5. From the following particulars of XY Bank Ltd., prepare a balance sheet as on 31.3.96 in the revised format.

	Rs.
Authorised capital	40,00,000
Subscribed capital	20,00,000
Investments	70,00,000
Bills discounted	1,50,00,000
Profit and loss A/c. (Cr)	8,50,000
Endorsement on bills for collection	1,00,000
Liability of customers for acceptances	50,00,000
Money at call and short notice	90,00,000
Cash in hand	20,00,000
Cash with RBI	40,00,000
Statutory reserve	30,00,000
Cash with State Bank of India	40,00,000
Letters of credit issued	5,00,000
Telegraphic transfers payable	8,00,000
Bank drafts payable	12,00,000
Short loans (Cr.)	40,000
Rebate on bills discounted	10,000
Acceptances for customers	50,00,000

Loans and advances	1,00,00,000
Cash credit	1,00,00,000
Overdraft	10,00,000
Bills purchased	10,00,000
Current and deposit accounts	5,60,00,000
Investments fluctuation fund	1,00,000
Bills for collection	1,00,000
Buildings	10,00,000

[B.Com., II year – April 1998]

[Ans: B/s. Total – Rs. 6,40,00,000]

Preparation of Profit & Loss Account and Balance sheet

6. From the following ledger balances of Indian Bank Ltd., prepare the Profit and Loss account and Balance sheet as on 30th June 1980.

	Rs.
Freehold and leasehold property	4,15,000
Premises and furniture	3,37,500
Loans and advances	46,65,000
Bills discounted	3,79,500
Money at call and short notice	2,74,250
Cash in hand and with RBI	15,84,750
Interest, discount and commission	2,44,500
Premises account-amount written off	22,500
Current expenditure, salaries, rent, etc.	71,250
Amount added to staff retirement fund	3,000
Shares and stock	6,37,500
Govt. securities	6,00,000

Other securities	8,25,000
Interest accrued and paid	25,500
Profit and loss Account (1.7.79)	15,300
Acceptance on behalf of customers	12,00,000
Current accounts and deposits	77,31,450
Reserve fund	6,00,000
Share capital 12,500 ordinary shares of Rs.100 each	12,50,000
Make provision for rebate on bills discounted	2450

[Madras, B.Com., March 1994]

[Ans: Net profit for the year – Rs.1,19,800;

Balance carried to B/s. Rs.1,11,140; B/s. total Rs. 97,19,000

Difference in Trial balance Rs.500 (Cr. excess)]

[Hint: Show Rs. 500 in schedule 11 as other asset, representing difference in trial balance]

7. The following are the balances of Karuna Bank Ltd., you are required to prepare the Profit and Loss account and the balance sheet as at 31st December 1994 as per the requirements of the Banking Regulation Act.

	Rs.
Share capital 2,000 equity shares of Rs. 500 each,	
Rs.100 per share paid up	2,00,000
Bad debts written off	12,871
Reserve fund investments	1,00,000
General expenses	18,242
Current accounts	20,24,422
Interest paid	16,052
Deposit accounts	6,92,023
Profit and Loss account (credit)	22,934

Acceptance for customers	1,54,282
Discount	24,376
Bills receivable	1,00,000
Endorsements and guarantees	7,402
Commission	4,424
Cash in hand	22,654
Interest received	53,226
Cash with banks	2,01,210
Endorsements and guarantees as per contra	7,402
Owing by foreign correspondents	20,044
Customers liabilities for acceptances	1,54,282
Short loans (Cr)	6,48,206
Loans and advances to customers	15,45,670
Investments	9,88,254
Bills discounted	6,22,824
Premises	2,21,790
Bills for collection	1,00,000
Statutory reserve	1,00,000

The following information is relevant:

i) During the year interim dividend of Rs.20,000 was paid.

ii) Reserve Rs.6,438 as Rebate on bills discounted.

iii) Provide Rs.15,000 for taxation reserve

iv) Particulars of investments and advances are not required.

[Madras, B.A., Crop., March 1991; Sep.1996]

[Ans: Net profit – Rs. 13,423; balance sheet total – Rs. 37,22,446

[Hint: Balance of Profit and Loss account is the balance left on that account after the payment of interim dividend of rs.20,000. So, interim dividend amount can be added to P & L balance b/f and then the interim dividend can be shown or the adjustment can be ignored. Former method is better].

8. The following are the balances of the Indra Bank Ltd., as at 31.3.1993

Particulars	**Debit**	**Particulars**	**Credit**
Cash in hand	3,41,644	Share Capital	
Cash with RBI	6,21,858	2,50,000 shares of Rs.20 each Rs.3 paid	7,50,000
Money at call and short notice	2,79,416	1,37,500 shares of Rs.10 each Re.1 paid	1,37,500
Bills discounted	8,33,483	Reserve	5,00,000
Advances to customers	13,42,120	Current accounts	25,81,343
Liability of customers for endorsement	1,61,599	Deposit accounts	6,85,135
Bank premises	2,60,000	Customers acceptance for customers	1,78,617
Shares in subsidiary Companies at cost	2,48,000	Dividend eqalisation fund	56,005
Shares in Affiliated companies at cost	1,68,000	P & L A/c. on 1.4.92	1,28,139
Balance with other banks	2,24,220	Interest received	1,41,010
Investments at cost	6,18,358	Discount charges	38,461
Interest paid	42,048	Commission charges	1,54,859
General expenses	1,91,363	Dividends received less tax	86,251
Dividend: Interim	32,188		
Final	56,005		
Liability of customers for acceptances	1,78,617		
	55,98,919		55,98,919

Adjustments:

i) Rebate on bills discounted Rs. 3,271

ii) Rs.20,000 to be allocated to reserve.

You are required to prepare Profit and Loss Account and Balance Sheet.

[Madras, B.A., Corp.Sep.1996]

[Ans: Net profit for the year Rs.1,83,899; Balance carried to balance sheet Rs.1,67,065; Balance Sheet total Rs.49,37,099]

9. The following Ledger balances of Bank of Purasawalkam Ltd., as on 31.12.1994 are furnished to you. Prepare Profit and Loss Account and Balance sheet as per requirement of law.

	Rs.
Reserve fund	12,00,000
Bad debts written off	1,28,000
General expenses	1,82,000
Current accounts	2,02,45,000
Interest paid	1,60,000
Deposit accounts	69,20,000
Profit and Loss account b/fd	2,29,000
Bills receivable for customers	15,00,000
Discounts	2,44,000
Endorsements and guarantees	5,75,000
Commission	45,000
Cash	2,25,000
Interest earned	5,50,000
Balance with RBI	20,30,000
Endorsements and guarantees (constituent liabilities)	5,75,000
Balance with foreign correspondents	12,06,000
Bills for collection	15,00,000
Borrowings from banks	64,82,000
Cash credit and overdrafts	1,54,57,000

Investments	98,82,000
Bills discounted	62,28,000
Premises	22,17,000
Share capital	20,00,000

The following information is furnished.

a) Rebate on bills discounted to be provided Rs.64,000

b) The bank has paid an interim dividend of Rs.2,00,000 during the year.

[Madras, B.Com., Sep.1995; Sep.16997]

[Ans: Net profit – Rs.3,05,000; balance sheet total – Rs. 3,72,45,000; Trial balance difference Rs.2,00,000 presumed as interim dividend]

[Hint: Interim dividend mentioned in adjustments is a part of trial balance and has single effect only]

NOTES