Unit–III

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Ledger Accounts : Preparation of Ledger Accounts, Bank Reconciliation Statements, Preparation of Trial Balance.

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Ledger Accounts, Trial Balance andRectification of Errors

Ledger : Principal Book of Accounts :

The ledger is the principal book of accounts where similar transactions relating to any subject matter or item (such as cash, stock of goods, each credit customer, each credit supplier, each item of cost of expenses, each item of revenue, each asset, etc.) must be brought together, arrnaged separately for increases and for decreases (i.e. debits and credits). In other words, it is a set of accounts containing all accounts related to the business enterprise. The main function of a ledger is to classify or sort out all the items appearing in the Journal or other subsidiary books under their appropriate accounts so that at the end of the accounting period, each account will contain the entire information of all the transactions relating to it, in a condensed or summarised form.

Utility of a Ledger

The usefulness of a ledger may be summarised as below :

(1) It provides complete information about all the accounts at one place.

(2) It enables to ascertain which are the assets and of what values.

(3) It enable to ascertain which are the liabilities and of what amounts.

(4) It provides the complete information regarding the main items of revenues.

(5) It enables to ascertain what are the main items of expenses.

(6) It provides useful summary for the preparation of final accounts.

In the previous chapters, we have learnt how to prepare ledger accounts ? First of all, all the transactions of financial nature are recorded in the books of accounts. With the help of subsidiary books and the Journal we prepare ledger accounts. These ledger accounts have debit or credit balances. One very important aspect of the double entry accounting system is that for each transactions there is debit and credit of equal amounts in two or more accounts. Thus the total of the debit balance must be equal to the total of credit balance. After balancing ledger accounts, we shall learn the method of verifying the correctness of posting to ledger accounts in terms of the debit and credit amounts, by preparing a trial balance.

Meaning of Trial Balance :

Trial balance is a statement, prepared with the debit and credit balances of ledger accounts to test the arithmetical accuracy of the books of accounts. If the totals of the debit and credit amount columns of the trial balance are equal, it is presumed that the posting to the ledger in terms of debit and credit amounts is accurate but we cannot take it as the conclusive proof of arithmetical accuracy. Thus, a trial balance has the following main characteristics :

(1) A trial balance is prepared on a specific date. This is why, we use the word "as on....." with its heading. It may be prepared at any time but it must be prepared at the close of the accounting year.

(2) A trial balance contains the list of all ledger accounts including cash account.

(3) The total of the debit and credit columns of the amount of the trial balance must be equal.

(4) If both the debit and credit columns have the same total, it does not mean that there is no mistake in accounting.

(5) The difference between the debit and credit side of the trial balance points out that certain mistakes have been committed somewhere.

(6) It is a statement prepared in a tabular form. It has two columns one for debit balances and another for credit balances.

(7) The trial balance may be prepared with the balances or totals of balances and totals of ledger accounts.

Objects and Functions of Preparing Trial Balance :

The following are the main objectives and functions of preparing the trial balance :

(1) **To ascertain the arithmetical accuracy of ledger accounts :** As indicated above trial balance helps in knowing the arithmetical accuracy of the accounting entries. This is because according to the dual aspect concept of accounting, for every debit there must be an equivalent credit. Trial balance represents a summary of all ledger balances and therefore, if correct journalising and posting to ledger accounts has been made, the debit and credit columns total of the trial balance must tally. However, there may be certain errors in the books of account inspite of an agreed trial balance.

(2) **To get summarised information of ledger accounts :** The summarised position of ledger accounts can be obtained at a glance from the trial balance. The position of a particular account can be judged simply by looking at the trial balance. The ledger may be seen only when details regarding the accounts are required. Infact, it would have been very difficult to assess the position of different ledger accounts from various subsidiary books and ledger accounts.

(3) **To use as basis for preparation of the final accounts :** The ultimate end of maintaining books of accounts is to ascertain the result of the business in terms of profit and to ascertain the financial position in terms of the value of different assets and liabilities. Preparation of trial balance facilitates the preparation of final accounts. For preparing the final accounts, one need not refer to the ledger. Infact, the availability of a tallied trial balance is the first step in the preparation of final accounts.

(4) **To use for making adjustments :** While preparing final accounts certain adjustments regarding outstanding and prepaid expenses, accrued and unearned incomes and closing stock etc. are to be made. While identifying such items for adjustments, we will have to use the information furnished by the trial balance.

(5) **To help in locating errors :** Where there are a large number of ledger accounts and the trial balance does not tally, the accountant is to face with the problem of locating and correcting the errors. Thus, when a trial balance does not tally, steps may be taken to locate the errors.

Preparation of Trial Balance :

After completing the two steps of recording business transactions in the books of account as : *(i)* to record the business transactions in subsidiary books and journal proper, and *(ii)* to prepare ledger accounts on the basis of subsidiary book and journal proper, the third step is the preparation of trial balance, which may be prepared in the following format :

Trial Balance *as on ....*

S.No.	Particulars	L.F.	Amount	
			Debit	Credit
			Rs.	Rs.
	(1)	(2)	(3)	(4)
	Total			

Methods of preparing Trial Balance :

There are three methods of preparing trial balance. The total of both the debit and credit columns of trial balance must be equal in all the methods. These methods are as under :

(1) **Total amount method :** Under this method the totals of debits and credits, instead of the balances of each account is separately written in the debit and credit columns of the trial balance. The total of both the debit and credit column must be equal.

(2) **Balance method :** To prepare the trial balance by this method, first of all every ledger account is to be balanced. This work is done immediately after completion of postings from books of original entry to the ledger. Excess of the total of the debit side of an account over its credit side is known as debit balance and written in the debit column of the trial balance. Similarly, excess of credit side of an account over its debit side shows credit balance and will be written at the credit side of the trial balance. The total of both the debit and credit sides must be equal.

(3) **Total and Balance Method :** Under this method the amount column of the trial balance is divided between total and balance method. Each method has further two columns of debit and credit. The total of the debit and credit under each method must be equal.

Illustration 8.1 :

Prepare a trial balance by Total Method according to following (Total of Accounts) information :
Cash Rs. 18,575 (Debit), Rs. 7,250 (Credit),
Capital Rs. 44,650, Sales Rs. 13,950,
Purchases Rs. 34,200 (Debit), Rs. 10,555 (Credit)
Ram & Company Rs. 2,950 (Debit), Rs. 2,950 (Credit),
Furniture Rs. 17,400, Discount Rs. 50 (Debit), Rs. 20 (Credit),
Drawings Rs. 500 (Debit), Salaries Rs. 2,500 (Debit), Rent Rs. 3,200 (Debit)

Solution :

Trial Balance as on.........
(By Totals Method)

S. No.	Name of Ledger Account	L.F.	Debit Total	Credit Total
			Rs.	Rs.
1.	Cash A/c		18,575	7,250
2.	Capital A/c		—	44,650
3.	Purchases A/c		34,200	10,555
4.	Sales A/c		—	13,950
5.	Ram & Company's A/c		2,950	2,950
6.	Furniture A/c		17,400	—
7.	Discount A/c		50	20
8.	Drawings A/c		500	—
9.	Salaries A/c		2,500	—
10.	Rent A/c		3,200	—
	Total		79,375	79,375

Illustration 8.2 :

Prepare a trial balance from the information given in illustration 9.1 by Balance Method.

Solution :

Trial Balance as on......
(By Balances Method)

S.No.	Name of Ledger Account	L.F.	Debit Balance	Credit Balance
1.	Cash A/c		11,325	—
2.	Capital A/c		—	44,650
3.	Purchases A/c		23,645	—
4.	Sales A/c		—	13,950
5.	Furniture A/c		17,400	—
6.	Discount Allowed A/c		30	—
7.	Drawings A/c		500	—
8.	Salaries A/c		2,500	—
9.	Rent A/c		3,200	—
	Total		58,600	58,600

Debit and Credit sides of Ram & Company are equal and does not have any balance.

Illustration 8.3 :

Prepare a trial balance from the information given in illustration 9.1 by total & balance methods :

Solution :

Trial Balance as on......

Total of & Balances Method

S. No.	Names of Accounts	L. F.	Totals Debit	Totals Credit	Balance Debit	Balance Credit
			Rs.	Rs.	Rs.	Rs.
1.	Cash A/c		18,575	7,250	11,325	—
2.	Capital A/c		—	44,650	—	44,650
3.	Purchases A/c		34,200	10,555	23,645	—
4.	Sales A/c		—	13,950	—	13,950
5.	Ram & Company's A/c		2,950	2,950	—	—
6.	Furniture A/c		17,400	—	17,400	—
7.	Discount A/c		50	20	30	—
8.	Drawings A/c		500	—	500	—
9.	Salaries A/c		2,500	—	2,500	—
10.	Rent A/c		3,200	—	3,200	—
	Total		79,375	79,375	58,600	58,600

Illustration 8.4 :

From the books of Jai Vijay Traders, following trial balance was prepared in which totals of debit and credit columns are equal whereas there are many mistakes in it. Prepare the correct trial balance :

Trial Balance *as on.....*

Name of Account	Debit Balances	Name of Account	Credit Balances
	Rs.		Rs.
Buildings	60,000	Capital	73,600
Machinery	17,000	Furniture	15,600
Return outwards	7,600	Sales	1,04,000
Bad debts	2,800	Debtors	70,000
Cash in hand	400	Interest Received	2,600
Discount Received	8,000		
Bank Loan	12,000		
Creditors	58,000		
Purchases	1,00,000		
Total	2,65,800	Total	2,65,800

Solution : (1) In the above trial balance, furniture and debtors have been written on credit side even when these are assets. So these should be shown on debit side (2) Similarly, Purchase Return A/c and Discount Received A/c have been shown on debit side whereas these should be shown on credit side. Hence, corrected trial balance will be as under :

Corrected Trial Balance *as on.......*

Names of Accounts	L.F.	Debit Balances Rs.	Credit Balances Rs.
Buildings		60,000	—
Machinery		17,000	—
Return outwards		—	7,600
Bad debts		2,800	—
Cash in hand		400	—
Discount Received		—	8,000
Bank Loan		—	12,000
Creditors		—	58,000
Purchases		1,00,000	—
Capital		—	73,600
Furniture		15,600	—
Sales		—	1,04,000
Debtors		70,000	—
Interest Received		—	2,600
Total		2,65,800	2,65,800

Illustration 8.5 :

Prepare a trial balance on the basis of following balances :

	Rs.		Rs.
Salaries A/c	58,000	Sales A/c	4,20,000
Rent & Taxes A/c	12,000	Purchases A/c	2,55,000
Printing & Stationery A/c	8,000	Sales Return A/c	20,000
Railway Freight A/c	15,000	Purchases Return A/c	15,000
Discount Allowed A/c	22,000	Building A/c	3,50,000
Trade Creditors	4,00,000	Cash A/c	1,30,000
Trade Debtors	3,00,000	Drawings A/c	1,40,000
Furniture & Fittings A/c	25,000	Capital A/c	5,00,000

Solution : In this illustration, it is not given that the balances are debit or credit. Before preparing the trial balance, it is to be seen on the basis of nature of accounts that which accounts are related to debit balances and which are related to credit balances. It may be decided as under :

(i) Accounts of expenses and losses-Debit Balances
(ii) Accounts of Assets-Debit Balances
(iii) Accounts of Liabilities-Credit Balances
(iv) Drawings Account-Debit Balance
(v) Sales A/c and Purchases Returns A/c–Credit Balances
(vi) Purchases A/c and Sales Return A/c–Debit Balances

On deciding the balances of accounts as above trial balance may be prepared as under :

Trial Balance as on......
(Balance Method)

S.No.	Name of Accounts	L.F.	Debit Amount Rs.	Credit Amount Rs.
1.	Salaries A/c		58,000	—
2.	Rent & Taxes A/c		12,000	—
3.	Printing & Stationary A/c		8,000	—
4.	Railway Freight A/c		15,000	—
5.	Discount Allowed A/c		22,000	—
6.	Trade Creditors		—	4,00,000
7.	Trade Debtors		3,00,000	—
8.	Furniture and Fittings A/c		25,000	—
9.	Sales A/c		—	4,20,000
10.	Purchases A/c		2,55,000	—
11.	Sales Return A/c		20,000	—
12.	Purchases Return A/c		—	15,000
13.	Building A/c		3,50,000	—
14.	Cash A/c		1,30,000	—
15.	Drawings A/c		1,40,000	—
16.	Capital A/c		—	5,00,000
	Total		13,35,000	13,35,000

Illustration 8.6 :

Prepare a Trial Balance from the following balance extracted from the books of Aditya and Company as on 31st March, 2015 :

Name of Accounts	Rs.	Name of Accounts	Rs.
Capital	1,85,000	Loan From Vijay	9,500
Purchases	1,04,650	Travelling Expenses	2,400
Drawings	19,500	Opening Stock	19,115
Sales	1,23,450	Fixtures and Fittings	17,400
Cartage	2,200	Bank Balance	31,500
Purchases Returns	900	Interest on Loan given	2,700
Buildings	82,000	Rent from Tenants	8,100
Machinery & Plant	58,000	Cash in Hand	4,050
Commission on Purchases	1,200	Sundry Creditors	13,650
Income Tax	1,300	Commission Received	7,400
Discount on Purchases	8,275	Motor Car Expenses	3,300
Salaries and .Wages	5,170	Professional Fee Received	4,200
Insurance and Taxes	3,120	Dock Charges	1,300

If there is any difference in Trial Balance it is to be written in suspense account :

Solution :

Trial Balance of Aditya and Company
as on 31st March, 2015
(Balance Method)

S.No.	Name of Accounts	L.F.		Debit Amount Rs.		Credit Amount Rs.
1.	Capital			—		1,85,000
2.	Purchases A/c			1,04,650		—
3.	Drawings A/c			19,500		—
4.	Sales A/c			—		1,23,450
5.	Cartage A/c			2,200		—
6.	Purchases Returns A/c			—		900
7.	Building A/c			82,000		—
8.	Machinery A/c			58,000		—
9.	Commission on Purchases			1,200		—
10.	Income Tax			1,300		—
11.	Discount on Purchases (Received)			—		8,275
12.	Salaries and Wages			5,170		—
13.	Insurance and Taxes			3,120		—
14.	Loan from Vijay			—		9,500
15.	Travelling Expenses			2,400		—
16.	Opening stock			19,115		—
17.	Fixtures and Fittings			17,400		—
18.	Bank Balance			31,500		—
19.	Interest given on Loan			2,700		—
20.	Rent from Tenants			—		8,100

21.	Cash in Hand			4,050		—
22.	Creditors			—		13,650
23.	Commission Received			—		7,400
24.	Motor Car Expenses			3,300		—
25.	Professional Fee Received			—		4,200
26.	Dock Charges			1,300		—
27.	Suspense A/c *(Balancing figure)*			1570		—
		Total		3,60,475		3,60,475

Errors affecting the Trial Balance :

It is very often found that certain errors may be there in recording, classifying and summarising the financial transactions whether the trial balance tallies or does not tally. Some of the errors affect the agreement of the trial balance. Such errors are easy to be located since they are detected at an early stage. The trial balance in case of this agreement is said to be out of balance. Following errors responsible for disagreement of trial balance :

(1) **Wrong totalling or casting of the subsidiary books :** Errors of totalling and substractions may occur in the subsidiary books or in the ledger accounts or even in the trial balance itself. The trial balance will be out due to these errors if they are not neutralised by some other compensating errors. For example, under casting or over casting of subsidiary books, errors in the balancing or totalling of ledger accounts, wrong totalling of trial balance etc.

(2) **Posting of the wrong amount :** In case the posting of certain entry from a subsidiary book to concerned ledger account has been made by wrong amount, the trial balance will not agree. For example, error of transposing figure *i.e.* writing 52 in place of 25, error of sliding figure *i.e.* writing 7,000 in place of 70,000, error of doubling the wrong figure *i.e.* writing 377 in place of 397, error of duplicate posting etc.

(3) **Posting at the wrong side of an account :** While posting of journal entries in the concerned ledger accounts if it is made at the wrong side of any specific account, the trial balance will not tally.

(4) **Omission of an amount from ledger accounts :** All the omissions taking place in posting or in the trial balance will make the trial balance out, for example, omission of total of any subsidiary book in ledger accounts, omission of posting of certain item from subsidiary books to ledger accounts, omission of posting the balance of any ledger accounts to trial balance etc.

(5) **Wrong posting in the trial balance :** If the credit balance has been posted at the debit side of the trial balance and/or the debit balance of an account has been posted at the credit side of trial balance, the trial balance will not tally.

Errors not affecting the Trial balance :

There are certain errors which do not affect the agreement of the trial balance. Their location is, therefore, a difficult task. They are usually found out when statement of accounts are received by the business or sent to the customers or during the course of internal or external audit and sometimes by chance. As stated earlier even if both the debit and credit columns of trial balance are equal to each other, it can never be taken of conclusive proof of accuracy. It means that there are certain errors which remain undetected by trial balance. Such errors are committed in two or more accounts. The errors may be mentioned as under :

(1) **Errors of Omission :** These errors are incurred when a transaction **completely omitted** from the books of accounts. It happens when a transaction is not recorded in the books of original entry *i.e.* various subsidiary books including Journal proper. For example, if goods worth Rs. 12,000 has been

received back from a customer and the entry has not been made at all in the Returns Inward Book, such an error will he termed as an error of omission. Since there has been neither a debit entry nor a credit entry, therefore, the two sides of the trial balance will not be affected on account of such error.

(2) **Errors of Principle :** If there is an error involving accounting principle such as where a proper distinction between revenue and capital items is not made, the trial balance will still agree. Such errors also are difficult to be located. Examples of such errors are treating an expense as an asset, treating an asset as an expenses, treating an income as a liability or vice versa etc.

(3) **Compensating Errors :** As the name indicates compensating errors are those errors by which the effect of certain errors is neutralised by the effect of another error. These errors also do not affect the agreement of the trial balance and, therefore, the location is also difficult. Example of such error is 'Sale of goods to Mr. X for Rs. 5,000 was debited to Mr. X's A/c with Rs. 500 only and Rs. 5,000 received from Rs. Y was credited to Y's A/c with Rs. 500 only. The effect of the error in the trial balance will he that the total of the debit and credit sides, both will be less by Rs. 4,500 and both sides of trial balance will tally inspite of the above two errors.

(4) **Errors of Commission :** These are errors which are caused due to wrong posting either of an amount or on the wrong side of an account or in the wrong account, wrong totalling, wrong balancing, wrong casting of the subsidiary books, wrong recording of amount in the books of original entry etc. For example, if a sum of Rs. 3,500 received from Mr. Ravi Kant is credited to his account as Rs. 350, this is an errors of commission. Errors of commission affect the agreement of the trial balance, therefore, their location is much easier.

Steps to locate errors :

As soon as the trial balance does not agree the accountant must immediately spot out the errors and to correct them. The following steps can be suggested for the location of errors :

(1) We should find out figure of the difference between the total of the debit and credit columns of the trial balance and check whether any entry of the same amount been omitted from posting.

(2) If one amount has been shown for a group of accounts *i.e.* sundry debtors, we should recheck the total of the list of such accounts.

(3) See that there is no mistake in the balancing of the various accounts.

(4) Posting of all amounts of corresponding to the difference or half the difference should be checked.

(5) It should be checked that the balances of all accounts including the cash and bank balances have been written in the trial balance. It should be checked that whether there is a transposition of figure if the difference between the debit and credit side of the trial balance is divided by nine evenly, there may be a mistake of transposition *i.e.*, the digits of the figure may have changed their place.

(6) If the difference is in the round figure, the mistake may have been committed in totalling or carrying forward the total of the subsidiary books to ledger accounts.

(7) If the difference is of a large amount, it is just possible that the certain ledger account may have been omitted from trial balance.

(8) Posting of all amounts corresponding to double the difference should be checked.

(9) In the last, thorough checking of subsidiary books and their totalling be made. Posting and balancing of ledger accounts and posting from ledger accounts to trial balance should also be checked.

Inspite of all the above efforts if the errors remain undetected the difference will be transferred to suspense account temporarily and Trial Balance be closed.

Suspense Account :

Sometimes, despite the best efforts of an accountant, all the errors are not located and the trial balance does not tally. In such a case, to avoid the delay in preparing final accounts, the difference in the trial balance is transferred in a newly Opened Suspense Account temorarily. After that, sincere efforts to locate the errors will be continued and suspense account shall be closed after the rectification of all the errors. If suspense account still shows a balance it will be shown in the Balance Sheet on the assets side if it shows a debit balance or on the liabilities side, if it shows a credit balance. Thus, the opening of the suspense account does not mean that the errors may be forgotten.

Rectification of Errors

The old statement "To Err is human" is true for accounts also. As discussed above, an accountant as a human being is likely to commit mistakes of omission, commission and principles in maintaining books of accounts. Errors should never be corrected by overwriting. However, errors committed in the books of account must be rectified at the earliest. It is better to rectify errors always through Journal entries. If immediately after passing an entry, it is clear that an error has been committed, it may be corrected by neatly crossing out the wrong entry and making the correct entry. If however, the errors are located after sometime, the error should be rectified only by making a suitable entry, called rectification entry.

Each error has to be dealt with on its merit. The guiding lines are :

Think about the transactions which have been wrongly recorded. See which account should have been debited and which account should have been credited. Now consider what has actually been done. In order to ascertain the rectifying entries if some account should have been debited but could not be debited, should be debited now. On the other hand if some account should have been credited but could not be credited should be credited now. Similarly, if some accounts have been debited wrongly, the same. Account should be credited now to remove the debit and on the other hand if some account has been credited wrongly, should be debited now to remove the unwanted credit. Thus the topic **"Rectification of errors" means to remove the effect of that error and to restore the correct position.**

Infact, the rectification of an error depends on at which stage it has been detected. An error may be detected at any one of the following stages :

(1) Before preparation of trial balance.
(2) After trial balance but before the final accounts are drawn,
(3) After final accounts *i.e.* in the next accounting period.

(1) Before Preparation of Trial Balance :

There may be certain errors which are found before preparation of trial balance. Such errors may be further classified in the following two categories :

(1) **One Sided Errors** : There may be certain errors which affect one side of an account or more than one account in such a way that it is not possible to pass a complete rectification entry and can be rectified, by making simply rectification statements in the appropriate side (s) of concerned account (s). Rectification of such errors is illustrated in following illustration :

Illustration 8.7 :

(1) The sales book for November is undercast by Rs. 400. The effect of this error is that the Sales Account has been credited short by Rs. 400. Since the account is posted by the total of the sales book, there is no error in the accounts of the customers since they are posted with the amounts of individual sales. Hence, only the Sales Accounts need to be corrected. This will be done by making an entry for Rs. 400 on the credit side **"By undercasting of Sales Book for November Rs. 400."**

(2) Rs. 5,000 received from Mr. X has been entered by mistake on the debit side of his account. Since the cash book seems to have been correctly written, the error is only in the account of Mr. X, he should have been credited and not debited by Rs. 5,000. Not only is the wrong debit to be removed but also a credit of Rs. 5,000 to be given. This can be done now by entering Rs. 10,000 on the credit side of his account. The entry will be **"By posting on the wrong side of X's A/c Rs. 10,000"**.

(3) Rs. 71 paid to Mr. Y has been posted as Rs. 17 to the debit of his account. Mr. Y has been debited short by Rs. 54. The rectifying entry is **"To mistake in posting on..... Rs. 54."**

(4) Goods purchased from Ram for Rs. 4,000 was wrongly credited to Ram's account by Rs. 400. Again we cannot pass a complete journal entry for rectification even though two accounts are involved. The rectification will be done by the entry **"To wrong posting on..... Rs; 400"** in the debit of Ram's account and **"By omission of posting on..... Rs. 4,000** in the credit of Ram's account.

Illustration 8.8 :

How would you rectify the following errors in the books of X & Co. :

(1) The total to the Purchases Book has been undercast by Rs. 400.
(2) The Returns Inward Book has been undercast by Rs. 500.
(3) A sum of Rs. 650 written off as depreciation on Machinery has not been debited to depreciation account.
(4) A payment of Rs. 200 for Salaries (to Gopal) has been posted twice to Salaries Account.
(5) The total of Bills Receivable Book Rs. 6,300 has been posted to the credit of Bill Receivable Account.
(6) An amount of Rs. 372 for a credit sale to 'M' although correctly entered in the Sales Book, has been posted as Rs. 273.
(7) Discount allowed to Mohit Rs. 35 has not been entered in the Discount Column of the Cash Book but it has been posted to his personal account.

Solution :

(1) The Purchases Account should receive another debit of Rs. 400 since it was debited short previously.
"To undercasting of Purchases Book for the month of.......... Rs. 400."
(2) Due to this error the Returns Inward Account has been posted short by Rs. 500, the correct entry will be :
"To undercasting of Returns Inward Book for the month of...... Rs. 500."
(3) The omission of the debit to the Depreciation Account will be rectified by the entry :
"To omission of posting on ..... Rs. 650."
(4) The excess debit will be removed by a credit in the Salaries account by the entry :
"By double posting on ..... Rs. 200."
(5) Rs. 6,300 should have been debited to the Bills Receivable Account and not should be credited. To correct the mistake, the Bills Receivable Account should be debited by Rs. 12,600 by the entry:
"To wrong posting of B/R received on .... Rs. 12,600."
(6) Ram's personal A/c is debited Rs. 99 short. The rectification entry will be :
"To wrong posting on .... of Rs. 99."
(7) Due to this error, the discount account has been debited short by Rs. 35. The required entry is:
"To omission of discount allowed to Mohit on ..... Rs. 35."

(2) Two-Sided Errors :

Such errors affect two accounts simultaneously and should be rectified by means of Journal Entries, which can be passed in the following four cases :

(1) When there is an excess debit in one account and a short debit in another account.
(2) When there is an excess credit in one account and a short credit in another account.
(3) When there is an excess debit in one account and an excess credit in another account.
(4) When there is a short debit in one account and a short credit in another account. Rectification of such errors is illustrated in the following illustrations :

Illustration 8.9 :

The following errors were found in the book of Refeeque Bros. Give the necessary Journal entries to correct them :

(1) Rs. 4,500 paid for furniture purchased has been charged to Purchases account.
(2) Repairs made were debited to Building account for Rs. 500.
(3) An amount of Rs. 2,100 withdrawn by the proprietor for his personal use has been debited to Trade Expenses account.

(4) Rs. 3, 100 paid for rent debited to Landlord's account.
(5) Salary Rs. 2,125 paid to a clerk due to him has been debited to his personal account.
(6) Rs. 4,100 received from Lal & Co. has been wrongly entered in Lalu & Co.
(7) Rs. 2,700 paid in cash for a typewriter was charged to Office Expenses account.
(8) Purchases of goods from Dev for Rs. 8,000 was wrongly recorded in Day Sales Book.

Solution :

Journal

	Particulars	L.F.	Rs.	Rs.
1.	Furniture A/c Dr. To Purchases A/c (Correction of wrong debit to Purchases for furniture)		4,500	4,500
2.	Repairs A/c Dr. To Building A/c (Correction of wrong debit to building for repairs made)		500	500
3.	Drawings A/c Dr. To Trade Expenses A/c (Correction of wrong debit to Trade Expenses A/c for cash withdrawn by the proprietor for his personal use).		2,100	2,100
4.	Rent A/c Dr. To Landlord's Personal A/c (Correction of wrong debit to land lord's A/c for rent paid)		3,100	3,100
5.	Salaries A/c Dr. To Clerk's (Personal) A/c (Correction of wrong debit to clerk's personal A/c for salaries)		2,125	2,125
6.	Lalu & Co. Dr. To Lal & Co. (Correction of wrong credit to Lalu & Co. instead of Lal & Co).		4,100	4,100
7.	Typewriter A/c Dr. To Office Expenses A/c (Correction of wrong debit of Office Expenses A/c for purchase of typewriter).		2,700	2,700
8.	Purchaes A/c Dr. Sales A/c Dr. To Dev's A/c (Goods purchased, wrongly entered in sales day book, now rectified.)		8,000 8,000	16,000

Illustration 8.10 :

The following errors were found in the books of Ravindra Bros. Give the necessary entries to correct them :

(1) Rs. 350 paid for Rent debited to Landlord's personal account.
(2) A sum of Rs. 4,000 spent on extension of Buildings was debited to Repairs to Buildings Account.
(3) A clerk of the firm was paid Rs. 3,600 as Salary. This amount was debited to his Personal Account.
(4) A cheque of Rs. 6,300 paid to Mr. Saleem had been debited to Mr. Raheem's Account.
(5) A cheque of Rs. 8,000 received from Y & Co., was dishonoured and debited to Allowances Account.
(6) Rs. 700 posted to the debit of Stationery Account instead of Shri Ram's Account for payment of his dues.
(7) Interest accrued on Investments Rs. 1,340 not recorded in books.
(8) Goods worth Rs. 400 were returned to Shyam was wrongly entered in Return Inward Book.

Solution :

Rectifying Journal Enteries

S.No.	Particulars	L.F.	*Cr.* Rs.	*Dr.* Rs.
1.	Rent A/c Dr. To Landlord's Personal A/c (For rent debited to Landlord's A/c, now corrected)		350	350
2.	Buildings A/c Dr. To Repairs A/c (For extension of buildings, wrongly debited in Repairs A/c, now corrected)		4,000	4,000
3.	Salaries A/c Dr. To Clerk's Personal A/c (For salaries wrongly debited to clerk's A/c, now corrected)		3,600	3,600
4.	Mr. Saleem's A/c Dr. To Mr. Raheem's A/c (For cheque paid to Saleem wrongly debited to Raheem, now corrected)		6,300	6,300
5.	Y & Co. Dr. To Allowances A/c (For Y & Co's, cheque dishonoured and wrongly debited to Allowances A/c, now corrected)		8,000	8,000
6.	Shree Ram's A/c Dr. To Stationery A/c (For Stationery account wrongly debited instead of Shree Ram, now corrected)		700	700

7.	Accrued Interest A/c Dr.		1,340	
	To Interest A/c			1,340
	(For interest accrued on investment, now recorded)			
8.	Shyam's A/c Dr.		800	
	To Purchases Return A/c			400
	To Sales Return A/c			400
	(Purchases returns wrongly recorded in sales return book, now corrected)			

Thus, it can be said that errors detected before the preparation of trial balance can be rectified either through rectification statements or through rectification entries.

(2) After preparation of Trial Balance but before Final Accounts :

There may be certain errors which are found before the end of the accounting period or preparation of final accounts but after preparation of trial balance. Sometimes the trial balance is artificialy made to agree inspite of errors by opening a Suspense Account as stated in foregoing pages. It means there are certain errors for which efforts must be made to locate them and by passing rectification entries, so that Suspense Account is closed and the trial balance be tallied correctly.

The rule of rectifying errors detected at this stage is simple. Those errors for which no complete Journal entries were possible in the earlier stage of rectification (i.e. before trial balance), can now be rectified by way of journal entry(s) with the help of suspense account; since it is these errors which gave rise to the suspense account in the trial balance. The rectification entry for other type of error *i.e.* error affecting more than one account in such a way that a complete journal entry is possible for its rectification, can be rectified in the same way as in the earlier stage *(i.e.* before trial balance). Rectification of such errors may be illustrated as under :

Illustration 8.11 :

Pass Journal Entries to rectify the following errors assuming the existence of necessary Suspense Account :

(1) Goods bought from Mr. Mukesh amounting to Rs. 7,800 was posted to the credit of his account as Rs. 7,700.

(2) Sales book was overcast by Rs. 3,400.

(3) While carrying forward the total of one page of the Purchases Book to the next, the amount of Rs. 1,465 was written as Rs. 1,546.

(4) Cartage Rs. 370 paid on Machinery newly acquired was debited to Carriage Inward Account.

(5) Purchases return to Z and Zee Bros. Rs. 2,400 were not recorded in Purchase Returns Book but the Account of Z & Zee Bros, was duly debited for the amount.

(6) Drawings of goods costing 6,700 were not recorded in the books of Account.

(7) Whitewashing expenses, Rs. 203 were posted from cash book to the nominal account as Rs. 302.

Also prepare Suspense Account starting with debit balance of Rs. 107. Have you any comments to offer on Suspense Account ?

Solution :

Journal Entries

Date	Particulars	L.F.	Amount	Amount
(1)	Suspense Account Dr.		100	
	To Mr. Mukesh			100
	(For rectification of short credit to Mr. Mukesh's A/c)			
(2)	Sales Account Dr.		3,400	
	To Suspense Account			3,400
	(For rectification of wrong total of Sales Book)			
(3)	Suspense Account Dr.		81	
	To Purchases Account			81
	(For rectification of wrong carry forward of total from one page to another in the Purchases Book)			
(4)	Machinery Account Dr.		360	
	To Carriage Inwards A/c			370
	(For rectification of wrong debit to carriage inwards for cartage paid on newly acquired Machinery)			
(5)	Suspense Account Dr.		2,400	
	To Purchase Returns A/c			2,400
	(For rectification of omission of credit to Purchases Returns A/c for goods returned to Z & Zee Bros.)			
(6)	Drawings Account Dr.		6,700	
	To Purchases Account			6,700
	(For rectification of omission of drawings of goods costing Rs. 6,700 by the proprietor)			
(7)	Suspense Account Dr.		99	
	To Whitewashing or Repairs Account			99
	(For rectification of excess debit in Whitewashing Account)			

Suspense Account

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
	To Balance b/d		107		By Sales Account		3,400
	To Mukesh		100				
	To Purchases Account A/c		81				
	To Purchase Returns		2,400				
	To Whitewashing A/c		99				
	To Balance c/d		613				
			3,400				3,400

Comments : Since suspense account still shows a balance it means all errors have not yet been detected totally.

Illustration 8.12 :

The following errors were located after closing the accounting books of a trading concern of Shri Ravi Shaker :

(1) Goods purchased from Mr. X Rs. 4,000 was posted to debit side of his personal account. .

(2) Goods sold to Mr. Y. Rs. 10,549 was posted to debit side of his personal account as Rs. 10,459.

(3) Sales Day Book was erroneously undercast by Rs. 7,100.

(4) Purchase Day Book was erroneously undercast by Rs. 4,500.

(5) Payment of Rent Rs. 1,459 was posted to Rent Account as Rs. 1,495.

Assume that on closing the books of the business the difference in Trial Balance Rs. 10,546 was put on the credit side of Suspense account. The errors were subsequently found out before preparing final accounts. Pass necessary Journal entries to rectify the errors and also prepare the Suspense Account.

Solution :

Journal of Shri Ravi Shaker

Date	Particulars (Rectification Enteries)		L.F.	Dr. Amount	Cr. Amount
1.	Suspense A/c	Dr.		8,000	
	To Mr. X				8,000
	(Being rectification of posting of credit purchases from Mr. X on wrong side)				
2.	Mr. Y	Dr.		90	
	To Suspense A/c				90
	(Sale of Rs., 10,549 to Mr. Y was posted in his account as Rs. 10,459, now rectified)				
3.	Suspense A/c	Dr.		7,100	
	To Sales A/c				7,100
	(being rectification of the undercasting of Sales Book by Rs. 7,100)				
4.	Purchases A/c	Dr.		4,500	
	To Suspense A/c				4,500
	(Being rectification of the undercasting of Purchase Book by Rs. 4,500)				
5.	Suspense A/c	Dr.		36	
	To Rent A/c				36
	(Payment of Rent Rs. 459 was wrongly posted as Rs. 495, now rectified)				

Suspense Account

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
	To Mr. X		8,000		By Balance b/d		10,546
	To Sales A/c		7,100		By Purcahses A/c		4,500
	To Rent A/c		36		By Mr. Y		90
			15,136				15,136

Illustration 8.13 :

The books of A could not be tailed. The accountant transferred the difference of Rs. 1,270 in the suspense accounton the debit side. The following mistake were found later on. Rectify these errors by passing Journal entries and prepare Suspense Account :

(1) The purchase of Rs. 400 from X was entered into sales book butX's personal account was rightly credited.

(2) The sale of Rs. 1,430 to Y was credited in his account as Rs. 1,340.

(3) The sale of old furniture Rs. 540 was credited in his Account as Rs. 340.

(4) Goods worth Rs. 100 were taken by the proprietor which was not recorded.

(5) The sales of Rs. 2,296 to Z was entered in sales book as Rs. 2,269.

(6) Sales return books balance of Rs. 210 was not included in the Account. (RU, BCA 2007)

Solution :

Journal Entries for Rectification of Errors

Date	Particulars (Rectification Enteries)		J.F.	Dr. Amount	Cr. Amount
1.	Purchase A/c	Dr.		400	
	Sales A/c	Dr.		400	
	To Suspense Account				800
	(for purchases wrongly entered as sales, now rectified)				
2.	Y's A/c	Dr.		770	
	To Suspense Account				770
	(Sales to Y Rs. 1,430 wrongly credited to his account as Rs. 340, now corrected)				
3.	Sales A/c	Dr.		450	
	Suspenses A/c	Dr.		90	
	To Furniture Account				540
	(Sale of furniture wrongly credited to sales A/c now corrected)				
4.	Drawing A/c	Dr.		100	
	To Purchases Account				100
	(Goods withdrawn' now recorded)				
5.	Z's Account	Dr.		27	
	To Sales Account				27
	(Sales to Z, Rs. 296 was wrognly entered as 269 in sales books, now corrected)				
6.	Sales Return A/c	Dr.		210	
	To Suspense Account				210
	(Balance of Sales Return book not included, now rectified)				

Suspense Account

		Rs.			Rs.
	To Balance b/d	1,270		By Purchases A/c	400
	To Furniture A/c	90		By Sales A/c	400
	To Balance c/d A/c	420		By Y's A/c	770
				By Sales Return A/c	210
		1,780			1,780

(3) Rectification of Errors after preparation of Final Accounts or Rectification in the next Accounting Period or Profit & Loss Adjustment Account.

Sometimes errors of one accounting period are to be rectified in the next accounting period. In this case care has to be taken that rectifying entry, does not affect the trading result of the subsequent accounting period. Since the profit or loss of each accounting period should be separately calculated, it is, therefore necessary that the rectification of errors relating to the previous year should be made in such a way that it should not affect the profit or loss of the current year. In order to achieve this basic objective a new account **'Profit & Loss Adjustment Account'** is opened which represents to all the nominal accounts appearing in the Trading & Profit & Loss Account. The balance is this newly opened, Profit & Loss Adjustment Account is transferred to Capital A/c or to Profit & Loss Appropriation Account. In this way Profit & Loss of the current year remains unaffected from the errors of the previous year.

Illustration 8.14 :

Rectify the following : (a) If there is no suspense account; (b) If there is a suspense account ; and (c) If rectification is to be done in the next accounting period.

- (i) An entry for the goods sold to Madhav for Rs. 204 was posted to his account as Rs. 240.
- (ii) Rs. 200 being the monthly total of discount allowed to customers was entered to discount received account in the ledger.
- (iii) Rs. 550 received from Sohan credited to Mohan as Rs. 750.
- (iv) The total of Purchases Book was Rs. 2,000 short.
- (v) Sale of old furniture for Rs. 350 to Furniture Mart was recorded in Sales Book. Book value of the furniture was Rs. 500.

Solution : (a) If there is no Suspense Account :

- (i) Credit Madhav with Rs. 36 saying *"By Excess debit for sales on..... Rs. 36."*
- (ii) Debit the Discount Received Account with Rs. 400 saying *"To rectification of wrong credit of Rs. 200 for discount allowed ...... Rs. 400."*
- (iii) Credit Sohan with Rs. 550 and debit Mohan with Rs. 750.
- (iv) Debit Purchase Account with Rs. 2,000 saying *"To short total of Purchases Book.... Rs. 2,000."*
- (v) Debit Sales Account with Rs. 350 and Loss on sales of Furniture with Rs. 150 and credit Furniture Account with Rs. 500.

(b) If there is a Suspense Account :

Journal Enteries (Without Narrations)

	Particulars		L.F.	Amount Rs.	Amount Rs.
(i)	Suspense Account	Dr.		36	
	To Madhav				36
(ii)	Discount Allowed Account	Dr.		400	
	To Suspense Account				400
(iii)	Mohan's Account	Dr.		750	
	To Sohan A/c				550
	To Suspense A/c				200
(iv)	Purchase Account	Dr.		2,000	
	To Suspense Account				2,000
(v)	Sales Account	Dr.		350	
	Loss on Sales of Furniture	Dr.		150	
	To Furniture Account				500

Dr. Suspense Account Cr.

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
	To Difference in Trial balance (*balancing figure*)		2,564	(ii)	By Discount		400
(i)	To Madhav		36	(iii)	By Mohan		200
				(iv)	By Purchases		2,000
			2,600				2,600

***(c)* If Rectification is to be done in Next Accounting Period :**

Journal Enteries (Without Narrations)

Date	Particulars		L.F.	Amount Rs.	Amount Rs.
(i)	Suspense Account	Dr.		36	
	To Madhav				36
(ii)	Profit and Loss Adjustment A/c	Dr.		400	
	To Suspense Account				400
(iii)	Mohan's A/c	Dr.		750	
	To Suspense A/c				200
	To Sohan 's A/c				550
(iv)	Profit and Loss Adjustment A/c	Dr.		2,000	
	To Suspense A/c				2,000
(v)	Profit and Loss Adjustment A/c	Dr.		500	
	To Furniture A/c				500
(vi)	Capital A/c	Dr.		2,900	
	To Profit & Loss Adjustment A/c				2,900

Profit & Loss Adjustment Account

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
(ii)	To Suspense A/c		400		By Capital Account (*Transfer*)		2,900
(iv)	To Suspense A/c		2,000				
(v)	To Furniture A/c		500				
			2,900				2,900

Illustration 8.15 :

The books of Mr. X were closed on March 31, 2015 with a Suspense Account showing a credit balance of Rs. 410. During 2014-15 the following errors were located :

(i) In November, 2014 the total of Sales Book on one page was carried forward to the next page as Rs. 27,130 instead of Rs. 22,630.

(ii) Furniture of the book value of Rs. 3,500 was sold for Rs. 4,100 to Rakesh but the amount was entered in the Sales Book. In 2014-15 10% depreciation was charged on the closing balance of all Assets Accounts.

(iii) The total of the Discount Column (Cr.) for March, 2015 Rs. 440 was not posted in the Ledger.

(iv) Goods returned to Mr. Y in January, 2015 (costing Rs. 450) were not recorded in the Books at all.

(v) Rs. 3,100 goods purchased from Mr. Sunil a supplier, were debited to the account of Mr. Somesh, a customer the amount was correctly entered in the Purchases Book.

Pass Journal entries to rectify the errors and make any comments that you may like.

Solution :

Journal Enteries

Date	Particulars	L.F.	*Dr.* Amount Rs.	*Cr.* Amount Rs.
(i)	Profit and Loss Adjustment A/c Dr.		4,500	
	To Suspense Account			4,500
	[Rectification of excess amount credited to Sales Account in 2014 because of wrong carry forward (Rs. 27,130-22,630)]			
(ii)	Profit and Loss Adjustment A/c Dr.		3,150	
	To Furniture Account			3,150
	[Furniture A/c for Rs. 3,150 *i.e.*, Rs. 3,500 (book value dep.)]			
(iii)	Suspense Account Dr.		440	
	To Profit & Loss Adjustment Account			440
	(Rectification of the omission to post in the discount column)			
(iv)	Mr. Y Dr.		450	
	To Profit & Loss Adjustment Account			450
	(Rectification of the omission of goods returned to Mr. Y)			
(v)	Suspense Account Dr.		6,200	
	To Mr. Somesh			3,100
	To Mr. Sunil			3,100
	(Entry to remove the wrong debit to Mr. Somesh and to give credit to Mr. Sunil in respect of goods purchased)			
(vi)	Capital Account Dr.		6,760	
	To Profit & Loss Adjustment Account			6,760
	(Transfer of the balance to P&L Adjustment A/c representing the net effect of errors affecting profit)			

Note : The balance of Profit & Loss Adjustment A/c being Debit (Rs. 4,500 + 3,150 - 440 - 450) Rs. 760 is transferred to Capital A/c.

The Suspense Account will now appear as under :

Suspense Account

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
2015				2015			
	To P & L Adjustment A/c		440	Jan., 1	By Blance b/d		410
	To Mr. Somesh		3,100		By P & L Adjustment A/c		4,500
	To Mr. Sunil		3,100		By Blance c/d		1,730
			6,640				6,640
	To Balance b/d		1,740				

Effect of Rectification of errors on Profit and Loss Account and Balance Sheet :

As stated above there are many errors which affect Profit & Loss Account and many other errors which, affect the balance sheet. However, certain errors may not affect either Profit & Loss Account or the Balance Sheet. In this regard it should be noted that on rectification, errors affecting Profit & Loss Account such as Wages, Salaries, Rent, Commission, Purchases and Sales Account etc. will reduce the profit if these are debited in the rectifying entry and will increase the profit it they are credited in the rectifying entry. However, if errors are committed in those accounts in rectifying entries which are related to the Balance Sheet, Profit & Loss Account will remain unaffected.

Illustration 8.16 :

The annual accounts of Gopi Enterprises prepared on 31st March, 2015 disclosed a net profit of Rs. 48,576 and the balance sheet total of Rs. 1,35,427. The following matters were, however, ignored before arriving at these figures :

(a) Goods valued at Rs. 450 were purchased, received and taken into stock; but were not recorded in the books.

(b) Expenses outstanding : Wages Rs. 750; Salaries Rs. 450; Advertisement Rs. 350; Law Charges Rs. 100; Electricity charges Rs. 275.

(c) Interest Accrued on Investment : Rs. 375.

(d) Goods costing Rs. 250 were taken away by the trader for his personal use.

(e) Depreciation to be written off; Building Rs. 2,500; Machinery Rs. 10,500; Motor vehicle Rs. 3,500; Furniture Rs. 300.

(f) A Reserve of Rs. 1,800 is to be created for Bad and Doubtful Debts.

(g) Rs. 1,650 Cash stolen by an ex-employee stood debited to a Suspense Account.

Give journal entries to record these matters and show how they would affect the net profit and the total of balance sheet.

Solution :

Rectifying Journal Enteries

Date	Particulars	L.F.	*Dr.* Amount Rs.	*Cr.* Amount Rs.
Mar. 31 *(a)*	Purchases A/c Dr.		450	
	To Creditor's A/c			450
	(Being goods purchased and taken into stock but omitted, now recorded)			

	Particulars		Dr. Rs.	Cr. Rs.
(b)	Wages A/c Dr. Salaries A/c Dr. Advertising A/c Dr. Law Charges A/c Dr. Electricity Charges A/c Dr. To Outstanding Expenses A/c (Being outstanding expenses omitted to be recorded, now recorded)		750 450 350 100 275	1,925
(c)	Accrued Interest A/c Dr. To Interest A/c (Being accrued interest omitted, now recorded)		375	375
(d)	Drawings A/c Dr. To Purchases A/c (Being goods taken away by Proprietor, now recorded)		250	250
(e)	Depreciation A/c Dr. To Building A/c To Machinery A/c To Motor Vehicles A/c To F.urniture A/c (Being rectification of depreciation on assets not recorded)		16,800	2,500 10,500 3,500 300
(f)	Profit & Loss A/c Dr. To Provision for bad and doubtful debts A/c (Being provision made for bad debts)		1,800	1,800
(g)	Profit & Loss A/c Dr. To Suspense A/c (Being cash stolen by an ex-employee which was charged to suspense account, now rectified)		1,650	1,650
	Capital A/c Dr. To Profit & Loss A/c (Being balance of profit and loss account transferred to capital account)		22,000	22,000

Effect of the above Entries (After Rectification)

S.No.	Profit & Loss Account		Balance Sheet			
	Net Profit		Assets		Liabilities	
	Increase	Decrease	Increase	Decrease	Increase	Decrease
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
(a)	–	450	–	–	450	450
(b)	–	1,925	–	–	1,925	1,925
(c)	375	–	375	–	375	
(d)	250	–	–	–	250	250
(e)	–	16,800	–	16,800	–	16,800
(f)	–	1,800	–	1,800	–	1,800
(g)	–	1,650	–	1,650	–	1,650
Total	625	22,625	375	20,250	3,000	22,875
		–22,000		–19,875		–19,875

Thus, net profit = Rs. 48,576 - Rs. 22,000 = Rs. 26,576.

Balance sheet total = Rs. 1,35,427 - Rs. 19,875 = Rs. 1,15,552.

Illustration 8.17 :

Rectify the following errors :

(a) Credit sales to Mohan Rs. 40,000 were recorded in Purchases Book.

(b) Credit sales to Sohan Rs. 40,000 were recorded in Purchases Book. However, Mohan account was correctly debited.

(c) Credit puchases from Arjun Rs. 25,000 were recorded in Sales Book.

(d) Credit puchases from Arjun Rs. 25,000 were recorded in Sales Book. However, Arjun's account was correctly credited.

(e) Goods returned to Khushi Rs. 18,000 were recorded in Sales Return Book.

(f) Goods returned to Khushi Rs. 18,000 were recorded in Sales Return Book. However, Khushi's account was correctly debited.

(g) Goods returned from Ashih Rs. 2,000 were recorded in Purchase Return Book

(h) Goods returned from Ashish Rs. 2,000 were recorded in Purchase Return Book. However, Ashish's account was correctly credited.

Solution :

Journal Enteries

Date	Particulars	L.F.	Dr. Amount Rs.	Cr. Amount Rs.
(a)	Mohan's A/c Dr. To Sales A/c To Purchases A/c (Credit sales to Mohan wrongly recorded in purchases book)		80,000	40,000 40,000
(b)	Suspenses A/c Dr. To Sales A/c To Purchases A/c (Credit sales to Mohan wrongly recorded in purchases book. However, Mohan's account was correctly debited)		80,000	40,000 40,000
(c)	Puchases A/c Dr. Sales A/c Dr. To Arjun's A/c (Credit puchases from Arjun wrongly recorded in sales book.		25,000 25,000	50,000

(d)	Purchases A/c Dr. Sales A/c Dr. To Suspense A/c (Credit purchases from Arjun wrongly recorded in sales Book. However, Arjun's account was corectly credited)			25,000 25,000	50,000
(e)	Khushi's A/c To Purchases Return A/c To Sales Return A/c (Goods returned to Khushi wrongly recorded in sales return book)			36,000	18,000 18,000
(f)	Suspen]se A/c Dr. To Purchase Return A/c To Sales Return A/c (Goods returned to Khushi wrongly recorded in sales return book However, Khushi's account was correctly debited)			36,000	18,000 18,000
(g)	Sales Return A/c Dr. Purchases Return A/c Dr. To Aashish's A/c (Goods returned from Aashish wrongly recorded in purchases return book)			2,000 2,000	4,000
(h)	Sales Return A/c Dr. Purchases Return A/c Dr. To Suspense A/c (Goods returned from Aashish wrongly recorded in purchases return book. However, Aashish's account was correctly credited)			2,000 2,000	4,000

Illustration 8.18

Pass the rectification entries and show the suspense account in the books of a partnership firm, from the following particulars :

(i) The total of sales return day book was over-cast by Rs. 4,000.

(ii) Purchase of equipment, from Raj Mohan, worth 12,000, in cash, was entered through the purchase day book and accordingly, credited to the Supplier's account.

(iii) Discount Rs. 2,500 allowed by Sahoo, a creditor, has not been entered in the books of account.

(iv) Rs. 1,350 paid for carriage on sale of goods was credited to carriage inward account when posted from the cash book.

(v) Bill receivable worth 4,800 received from a debtor was entered in the bills payable book though correctly entered in the debtor's account.

(vi) A sum of Rs. 12,500 collected from Suraj a debtor, whose dues were already witten off as bad debt, was posted to the credit side of Suraj account.

(vii) Goods worth Rs. 4,500 bought by the partner Mr. B for his personal use without any payment being made as yet, was wrongly entered in the purchase day book.

Solution :

Rectifying Journal Enteries

Date	Particulars	L.F.	Dr. Amount Rs.	Cr. Amount Rs.
(i)	Suspense A/c Dr. To Sales Retun A/c (Sales return book over-castly Rs. 4,000)		4,000	4,000
(ii)	Equipment A/c Dr. Raj Mohan A/c Dr. To Cash A/c To Purchases A/c (Purchase of equipment in cash wrongly entered through the purchase day book)		12,000 12,000	12,000 12,000
(iii)	Sahoo's A/c Dr. To Discount Received A/c (Discount allowed by Sahoo not entered in the books)		2,500	2,500
(iv)	Carriage Outward A/c Dr. Carriage Inward A/c Dr. To Suspense A/c (Carriage on sale of gôods credited to carriage inward account, now corrected)		1,350 1,350	2,700
(v)	Bills Receivable A/c Dr. Bills Payable A/c Dr. To Suspense A/c (Bills receivable wrongly entered in the bills payable book though correctly entered in the debtor's account, now corrected)		4,800 4,800	9,600
(vi)	Suraj's A/c Dr. To Bad Debt Recovered A/c (Bad debts recovered from Suraj was worngly credited to his personal Account)		12,500	12,500
(vii)	B's Drawings A/c Dr. To Purchase A/c (Goods bought for personal use of a partner B was wrongly entered in the purchase day book)		4,500	4,500

Dr. **Suspense Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Difference in Trial Balance *(Balancing Figure)*	2,300	By Carriage Outward A/c	1,350
To Sales Return A/c	4,000	By Carriage Inward A/c	1,350
		By Bills Receivable A/c	1,800
		By Bills Payable A/c	1,800
	6,300		6,300

Illustration 8.19

Trial Balance of Mr. Shyam, a trader did not agree. He puts the difference to Suspense Account and discovered the following errors :

(i) In the Sales Book for the month of January total of Page No. 12 was carried forward to Page No. 13 as Rs. 4,000 instead of Rs. 4,200 and total of Page No. 16 was carried forward to Page No. 17 as Rs. 15,600 instead of Rs. 15,000.

(ii) Wages paid for installation of Machinery Rs. 5,500 was posted to wages Account as Rs. 550.

(iii) Machinery purchased from Sridhar for Rs. 40,000 on credit was entered in Purchase Book as Rs. 36,000 and posted thereform to Shridhar's A/c as Rs. 31,000.

(iv) Credit Sales to Mohan Rs. 5,000 were recorded in Purchases Book.

(v) Goods returned to Ram Rs. 1,000 were recorded in Sales Book.

(vi) Credit Purchases from Sanjay Rs. 16,000 were recorded in Sales Book. However, it was correctly credited to Sanjay's Account.

(vii) Credit Purchases from M Rs. 26,000 were recorded in Sales Book as Rs. 22,000 and posted there from to the credit of M's A/c as Rs. 21,000.

(viii) Credit Sales to Raman Rs. 44,000 posted to the credit of Raghvan as Rs. 41,000.

(ix) Bill receivable for Rs. 4,600 from N was dishonoured and posted to debit of Allowances Account.

(x) Cash paid to Mani Rs. 5,000 against our acceptance was debited to Manu.

(xi) Old furniture sold for Rs. 13,000 was posted to Sales Account as Rs. 11,000.

(xii) Depreciation provided on furniture Rs. 4,800 was not posted.

(xiii) Material Rs. 40,000 and Wages Rs. 30,000 were used fo construction of Building. No adjustement was made in the books.

Rectify the errors and prepare Suspense Account to ascertain the difference in Trial Balance.

Solution :

Rectifying Journal Enteries

Date	Particulars	L.F.	Dr. Amount Rs.	Cr. Amount Rs.
(i)	Sales A/c Dr. To Suspense A/c (Error in carry foward of sales book Rs. 600 - 400 = Rs. 200, now rectified)		400	400

Date	Particulars	L.F.	Dr. Amount Rs.	Cr. Amount Rs.
(ii)	Machinery A/c Dr. To Wages A/c To Suspense A/c (Wages paid for installation of machinery 5,500 wrongly posted to wages account as Rs. 550, now rectified)		5,500	550 4,950
(iii)	Machinery A/c Dr. Suspense A/c Dr. To Purchases A/c To Shridhar's A/c (Machinery purchased for Rs. 40,000 wrongly passed through puchase book as Rs. 36,000, now rectified)		40,000 5,000	36,000 9,000
(iv)	Mohan Dr. To Sales A/c To Purchases A/c (Credit sales wrongly recorded through purchases book)		10,000	5,000 5,000
(v)	Sales A/c Dr. To Purchases Return A/c (Purchases return wrongly recorded in sales book, now corrected)		1,000	1,000
(vi)	Purchases A/c Dr. Sales A/c Dr. To Suspense A/c (Credit Purchases wrongly recorded in sales book)		16,000 16,000	32,000
(vii)	Purchases A/c Dr. Sales A/c Dr. To M (26,000 - 21,000) To Suspense A/c (Credit Purchases for Rs. 26,000 wrongly recorded in sales book as Rs. 22,000, now rectified)		26,000 22,000	5,000 43,000
(viii)	Raman Dr. Raghvan Dr. To Suspense A/c (Sales to Raman 44,000 wrongly credited to Raghvan as Rs. 41,000, now rectified)		44,000 41,000	85,000
(ix)	N's A/c Dr. To Allowances A/c (B/R dishonoured wrongly debited to Allowances Account)		4,600	4,600
(x)	Bills Payable A/c Dr. To Manu's A/c (Bills payable met wrongly debited to Manu's A/c, now corrected)		5,000	5,000

(xi)	Sales A/c	Dr.		11,000	
	Suspense A/c	Dr.		2,000	
	To Furniture A/c				13,000
	(Furniture sold for Rs. 13,000 wrongly credited to sales account as Rs. 11,000, now corrected)				
(xii)	Depreciation A/c	Dr.		4,800	
	To Furniture A/c				4,800
	(Depreciation provided was not posted, now corrected)				
(xiii)	Building A/c	Dr.		70,000	
	To Purchases A/c				40,000
	To Wages A/c				30,000
	(Material and wages used for construction of building, now passed)				

Dr. **Suspenses Account** Cr.

	Rs.		Rs.
To Difference in Trial Balance *(Balancing Figure)*	1,58,350	By Sales A/c	400
To Shridhar A/c	5,000	By MachineryA/c	4,950
To Furniture A/c	2,000	By Purchases A/c	16,000
		By Sales A/c	16,000
		By Purchases A/c	21,000
		By Sales A/c	22,000
		By Raman	44,000
		By Raghvan	41,000
	1,65,350		1,65,350

Test Questions

Very Short Questions and Answers : (Not exceeding 40 words)

Q.1. What is meant by Trial Balance ?

Ans : Trial balance is a statement prepared with debit and credit balances of Ledger Accounts to test the arithmetical accuracy of the books of accounts.

Q.2. State any two characteristics of trial balance.

Ans. : (i) A trial balance contains the list of all ledger accounts including Cash Account.
(ii) The total of debit and credit columns of amount of the trial balance must be equal.

Q.3. Is trial balance a conclusive proof of accuracy of the Ledger Accounts?

Ans. : A trial balance is not a conclusive (absolute) proof of accuracy of the books of accounts since there may be certain types of errors which may remain undetected despite the fact of agreement of trial balance.

Q.4. State any two objectives of preparing a trial balance.

Ans. : Objectives of preparing trial balance :
(i) To ascertain and find out smmarised information of ledger accounts.

(ii) To help and assist in locating the errors of different types.

Q.5. Enumarate different types of errors.

Ans. : Types of errors
(i) Errors of Omission (iii) Compensating Errors
(ii) Errors of Principle (iv) Errors of Commission.

Q.6. What are errors of omission ?

Ans. : When a transaction is completely omitted to be recorded either in the Journal or in Subsidiary books, it will be called an error of omission. Such errors do not affect the agreement of trial balance because the transaction has neither been recorded on debit side of an account nor on the credit side of any other account.

Q.7. What are errors of Principle ?

Ans. : When an error involving accounting principle is committed, it is termed as errors of principle, for example, proper distinction between capital and revenue items is not made. Such errors are difficult to be located because, these errors do not affect agreement of trial balance.

Q.8. What is meant by errors of Commission ?

Ans. : These are the errors which are caused due to wrong posting either of an amount or on the wrong side of an account or in the wrong account, wrong totalling, wrong balancing, wrong casting of subsidiary books, wrong recording of an amount in the books of original entry etc. Such errors will affect the agreement of trial balance.

Q.9. Give two examples of error of commission :

Ans. : (i) Purchase of goods from Mohan Rs. 25,000 on credit entered in the Purchase book as Rs. 52,000.
(ii) Sales book is over cast by Rs. 10,000.

Q.10. State two examples of error of omission. [BBA 2003]

Ans. : Error of Omission :
(i) Purchased goods for Rs. 40,000 from Rampal on credit but the transaction was omitted to be recorded.
(ii) Sold goods to Shrikant for Rs. 10,000 on credit but was recorded as Rs. 1,000 in the Sales Book.
The above two examples will not affect the agreement of trial balance.

Q.11. State any two errors which will affect the agreement of Trial Balance. [BBA, 2005]

Ans. : Example affecting Trial Balance :
(i) Sales book is overcast by Rs. 10,000
(ii) Credit purchase of goods from Shriniwas was wrongly posted on debit side of the Account of Shiniwas.
The above two examples will affect the agreement of trial balance.

Short Questions and Answers : (Not exceeding 40 words)

Q.1. How will you locate errors in ledger on wrong side of an Account ?

Ans. : (i) We should first find out the difference between the total of debit and credit columns of the trial balance.
(ii) Posting of all amounts of corresponding to the difference of half the difference should be checked.
Posting of all amounts of corresponding to the difference of half the difference should be checked.
(iii) It should be checked that the balances of all accounts including the Cash and Bank balances have been written in the trial balance. It should be checked that whether there is a transposition of figure. If the difference between the debit and credit side of the trial balance divided by nine evenly, there may be a mistake of transposition, for example, the digits of the figure may have changed their places.
(iv) Posting of all amounts corresponding to double the difference should be checked.
Despite all the efforts if the error remain undetected, the difference will be transferred to Suspense Account temporarily and trial balance be closed.

Q.2. Write a note on Suspense Account. **(RU, BBA, 2004)**

Ans. : Meaning of Suspense Account : When inspite of the best efforts, the Trial Balance does not tally, the difference is put to a newly opened account named 'Suspense Account' and the Trial Balance is thus made to tally. This is done to avoid the delay in the preparation of Final Accounts.

In case, the debit side of the Trial Balance exceeds the credit side, the difference is put on the credit side of the trial balance. In this case 'Suspense Account' will show a credit balance. Likewise, if the credit side of the Trial Balance exceeds the debit side, the difference is put on the debit side of the trial balance. In this case 'Suspense Account' will show a debit balance.

Disposal of Suspense Account : Suspense Account is an inaginary account used as temporary measure for reconciling a Trial Balance. Later, as and when the errors are located, rectification entries should be passed with the help of Suspense Account. When all errors are detected, and rectified, the Suspense Account will be closed.

Q.3. How will you rectify the error of principle ? **(BBA, 2005)**

Ans. : Errors of Principle—When some fundamental principle of Accountancy is violated in recording a transaction, it is temed as an error of principle. For example, Capital expenditure is treated as revenue expenditure and *vice-versa.*

(i) When a Capital expenditure is treated as Revenue Expenditure : Pur- .lase of Furniture or Plant is treated as normal Purchases. In this case, Purchases Accont is debited instead of Furniture or Plant A/c, so for rectification Fumiture A/c or Plant A/c shall be debited and Purchases A/c be credited.

(ii) When a revenue item is treated as capital item—For example, repairs to Plant is charged to Plant Account. In this case Repairs Account should be debited and Plant Account should be credited to rectify the mistake.

Q.4. Give five different examples of errors which will not affect the agreement of trial balance.

Ans. : The following errors will not affect the agreement of trial balance—

(i) **Errors of omission,** for example bought goods on credit from Rahul was omitted to be entered in books.

(ii) **Errors of Principle** for example X the proprietor of a business paid Rs. 2,800 for repairs of plant was charged to Plant Account.

(iii) **Compensating errors**—for example sale of goods for Rs. 5000 was recorded as Rs. 500 in Personal Account and cash received from Y 5,000 was also credited to Y's A/c with Rs. 500 only. Thus debit error is compensated by credit error for the same amount.

(iv) **Partial Omission**—for example purchase of goods for Rs. 10,000 was entered in purchase book as Rs. 1,000.

(v) **Furniture bought** for Rs. 5,500 and carriage paid on bringing furniture to office Rs. 500 was charged as revenue expenditure, whereas it should be debited to Furniture A/c.

Q.5. State any five functions of Trial Balance.

Ans. : Functions of Trial Balance

(i) To ascertain the arithmetical accuracy of Ledger Accounts.

(ii) To obtain summarised information of Ledger Accounts.

(iii) To use the information so obtained as the basts for preparation of Final Accounts.

(iv) While preparing final accounts certaine adjustments regarding expenses, incomes etc. are required to be made. Trial balance is used for making these adjustments.

(v) To help and assist in locating errors.

Q.6. What are the characteristics of Trial Balance ?

Ans. : The following are the characteristics of a Trial Balance :

(1) A Trial Balance is prepared on a specific date. This is why, we use the word "as on....." with its heading. It may be prepared at any time but it must be prepared at the close of the accounting

year.

(2) A trial balance contains the list of all ledger accounts including cash account.

(3) The total of the debit and credit columns of the amount of the trial balance must be equal.

(4) If both the debit and credit columns have the same total, it does not mean that there is no mistake in accounting.

(5) The difference between the debit and credit side of the trial balance points out that certain mistakes have been committed somewhere.

(6) It is a statement prepared in a tabular form. It has two columns one for debit balances and another for credit balances.

(7) The trial balance may be prepared with the balances or totals or balances and totals of ledger accounts.

Q.7. What is meant by one sided errors ? Give a few examples.

Ans. : One sided Errors : There may be certain errors which affect one side of an account or more than one account in such a way that it is not possible to pass a complete rectification entry and can be rectified, by making simply rectification statements in the appropriate side (s) of concerned account (s). Example of such errors are in the following illustration :

(i) The sales book for February, 2015 is undercast by Rs. 5,000.

(ii) Rs. 5,000 received from Mr. X has been entered by mistake on the debit of Mr. X.

(iii) The return inward book is overcast by Rs. 1,000.

(iv) A sum of Rs. 2,000 witten off as depreciation on Plant & Machinery has not been debited to Depreciation Account.

(v) A payment of Rs. 3,000 as salaries to Arun has been posted twice in Salaries Account.

Q.8. Which of the following errors will affect the agreement of trial balance.

(i) The total of purchase book has not been posted to Purchases Account.

(ii) Rs. 5,000 paid for erecting a new machine has been debited to Repairs Account.

(iii) Goods Costing Rs. 10,000 was drawn by the Owner of business for domestic use was debited to Sundry debtors Accounts.

(iv) Rs. 3,000 paid for white washing of the shop was debited to Building Account.

(v) Furniture purchased was wrongly recorded as Purchases.

(vi) Sales book is overcast by Rs. 1,000.

Ans. : Looking to the above Errors—

(1) Error no (i) and (vi) will affect the agreement of trial balance because these are the errors of posting and totalling.

(2) Errors no. (ii), (iii), (iv) and (v) will not affect the agreement of trial balance.because these are the errors of principle.

Q.9. What is meant by compensating error ? Explain taking an example.

Ans. : Compensating errors : As the name indicate compensating errors are those errors by which the effect of certain errors is neutralised by the effect of another error. These errors also do not affect the agreement of the trial balance and therefore, their location is also difficult. Example of such error is 'Sale of goods to Mr. X for Rs. 5,000 was debited to Mr. X's A/c with Rs. 500 only and Rs. 5,000 received from Y was credited to Y's A/c with Rs. 500 only. The effect of the error in the trial balance will be that the total of the debit and credit sides, both will be short by Rs. 4,500 and both sides of trial balance will tally inspite of the above two errors.

Q.10. Write short notei on Errors of Omission and Errors of Principle.

Ans. : (1) Errors of Omission : These errors are incurred when a transaction is **completely omitted** from the books of original entry *i.e.* various subsidiary books including Journal proper. For example, if goods worth Rs. 12,000 has been books of accounts. It happens when a transaction is not recorded in the books of accounts.

received back from a customer and the entry has not been made at all in the Returns Inward Book, such an error will he termed as an error of omission. Since there has been neither a debit entry nor a credit entry, therefore, the two sides of the trial balance will not be affected on account of such error.

(2) Errors of Principle : If there is an error involving accounting principles such as where a proper distinction between revenue and capital items is not made, the trial balance will still agree. Such errors also are difficult to be located. Examples of such errors are treating an expense as an asset, treating an asset as an expenses, treating an income as a liability or vice versa etc.

Easy Type / Long Questions :

1. State the meaning and utility of Ledger. (see page no. 8.1)
2. State the meaning, object and limitations of Trial Balance. (see page no. 8.2)
3. Is trial balance a conclusive proof of accuracy of ledger positing in accounts? If not, state such errors which can not be detected and which will affect trial balance. (see page no. 8.2)
4. What are different methods of preparing trial balance? Explain with the help of an numerical example. (see page no. 8.3)
5. Explain different types of errors giving at least two examples of each. **(R.U., BCA, 2005)** (see page no. 8.3)
6. Explain taking examples the procedure of rectifying errors : (see page no. 8.10 and 8.11)
   (i) Before preparation of final accounts.
   (ii) After preparing final accounts.
7. Illustrate the effect of rectification of errors on Profit & Loss Account and the Balance Sheet of a firm. (see page no. 8.16 and 8.21)
8. Explain the procedure of detecting or locating errors in Accounting Books. (see page no. 8.10 and 8.9)

Numericals

1. From the following balances taken from the books of M/s Raj. Bros., prepare a Trial Balance as on 31st March 2015; Stock (1.4.2014) Rs. 22,000, Bill Receivable Rs. 9,000, Bills Payable Rs. 7,400, Purchases Rs. 78,000, Purchases Return Rs. 1,000, Sales Rs. 1,20,000, Sales Return Rs. 2,600, Salaries & Wages Rs. 5,000, Insurance Rs. 1,400, Debtors Rs. 60,000, Creditors Rs. 37,200 Carriage Rs. 1,600, Commission (Cr.) Rs. 1,600, Capital Rs. 35,800, Interest on Capital Rs. 1,400, Stationery Rs. 2,800, Office Expenses Rs. 1,600, Furnitung Rs. 2,000, Cash Rs. 1,000, Bank Balance Rs. 9,500, Rent & Taxes Rs. 2,200. Carriage on Sales Rs. 2,900.

[Answer Total : Rs.2,03,000]

Ans. :

Trial Balance as on 31-3-2015

	Rs. (Dr.)	Rs. Cr.
Stock (1-4-2014)	22,000	
Bills Receivable	9,000	
Bills Payable		7,400
Purchases and Purchase Returns	78,000	1,000
Sales Return and Sales	2,600	1,20,000
Salaries & Wages	5,000	
Insurance A/c	1,400	
Debtors and Creditors	60,000	37,200
Carriage A/c	1,600	
Commission (Cr.)	—	1,600
Capital A/c	—	35,800
Interest on Capital A/c	1,400	
Stationery A/c	2,800	
Office Expenses A/c	1,600	
Furniture A/c	2,000	
Cash A/c	1,000	
Bank Balance	9,500	
Rent and Taxes	2,200	
Carriage on Sales	2,900	
Total	2,03,000	2,03,000

Q2. The following Trial Balance is prepared by less experienced Accountant :

Name of Accounts	Debit Balances	Credit Balances
	Rs.	Rs.
Capital Account	—	50,000
Opening Stock	—	30,000
Closing Stock	1,30,000	—
Purchases	90,000	—
Sales	—	1,50,000
Salaries & Wages	—	40,000
Bank Overdraft	4,000	-
Purchases Returns	3,000	-
Sales Returns	—	2,000
Furniture	45,000	—
Total	2,72,000	2,72,000

You are required to prepare it in correct form. **[Ans :** Corrected Total Rs. 2,07,000]

Hint : Opening Stock Rs. 30,000, Salaries & Wages Rs. 40,000 Sales Returns Rs. 2,000 should be debit balances, where as Bank Overdraft Rs. 4,000. Purchase Returns Rs. 3,000 should be credit balances. Closing stock Rs. 1,30,000 will be written below or outside the Trial Balance.

Q3. Correct the following trial balance prepared by an inexperienced accountant.

Trial Balance

(for the year ended 31st March, 2015)

Name of Accounts	L.F.	Debit Balances	Credit Balances
		Rs.	Rs.
Capital Account		8,000	—
Purchases		10,000	—
Sales		—	8,000

Drawings	—	4,000
Sales Returns	—	3,000
Bad Debts	—	1,000
Sundry Debtors	6,000	—
Sundry Creditors	—	8,000
Cash in hand	—	3,000
Commission received	1,000	—
Bill Payable	2,000	—
Total	27,000	27,000

Ans. : Debit Balances : Purchases Rs. 10,000 + Drawings Rs. 4,000 + Sales Return Rs. 3,000 + Bad debts Rs. 1,000 + Debtors Rs. 6,000 + Cash in hand Rs. 3,000 = **Rs. 27,000**

Credit Balances : Capital Rs. 8,000 + Sales Rs. 8,000 + Creditors Rs. 8,000 + Commission Received Rs. 1,000 + Bills Payable Rs. 2,000 = **Rs. 27,000.**

Q4. Rectify the following errors :

(i) A customer Mr. X, returned goods of the value of Rs. 800 which was not recorded in the books.

(ii) The debit side of Pyare Lal, a debtor, is overcast by Rs. 6,000.

(iii) A cheque of Rs. 3,400 received from Y & Sons was dishonoured and debited to Allowances Account.

(iv) A typewriter purchased for the office for Rs. 7,200 was entered in the purchases book.

(v) Purchase of goods from Sahil & Co. for Rs. 4,800 was entered in the sales book as Rs. 6,800.

(vi) A credit sale to L. Mathur of Rs. 30,000 has been wrongly passed through the purchases book.

(vii) Rs. 450 being the total discount allowed to debtors has been posted to the credit of Discount Received Account.

Hint for Solution :

(i) Record the entry for Sales Return Rs. 800; (ii) Debit Suspense A/c and Credit Pyarelal's A/c Rs. 6,000;

(iii) When a cheque is dishonoured, Y & Sons be debited and Allowance A/c be credited for cancellation.

(vi) Debit office equipment A/c and credit Purchases A/c

(v) Purchases A/c	Dr.	4,800	
Sales A/c	Dr.	6,800 (for cancellation)	
To Sahil & Company			11,600
(vi) L. Mathur's A/c	Dr.	60,000	
To Purchases A/c			30,000
To Sales A/c			30,000
(vii) Discount Allowed A/c	Dr.	450	
Discount Received A/c	Dr.	450	
To Suspense A/c			900

Q5. Pass Journal entries necessary to rectify the following errors :

(i) An amount of Rs. 700 withdrawn by the proprietor for his personal use has been debited to Trade Expenses Account.

(ii) A purchase of goods from Nathan amounting to Rs. 600 has been wrongly entered through the Sales Book.

(iii) A credit sale of Rs. 500 to Sanjeev has been wrongly passed through the Purchases Book.

(iv) Rs. 450 received from Manak have been credited to Mayank.

(v) Rs. 675 paid on account of salary to the cashier Mathur stands debited to his personal account.

(vi) A contractor's bill for extension of premises amounting to Rs. 5,750 has been debited to Building Repairs Account.

(vii) A bill of Rs. 900 for old ofice furniture sold to Saleem were entered in the Sales Day Book.

(viii) An amount of Rs. 400 received on account of Interest was credited to Commission Account.

Ans. :

(i) Drawings A/c	Dr.	700	
To Trade Expenses A/c			700
(ii) Purchases A/c	Dr.	600	
Sales A/c	Dr.	600	
To Nathan			1,200
(iii) Sanjeev's A/c	Dr.	1,000	
To Sales A/c			500
To Purchases A/c			500
(iv) Mayank's A/c	Dr.	450	
To Mank's A/c			450
(v) Salary A/c	Dr.	675	
To Mr. Mathur's A/c			675
(vi) Business Premises A/c	Dr.	5,750	
To Building Repairs A/c			5,750
(vii) Sales A/c	Dr.	900	
To Office Furnitures A/c			900
(viii) Commission A/c	Dr.	400	
To Interest A/c			400

7. Correct the following errors found in the books of Mr. Z. The Trial Balance was out by Rs. 1,003 excess credit. The difference thus been posted to a Suspense Account : Prepare Suspenses A/c & Comment.

(i) An amount of Rs. 200 was received from Mr. Y on 31st December, 2015 but has been entered in the Cash Book on 3rd January 2015.

(ii) The total of Returns Inward Book for December has been cast Rs. 200 short.

(iii) The purchase of an office table costing Rs. 400 has been passed through the Purchases Day Book.

(iv) The purchase of an office table costing Rs. 400 has been passed through the Purchases Day Book. The purchase of an office table costing Rs. 400 had been charged to Wage Account.

(iv) Rs. 475 paid for Wages to workmen for making show-cases had been charged to Wage Account.

(v) A purchase of Rs. 547 had been posted to the creditor's account as Rs. 550.

(vi) A cheque for Rs. 400 received from P.C. Verma had been dishonoured and was passed, to the debit of "Allowances Account".

(vii) Rs. 2,000 paid for the purchase of a motor cycle for Mr. Z had been charged to "Miscellaneous Expenses Account".

(viii) Goods amounting to Rs. 2,000 had been returned by customer and were taken into stock, but no entry in respect thereof was made in the books.

(ix) A sale of Rs. 4,000 to Jupiter & Co., was wrongly credited to their account.

Note : Assume calender year as accounting year.

Ans. : (i) Enter the transaction in Cash Book by debiting cash and crediting Mr. Y's A/c

(ii) These are Sales Returns, debit S/R and Credit Suspense A/c with Rs. 200.

(iii) Debit Furniture A/c and Credit Purchases A/c with Rs. 400.

(iv) Debit furniture A/c and Credit wages A/c with Rs. 475.

(v) Debit Creditor's A/c and Credit Suspense A/c with Rs. 3

(vi) Debit PC Verma's A/c and Credit Allowances A/c with Rs. 400

(vii) Debit Drawings A/c and Credit Miscellaneous Expenses A/c with Rs. 2,000

(viii) Pass the entry for Purchases Returns.

(ix) Debit Jupitor & Company's A/c with double amount and credit Suspenses A/c. Prepare Suspenses A/c and comment on it, whether it talies or not.

8. An accountant, while balancing his books found that there was a difference of Rs. 2,700 the trial balance. Being required to prepare the final accounts he placed the difference to a newly opened Suspense Account, which was carried forward to the next year when the following errors were discovered :

(i) Salary for the month of March was posted twice, Rs. 1550

(ii) Interest on investments collected by the bankers, were posted directly in concerned accounts through the pass book, but no entry was made in the bank column of the cash book Rs. 750.

(iii) Goods worth Rs. 1,000 were distributed as free samples but this fact has not been taken into Books.

(iv) Rent of Rs. 3,500 received from Ashok credited both to Rent Account and Ashok Account.

(v) A purchase of a chair from Karnal Furniture Mart for Rs. 650 has been entered in purchases book as Rs. 500.

(vi) Old Machinery sold to the proprietor Keshav for Rs. 4,000 was entered in Sales Book as sale to Kishore.

(vii) Cash Purchases from Ajay Rs. 1,890 were recorded in Cash Book as well as in Purchases Book and posted from both.

(viii) Closing stock has been under valued by Rs. 3,000.

Give necessary rectifying entries and prepare Suspenses Account.

Ans. :

Redifying Entries

	Particulars		L.F.	Rs.	Rs.
(i)	Suspense A/c To Salaries A/c (Salary posted twice in the books)	Dr.		1,550	1,550

(ii)	Bank A/c To Suspense A/c (Interest collected by the bank not entered in Cash Book)	Dr.		750	750
(iii)	Advertisement or Free Samples A/c To Purchases A/c (Goods distributed as free samples not recorded in the books)	Dr.		7,000	7,000
(iv)	Ashok To Suspense A/c (Rent received wrongly credited to Ashok Account also)	Dr.		3,500	3,500
(v)	Furniture A/c To Purchases A/c To Karnal Furniture Mart's A/c (Furniture purchased wrongly entered in the purchase book with wrong amount)	Dr.		650	560 90
(vi)(a)	Sales A/c To Machine A/c (Old Machinery sold wrongly entered in Sales Book)	Dr.		4,000	4,000
(b)	Capital A/c To Kishore's A/c (Sale of machinery to proprietor wrongly debited to Kishore's Account	Dr.		4,000	4,000
(vii)	Ajay's A/c To Purchases A/c (Cash purchases wrongly entered in Purchase Book also)	Dr.		1,890	1,890
(viii)	Closing Stock A/c To Trading A/c (Under valuation of closing stock now corrected)	Dr.		3,000	3,000

Dr. **Suspense Account** Cr.

	Rs.		Rs.
To Difference in Trial Balance *(Balancing Figure)*	2,700	By Bank A/c	750
To Salaries A/c	1,550	By Ashok's A/c	3,500
	4,250		4,250

Q9. Trial Balance of Khetan did not agree. He puts the difference to Suspense Account and discovered the following errors :

(i) Credit sales to Manav Rs. 16,000 were recorded in the Purchases Book as Rs. 10,000 and posted to the debit of Manav Rs. 1,000.

(ii) Furniture purchased from Saleem Rs. 6,000 was recorded through purchases book as Rs. 5,000 and posted to the debit of Saleem's A/c Rs. 2,000.

(iii) Goods returned to Ram Rs. 3,000 recorded through the Sales Book as Rs. 1,000.

(iv) Old machinery sold for Rs. 2,000 to Manav recorded through Sales Book as Rs. 1,800 and posted to the credit of Manav as Rs. 1,200.

(e) Total of Returns Inward Book Rs. 2,800 posted to Purchase Account.

Rectify the above errors and prepare Suspense Account to ascertain the difference in Trial Balance.

Ans. :

Redifying Entries

	Particulars		Debit (Rs.)	Credit (Rs.)
(i)	Manav's A/c	Dr.	15,000	
	Suspense A/c	Dr.	11,000	
	To Sales A/c			16,000
	To Purchases A/c			10,000
	(Credit sales to Manav Rs. 16,000 wrongly recorded through purchases book as Rs. 10,000, now rectified)			
(ii)	Furniture A/c	Dr.	6,000	
	Suspense A/c	Dr.	7,000	
	To Purchases A/c			5,000
	To Saleem's A/c			8,000
	(Purchase of furniture Rs. 6,000 wrongly recorded through purchases book as Rs. 5,000, now rectified)			
(iii)	Sales A/c	Dr.	1,000	
	Ram's A/c	Dr.	2,000	
	To Purchases Return A/c			3,000
	(Goods returned to Ram Rs. 3,000 wrongly recorded though sales book as Rs. 1,000, now rectified)			
(iv)	Sales A/c	Dr.	1,800	
	Manav's A/c	Dr.	3,200	
	To Machinery A/c			2,000
	To Suspense A/c			3,000
	(Machinery sold for Rs. 2,000 to Manav wrongly recorded through sales book as Rs. 1,800, now rectified)			
(v)	Sales Return A/c	Dr.	2,800	
	To Purchases A/c			2,800
	(Total of returns inwards book wrongly posted to purchases account, now corrected)			

Q.10. Mr. Kumar was unable to agree the Trial Balance last year so he wrote the difference in Suspense Account. The following errors were located in the next year :

(i) Purchase Day Book was overcast by Rs. 10,600.

(ii) Receipt of cash form Mr. A was posted to the debit of his account Rs. 5,250.

(iii) Sales of goods to Mr. B for Rs. 4,500 was omitted to be recorded.

(iv) Payment of Rs. 4,579 for purchases was wrongly posted as Rs. 4,795.

(v) A credit purchase of goods from Mr. C for Rs. 5,000 was entered as credit sales.

(vi) Rs. 560 due by Mr. D was omitted to be taken to trial balance.

Pass necessary rectification entries (without narration) and also prepare Suspense Account and Profit & Loss Adjustment Account, Rs. 20,756 were written on the credit side of Suspense Account.

Ans. :

Journal of Mr. Kumar

	Particulars		L.F.	Dr. Rs.	Cr. Rs.
(i)	Suspense A/c	Dr.		10,600	
	To Profit & Loss Adjustment A/c				10,600
(ii)	Suspense A/c	Dr.		10,500	
	To Mr. A's A/c				10,500
(iii)	Mr. B's A/c	Dr.		4,500	
	To Profit & Loss Adjustment A/c				4,500
(iv)	Suspense A/c	Dr.		216	
	To Profit & Loss Adjustment A/c				216
(v)	P&L Adjustment A/c	Dr.		10,000	
	To Mr. C's A/c				10,000
(vi)	Mr. D's A/c	Dr.		560	
	To Suspense A/c				560

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

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
	To P&L Adjustment A/c		10,600		By Balance b/d		20,756
	To Mr. A's A/c		10,500		By Mr. D's A/c		560
	To P&L Adjustment A/c		216				
			21,316				21,316

Dr. **Profit & Loss Adjustment Account** *Cr.*

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
	To C's A/c		10,000		By Suspense A/c		10,600
	To Capital A/c *(Balance Figure)*		5,316		By Mr. B's A/c		4,500
					By Suspense A/c		216
			15,316				15,316

Q.11. A merchant's trial balance as on 31st March, 2015 did not agree. The difference was put to a Suspense Account. During the next trading period, the following errors were discovered :

(i) The total of the Purchase Book of one page, Rs. 5,539 was carried forward to the next page as Rs. 5,593.

(ii) A sale of Rs. 2,700 was entered in the Sales Book as Rs. 653 and posted to the credit of the customer.

(iii) A return to a Ccreditor, Rs. 410 was entered in the Returns Inward Book; however, the creditor's account was correctly posted.

(iv) Cash received from Chetan, Rs. 320, was posted to the debit of Chaman.

(v) Goods worth Rs. 740 were despatched to a customer before the close of the year but no invoice was made out.

(vi) Goods worth Rs. 2,000 were sent on sale or return basis to a customer and entered in the Sales book. At the close of the year, the customer still had the option to return the Goods. The sale price was 25% above cost.

You are required to give journal entries to rectify the errors in a way so as to show the current year's profit or loss correctly.

Ans. (i) Debit Suspense A/c and Credit P&L Adjustment with Rs. 54 (Purchase Book.)

(ii) Debit Customer's A/c with Rs. 3,353 and credit P&L Adjustment A/c with Rs. 2,047 and suspense A/c with Rs. 1,306.

(iii) Debit Suspense A/c (Rs. 410 + 410) and Credit P&L Adjustment A/c (Rs. 410 for cancellation) and Rs. 410 for the entry)

(iv) Debit Suspense A/c with Rs. (320 + 320), and credit Chetan with Rs. 320 and Chaman with Rs. 320.

(v) Debit Customer' A/c and Credit P&L Adjustment A/c (error of Ommission) Rs. 740.

(vi) Cost of Sales $= \frac{2,000 \times 100}{125} = Rs.1,600.$

(a) Debit P & L Adjustment A/c and Credit Debtor's A/c with Rs. 2,000 (Cancellation of Sales)

(b) Closing Stock, A/c Dr. to P&L Adjustment A/c. with Rs. 600

Prepare P&L Adjustment A/c, transfer the balance to Capital A/c.

Q.12. How would you rectify the following errors :

(i) A sale of goods of the value of Rs. 450 to M & Sons has been wrongly debited to N. & Sons.

(ii) A purchase of Rs. 450 from Narayan instead of being credited to him from the Invoice Book, has been wrongly debited to him.

(iii) Cash Rs. 475 received from Basu and entered on the receipts side of the cash book has not been posted.

(iv) A payment of Rs. 325 made to Jones for cash purchases stands debited to his account.

(v) A-payment of Rs. 2,300 in respect of salary has been posted twice in salaries account.

(vi) An amount of Rs. 445 drawn by the proprietor for his personal use stands debited to General Expenses Account.

(vii) The total of the discount column on the debit side of the cash book for the month of March has been added short by Rs. 200.

(viii) Rs. 440 relating to purchase of office stationery has been wrongly debited to the personal account of the proprietor.

(xi) A credit purchase of Rs. 175 from Ram Das stands wrongly credited to Ramji Das.

The trial balance of trader did not agree. The difference was put in suspense account credit Rs. 5,000

Ans. :

Journal of Mr. Kumar

Date	Particulars		L.F.	Dr. Rs.	Cr. Rs.
(i)	M & Sons A/c	Dr.		450	
	To N & Sons A/c				450
(ii)	Suspenses A/c	Dr.		900	
	To Narayan's A/c				900

(iii)	Suspense A/c	Dr.		475	
	To Basu's A/c				475
(iv)	Suspense A/c	Dr.		325	
	To Jone's A/c				325
(v)	Suspense A/c	Dr.		2,300	
	To Salaries A/c				2,300
(vi)	Drawings A/c	Dr.		445	
	To General Expenses A/c				445
(vii)	Discount Allowed A/c	Dr.		200	
	To Suspense A/c				200
(viii)	Office Stationery A/c	Dr.		440	
	To Proprietor's A/c				440
(ix)	Ramji Dass's A/c	Dr.		175	
	To Ram Das's A/c				175

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

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
	To Naryan's A/c		900		By Balance b/d		5,000
	To Basu's A/c		475		By Discount Allowed A/c		200
	To Jones A/c		325				
	To Saleem's A/c		2,300				
	To Balance c/d		1,200				
			5,200				5,200

Q.13. **On scrutiny the following errors were subsequently detected :**

(i) Goods drawn by Mr. *X*, the proprietor, for personal consumption of Rs. 2,500 have not at all been recorded.

(ii) Goods sold to Raman for Rs. 2,250 on credit was debited to Abrar's account with Rs. 250 only.

(iii) Wages paid for fittings Rs. 400 was debited to salaries and wages account.

(iv) Goods purchased from Ashish for Rs. 3,500 on credit was wrongly debited to his account.

(v) Bill received from Ajay, a debtor, for Rs. 400 was recorded in Amar's Account.

(vi) A cash sale of Rs. 4,000 was entered in Sales Day Book.

You are required to pass necessary rectification entries and prepare Suspense Account.

Ans : Credit Balance of Suspense A/c Rs. 3,000 at the beginning.

Q.14. While closing his books of account, Mr. X finds that the Trial Balance on that date i.e. 31st March, 2015 is out by Rs. 907 excess debit. He places the difference in a newly opened Suspense Accont and prepares his final acconts which reveals a Profit of Rs. 14,980 for the year ended 31st March, 2015

During 2015-16 the following errors were detected in respect of Account for 2014-15 :

(i) Purchases book was underscast by Rs. 800.

(ii) Cash received from Ram Das Rs. 487 was posted to the debit of Raman Das as Rs. 878

(iii) Discount received Rs. 7,630 and discount allowed Rs. 6,873 were nor posted in the ledger in respective Discount Accounts.

(iv) Schedule of debtors was totalled Rs. 16,280 instead of Rs. 16,380. Mr. X maintains a provision for bad debts @ 5%.

(v) Bank charges and interest, Rs. 315 remained unposted to the debit side of the nominal account.

(vi) Depreciation on furniture Rs. 970 was wrongly recorded as Rs. 790.

Pass Journal entries to rectify the above mentioned errors, prepare Suspense Account and Profit and Loss Adjustment Account and ascertain the correct amount of profit for the year ending 31st March, 2015.

Ans. :

Rectifying Journal Entries

Date	Particulars		L.F.	Dr. Rs.	Cr. Rs.
(i)	Profit & Loss Adjustment A/c	Dr.		800	
	To Suspense Account				800
	(Being rectification of error caused by undercasting of Purchases Book for 2014-15 by Rs. 800)				
(ii)	Suspense Account	Dr.		1,365	
	To Ram Das				487
	To Raman Das				878
	(Being rectification of wrong debit of Rs. 878 to Raman Das and Omission of credit Rs. 487 to Ram Das, during last year)				
(iii)	Suspense Account	Dr.		757	
	To Profit and Loss Adjustment A/c				757
	(Being rectification of omission of posting of discount received Rs. 7,630 and discount allowed Rs. 6,873 during last year)				
(iv)	Sundry Debtors A/c	Dr.		100	
	Profit & Loss Adjustment A/c	Dr.		5	
	To Suspense A/c				100
	To Provision for Bad Debts A/c				5
	(Being rectification of schedule of debtors and also of Provision for Bad debts Account due to wrong total in schedule of debtors)				
(v)	Profit and Loss Adjustment A/c	Dr.		315	
	To Suspense Account				315
	(Rectification of omission of posting of bank charges and interest)				
(vi)	Profit and Loss Adjustment A/c	Dr.		180	
	To Furniture Account				180
	(Being rectification of wrong entry for depreciation on furniture)				

Suspense Account

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
2015 Mar. 31	To Balance c/d		907	2015 Mar. 31	By Difference in Trial Balance b.d		907
April 1	To Ram Das		487	April 1	By Balance b/d		907
(i)	To Raman Das		878	(i)	By P&L Adj. A/c		800
(ii)	To P & L Adjustment		757	(iv)	By Sundry Debtors		100
				(v)	By P&L Adj. A/c		315
			2,122				2,122

Dr. / Cr.

Profit & Loss Adjustment Account

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
(i)	To Suspense Account		800	(iii)	By Suspense Account		757
(iv)	To Provision for Bad Debts		5		By Mr. X's Capital A/c Transfer of Loss		543
(v)	To Suspense Account		315				
(vi)	To Furniture Account		180				
			1,300				1,300

Dr. / Cr.

Actual profit for the year ended 31st March, 2015 = Rs. 14,980 - 543 or Rs. 14,437.

9

Bank Reconciliation Statement

For exercising great control over cash, most of the business enterprises prefer to operate Bank Account. Generally banking facilities are available for four types of accounts. For example, (a) Fixed deposit account, (b) Savings fund account, (c) Recurring deposit account, and (d) Current account. But usually all the firms open a Current Account with the Bank to record day to day transactions through the Bank. For this they maintain a Bank column in the Cash Book. Bank also maintains a separate ledger account for each firm in its Ledger. It enters all the transactions with the firm in this ledger account. Bank furnishes a copy of firm's account in its ledger to the firm for information periodically. This copy of the firm's account furnished by the Bank is called Bank Statement or a Bank Pass Book.

As all the transactions with the bank are recorded in both the books, viz., in the Cash Book by the merchant and in the Bank's Ledger by the Bank, there should be no difference between the balance disclosed by Cash Book as well as that of Pass Book. The balances of these two books must tally with each other, because when the merchant debits the bank, Bank will give credit to the customer in its ledger. Similarly if some money is withdrawn from the bank, the firm records it on credit side of bank column of Cash Book, the bank at the same time enters it on the debit side of the Firm's Account.

Thus all the entires recorded on the debit side of the Cash Book must tally with the entries recorded on the credit side of Pass Book and vice versa. As such the bank balance as revealed by the cash book must tally with the balance shown by the pass book.

However, on certain date, the bank balance shown by Cash book and the balance shown by Pass book do not tally. This is because on that date, it is possible that some entires recorded in Cash Book might not have been entered in the Pass Book and vice versa. Therefore, a statement is prepared to identify the reasons for the difference and to reconcile the balances of the two books, viz., Cash Book and the Pass Book. Such a statement is called **'Bank Reconciliation Statement :**

Meaning of Bank Reconciliation Statement

It is a statement which contains a complete and satisfactory explanation of the differences in the two balances as per Cash Book and the Bank Pass Book. It is not a part of double entry booking system. It is just a procedure to prove the cash balance at the Bank. It is important to note that a Bank Reconciliation Statement is to be prepared when a Bank Statement in received on a stated day.

Causes of Difference in Cash Book and Pass Book Balances

The difference in two balances may arise on a **specified date** because of the following reasons :

(1) Cheques issued but not presented for payment in the Bank : When a cheque is issued to any party or person it is immediately entered in Cash Book by crediting the Bank. This has the effect of reducing the bank balance in customer's books. But the receiving party may not present the cheque to the Bank for payment upto the date of preparing Bank Reconciliation Statement. The bank debits the customer's account only when the cheque has been presented for payment. So long as it is not presented the balance shown in Pass Book is more than the balance shown in the Cash Book of the customer.

(2) Cheques paid into the bank for collection but not yet collected and credited by the Bank : When a firm receives cheques, drafts, hundies etc. from its customers, they are deposited into bank for collection. An entry is made on the debit side of the bank column of the cash book. But the bank will credit the firm's account only when it has actually collected the payment of these cheques from other banks. There will be a gap of some days between depositing of the cheques into the bank and credit given by the bank. In some cases, this gap may be quite longer. Thus, until the cheques are collected and credited by the bank, the cash book will show an increased balance in comparison to the pass book.

(3) Cheques paid into the bank for collection but dishonoured : When the cheques received from outside parties are deposited with the bank, these are immediately recorded on the debit side of the bank column of the cash book. If these cheques are dishonoured, bank will not make any entry on the credit side of customer's account. As a result, the cash book will show an increased balance in comparison to the pass book.

(4) Interest charged by the bank on overdraft : When a bank gives customer, the facility of withdrawing in excess of his deposits; this excess withdrawn in called overdraft. The bank charges interest on this overdraft and debits the firm's account for such interest from time to time. But the entry for interest will be made in the cash book only when the customer receives a bank statement or an intimaton. Till then, the balance as per pass book would be less then the balance as per cash book.

(5) Interest credited by bank not entered in cash book : When the Bank allows interest to a customer, it credits the account of the customer. As a result the bank balance would increase. But the customer comes to know about it only when the pass book is completed. Unit then, the bank balance as per pass book would be more than the balance as per cash book.

(6) Bank charges not entered in cash book : The bank charge some amount from each customer by way of incidental charges, collection charges etc. It debits the customer's account for this amount from time to time and reduces his bank balance. But the customer comes to know about these charges only when he receives advice from Bank to credit the bank and reduce his balance in bank. Until then the bank balance as per pass book would be less than the bank balance as per cash book.

(7) Amount directly deposited into bank by customers : When any amount is directly deposited by a customer into the Bank account of the merchant, the bank will credit his account immediately. But the merchant would know about it only when the advice is received from the bank. Until then the bank balance as per pass book would be higher than that of the balance in bank column of the cash book.

(8) Dividend and Interest collected by bank but not recorded in cash book : When the bank collects dividend and interest on behalf of the customer, it gives credit. The customer's account would be credited and bank balance would increase. But the customer will make the entry only when he receives advice from the bank. Till then, the bank balance as per pass book will be higher than that of the balance as per cash book.

(9) Direct payment made by the bank on the behalf of the customer : When an account holder gives a standing order to the bank to make certain payments, such as insurance premium, rent, locker charges etc., on his behalf, the bank makes these payment and debits the customer's account. But the customer will make the entry only when the receives he advice from the bank. Until then the Bank balance as per pass book will be less than the balance as per cash book.

(10) Wrong entry made by the Bank : When an error is committed by the Bank in recording a wrong entry in customer's account, it causes a difference in the balance as disclosed by two sets viz., balance as per pass book and the balance as per cash book. This difference will be corrected only when the error is detected.

Other Reasons : The difference in cash book and pass book balances may also be on account of the following :

(a) Cheques issued to a creditor but omitted to be recorded in cash book;

(b) Cheques received and entered in cash book but omitted to be sent for collection;

(c) Error in totalling or balancing the bank column of cash book.

Need for Preparing Bank Reconciliation Statement :

It is essential to prepare Bank Reconciliation Statement because of the following reasons :

(1) The errors and omissions committed by the Bank or the Merchant (customer) would be detected and can be rectified accordingly.

(2) It will reflect the actual bank balance position of the customer so as to assisst him in making the further transactions with the Bank.

(3) It facilitates the preparation of revised cash book by making necessary entries as regards bank charges, bank interest allowed or charged by bank, direct payments by bank etc.

(4) It prevents frauds in recording banking transactions and reduces the chances of embezzlement by the staff of the firm or of the bank.

(5) It helps in revealing unnecessary delay in the collection of cheques etc. by the bank.

Preparation of Bank Reconciliation Statement :

A reconciliation statement is prepared only when a statement is received from the bank and the balance as shown by the pass book does not tally with the balance as per cash book. The following points should be kept in mind while preparing this statement :

(1) It is prepared on a particular date. Its heading would be "Bank Reconciliation Statement as on........".

(2) It can be prepared, starting with the balance either as per bank column of cash book, or with the balance as per pass book. The balance of cash book may be debit or credit. Similarly the balance as per pass book may be credit or debit –

(a) Debit balance as per cash book indicates favourable or deposit balance in the bank.

(b) Credit balance as per cash book indicates overdraft bank balance.

(c) Credit balance as per pass book indicates the deposit balance of the party.

(d) Debit balance as per pass book indicates the excess withdrawals over deposits, called overdraft balance as per pass book.

(e) If nothing is mentioned in the question about debit or credit balances, the usual balance of Cash book is treated as debit (deposit) and that of pass book as credit (deposit).

(f) A Bank Reconciliation Statement can be started with any of the balance mentioned below :

(i) **Dr. Balance** as per Cash Book; or (ii) Cr. Balance as per Cash Book,

(iii) **Dr. Balance** as per Pass Book. or (iv) Cr. Balance as per Pass Book.

The adjustment of various items of differences depends upon the starting balance which is summarized as follows :

Bank Reconciliation Statement as on..........

Entries Given	When Cash Book Balance is starting point		When Pass Book Balance is starting point	
	Normal Balance (Dr. Bal.)	Overdraft Balance (Cr. Bal.)	Normal Balance (Cr. Bal.)	Overdraft Balance (Dr. Bal.)
1. Cheqes issued but not yet presented for payment.	Add	Deduct	Deduct	Add
2. Cheques deposted into Bank but not yet collected.	Deduct	Add	Add	Deduct
3. Interest allowed by Bank but not yet entered in Cash Book.	Add	Deduct	Deduct	Add
4. Bank charges not yet entered in Cash Book.	Deduct	Add	Add	Deduct
5. Direct deposit into the bank by a customer.	Add	Deduct	Deduct	Add
6. Direct payment by the Bank not yet entered in Cash Book.	Deduct	Add	Add	Deduct
7. Direct collection made by bank not yet entered in Cash Book.	Add	Deduct	Deduct	Add
8. Cheques issued and payment received by the customer but not yet entered in Cash Book.	Deduct	Add	Add	Deduct
9. Cheques paid into Bank but omitted to be entered in Cash Book.	Add	Deduct	Deduct	Add
10. Dishonour of a cheque and bill discounted with Bank.	Deduct	Add	Add	Deduct
11. Cheques entered in Cash Book but not yet sent to Bank	Deduct	Add	Add	Deduct

Illustration 9.1 (When debit balance of Cash Book is given)

Prepare a Bank Reconciliation Statement from the following particulars as on 31st March, 2015.

	Rs.
(i) Debit balance as per bank column of the Cash Book	40,000
(ii) Cheques issued to creditors but not yet presented for payment	8,400
(iii) Cheques deposited into bank for collection but not yet collected by the bank	11,800
(iv) Bank charges not recorded in Cash Book	800
(v) Bank paid house tax on behalf of customer but no information received from bank in this connection	400
(vi) A cheque deposited into bank was dishonoured but no intimation received	500
(vii) Dividend collected by the bank but not entered in the Cash Book	700
(viii) Interest credited by Bank not considered in Cash Book	350

Soltuion :

Bank Reconciliation Statement

As on 31st March, 2015

Particulars	Details Rs.	Total Rs.
Debit Balance as per Cash Book		40,000
Add : Cheques issued to creditors but not yet presented to the bank for payment	8,400	
Dividend collected by the bank	700	
Interest allowed by the bank	350	9,450
		49,450
Less : Chques deposited into bank but not yet collected	11,800	
Bank charges	800	
House Tax paid directly by the bank	400	
Chques deposited but dishonoured	500	13,500
Credit Balance as per Pass Book		35,950

Illustration 9.2 : (When Cr. Balance as per Cash Book as given)

Prepare a Bank Reconciliation Statement from the following particulars :

		Rs.
(i)	Bank overdraft as per Cash book	60,40
(ii)	Cheques deposited in to bank but no entry was passed in the Cash Book.	2,70
(iii)	Cheques received and entered but omitted to be banked	7,40
(iv)	Credit side of the bank column of Cahs Book is cast short	3,50
(v)	Insurance Premium paid directely by bank under standing instructions	7,00
(vi)	Bank charges entered in cash book twice	15
(vii)	Cheques received & returned dishonoured by bank but no entry passed in Cash Book	5,25
(viii)	Cheques issued and returned on technical grounds	2,65
(ix)	Bills directly collected by bank	2,47
(x)	Bank charges debited by bank	11
(xi)	Cheques received entered twice	4,76
(xii)	Bill discounted from Bank was dishonoured on due date	36,75

Solution :

Bank Reconciliation Statement

As on ....

Particualrs	Details Rs.	Total Rs.
Overdraft Balance as per Cash Book		60,400
Add : 1. Cheques received and entered but not sent to the Bank	7,400	
2. Credit side of the bank column cast short	3,500	
3. Insurance premium paid directly by Bank	7,000	
4. Cheques received and returned by Bank but no entry passed	5,250	
5. Bank charges	115	
6. Cheques received and entered twice	4,760	
7. Bill discounted dishonoured	36,750	64,775

		1,25,175
Less : 1. Cheques deposited in bank but no entry was passed in the cash book	2,700	
2. Bank charges entered in cash book twice	150	
3. Cheques "issued" returned on technical grounds	2,650	
4. Bills directly collected by bank	2,470	7,970
Overdraft (Dr.) Balance as per Pass Book		1,17,205

Illustration 9.3 : (When Dr. Balance of Pass Book is given)

On 31st March, 2015 Mohd. Rafeeque had an overdraft of Rs. 12,400 as shown by his Pass Book. He had issued cheques amounting to Rs. 2,500 of which Rs. 2,000 worth only seems to have been presented for payment. Cheques amounting to Rs. 1,000 had been paid into the Bank on 30th March, but of these only Rs. 650 had been credited in Pass Book. A cheque of Rs. 100 which was debited in bank account in his books had been omitted to be banked. There is a debit in his pass Book of Rs. 250 for interest. An entry of Rs. 870 of a payment by a customer direct into the bank appears in the Pass Book. Rafeeque's Pass Book also showed a credit of Rs. 600 to his account, being interest on investments collected direct by his Bankers.

Prepare Basic Reconciliation statement as on 31st March, 2015.

Solution :

Bank Reconciliation Statement

As on 31st March, 2015

Particulars	Details Rs.	Total Rs.
Overdraft : (Debit) Balance as per Bank Pass Book		12,400
Add : Cheques issued but not yet presented for payment	500	
Directly deposited by a customer	870	
Interest on Investments collected by the Bank	600	1,970
		14,370
Less : Cheques deposited but not yet collected by the Bank	350	
Cheques entered in the Cash Book but omitted to be banked	100	
Interest on overdraft	250	(700)
Overdraft : (Credit) Balance as per Cash Book		13,670

Illustration 9.4 : (When Dr. Balance as per Pass Book is given)

On 31st March, 2015, the Bank Pass Book of a merchant showed debit balance Rs. 3,46,670. On comparing it with the Cash Book the following differences were found

(i) The following cheques were issued in the last week of March, 2015 :

(A) Mr. Ram Rs. 22,000; (b) Mr. Gopal Rs. 97,000

(c) Mr. Peters Rs. 47,500; (d) Mr. Saleem Rs. 83,200

Out of these, only Ram and Peters have presented their cheques for payment upto 31st March, 2015.

(ii) Interest on Bank overdraft not entered in the Cash Book Rs. 4,350.

(iii) Out station cheques amounting to Rs. 76,850 were sent to the bank for collection on 31st March, 2015 but were not collected.

(iv) A Bill for collection Rs. 1,12,500 due on 31st March, 2015 was sent to the bank but not credited in the Pass Book till 5th April, 2015.

(v) Bank charges debited in Pass book but not entered in the Cash Book Rs. 1,240.

(vi) The bank paid subscription to Chamber of Commerce accourding to on standing instruction but it was not entered in the Cash Book Rs. 3,670.

Prepare Bank Reconciliation Statement as on 31st March, 2015.

Solution :

Bank Reconciliation Statement

As on 31st March, 2015

Particulars	Details Rs.	Total Rs.
Dr. Balance (overdraft) as per Pass Book		3,46,670
Add : Cheques issued but not presented for payment		
(i) Mr. Gopal	97,000	
(ii) Mr. Saleem	83,200	1,80,200
		5,26,870
Less : (i) Interest on Bank Overdraft	4,350	
(ii) Outstation cheques sent to the bank for collection but not yet collected	76,850	
(iii) Bill for collection deposited but not credited in Pass Book	1,12,500	
(iv) Bank charges	1,240	
(v) Subscription paid to Chamber of Commerce	3,670	1,98,610
Cr. Balance as per Cash Book (overdraft)		3,28,260

Illustration 9.5 : (When Credit Balance as per Pass Book is given)

From the following particulars prepare a Bank Reconcilliation Statement as on 31st March 2015 and ascertain bank balance as it would appear in Cash Book.

1. Bank Pass Book showed a balance of Rs. 95,000
2. Interest of Rs. 2,500 has been debited in the pass book, but has not been entered the Cash Book.
3. Cheques issued but not cashed, prior to 31-3-2009 amounted to Rs. 15,000.
4. Club bill directly debited by bank not yet reflected in Cash Book Rs. 27,000.
5. Cheques paid into bank, but not cleared and credited before 31st March Rs. 2,500.
6. Interest on Investment collected by the bankers and credited in the Pass Book, not yet entered in cash book amounted to Rs. 18,000.
7. A cheque for Rs. 9,000 was issued for LIC premium which was returned as the amount in figure and words was not tallying. The premium was subsequently paid in cash and this was not rectified in the books of accounts.

Solution : **Bank Reconcilliation Statement as on 31st March, 2009**

	Rs.	Rs.
Cr. Balance as per Pass Book as on 31-3-2015		95,000
Add : (i) Interest debited in Pass Book not entered in Cash Book	2,500	
(ii) Club Bill directly debited in Bank Account not entered in Cash Book	27,000	
(iii) Cheques paid into Bank not yet cleared and credited	25,000	54,500
		1,49,500
Less : (i) Cheques issued but not cashed prior to 31-3-2015	15,000	
(ii) Interest on Investments collected by Bank, not entered in Cash Book	18,000	
(iii) Cheque issued for LIC premium returned, but not reversed in Cash Book.	9,000	(42,000)
Dr. Balance as per Cash Book		1,07,500

Illustration 9.6 :

Rectify the errors in the following Bank Reconciliation Statement and prepare a correct one :

Particulars	Details Rs.	Total Rs.
Dr. Balance as per Cash Book		15,000
Add : (a) Cheques sent for collection but not collected	2,500	
(b) Bank paid Insurance Premium	1,000	
(c) Direct deposit by a customer	1,500	5,000
		20,000
Less : (a) Cheques issued but nor presented before the Bank	3,000	
(b) Commission charged by the Bank	250	
(c) A cheque deposited with the Bank was dishonoured	750	
(d) Bank has credited Interest	1,000	5,000
Cr. Balance as per Pass Book		15,000

Solution :

Corrected Bank Reconciliation Statement

As on..........

Particulars	Details Rs.	Total Rs.
(Dr.) Balance as per Cash Book		15,000
Add : (i) Direct deposit by a customer	1,500	
(ii) Cheques issued but nor presented for payment before the bank	3,000	
(iii) Interest credited by bank	1,000	5,500

			20,500
Less :	(i) Cheques sent for collection but nor collected	2,500	
	(ii) Insurance premium paid by bank	1,000	
	(iii) Commission charged by bank	250	
	(iv) Cheque deposited but dishonoured	750	(4,500)
	(Cr.) Bank Balance as per Pass Book		16,000

Illustration 9.7 :

From the following extracts from the Cash Book and Bank Pass Book for the month of January 2015, prepare the Bank Reconciliation Statement as on 31st January, 2015.

Dr. **Cash Book** Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2015			2015		
Jan., 1	To Balance b/d	45,100	Jan., 2	By M	12,300
Jan., 3	To Cash	3,000	Jan., 6	By Wages	30,000
Jan, 10	To K	10,000	Jan., 14	By K	10,000
Jan., 15	To L	23,000	Jan., 15	(Cheques dishonoured)	
Jan., 17	To Cash	6,000	Jan., 18	By X	3,000
Jan., 20	To A	15,500	Jan., 24	By Q	4,700
Jan., 24	To B	7,400	Jan., 28	By Cash	4,000
Jan., 31	To C	21,300	Jan., 31	By Y	7,800
			Jan., 31	By Z	3,400
				By Balance c/d	56,100
		1,31,300			1,31,300
Feb., 1	To Balance b/d	56,100			

Bank Pass Book

Date	Particulars	Withdrawsls	Deposits	Dr. or Cr.	Balance
2015					
Jan., 1	By Balance b/d				
Jan., 3	By Cash			Cr.	45,100
Jan., 6	To self-cash		3,000	Cr.	48,100
Jan., 10	To M	30,000		Cr.	18,100
Jan., 16	By L	12,300		Cr.	5,800
Jan., 17	By Cash		23,000	Cr.	28,800
Jan., 20	To Q		6,000	Cr.	34,800
Jan., 24	To Cash	4,700		Cr.	30,100
Jan., 24	To Bank charges as per instructions	4,000		Cr.	26,100
Jan., 31	To Life Inusrance Premium under	100		Cr.	26,000
	standing instructions	2,500			
Jan., 31	By Interest on Government			Cr.	23,500
	Securities			Cr.	
			3,000	Cr.	26,500

Solution : The Cash Book and the Pass Book given above are for the same period. Three cheques received and sent to Bank for collection are debited in cash book. If collection wouuld have made, the same will appear in deposit column of the Pass Book. Similarly, cheques issued, are credited in Cash Book| When they present for payment, bank records in withdrawals column. On careful scrutiny it reveals that :

(i) Cheques of A Rs. 15,500, B Rs. 7,400, C Rs. 21,300 are not collected.

(ii) K's cheques is dishonoured entered in the cash book only. No entry appears in pass book.

(iii) Cheques issued to X Rs. 3,000, Y Rs. 7,800 and Z 3,400 seem to have not presented for payment.

(iv) Bank charges Rs. 100 and life insurance premium paid Rs. 2,500 are not credited in Cash Book.

(v) Interest on government securities Rs. 3,000 collected by bank is also not entered in Cash Book.

Solution :

Bank Reconciliation Statement

As on 31st January, 2015

Particulars			Details Rs.	Total Rs.
Debit Balance as per Cash Book				56,100
Add : Cheques issued but not presented for payment		Rs.		
	X	3,000		
	Y	7,800		
	Z	3,400	14,200	
Interest on Government Securities collected directly and creidted by bank but not entered in Cash Book			3,000	17,200
				73,300
Less : Cheques deposited but nor yet cleared		Rs.		
	A	15,500		
	B	7,400		
	C	21,300	44,200	
Bank charges debited by the bank but nor entered in the Cash Book			100	
Life Insurance Premium paid by bank but not entered in the Cash book			2,500	(46,800)
Credit Balance as per Pass Book				26,500

When Bank Reconciliation Statement is prepared after adjusting the Cash Book

Adjustment of Cash Book is optional, when it is prepared during different months of the financial year. But if it is prepared at the end of the financial year, Cash Book must be adjusted and this adjusted balance is shown in the Balance Sheet. The following procedure be followed :

When Balance as per Cash Book, debit or credit, is given :

(i) Draw up Cash Book (Bank column), put favourable balance on debit side, and overdraft balance on credit side.

(ii) **Make necessary entries for** such items recorded in Pass Book but not in the Cash Book. For example, **bank charges,** dividend and interest collected by bank, direct payment by Bank under standing order, dishonour of Cheques and Bills not yet recorded in Cash Book. All errors committed in Cash Book **be rectified** such as over casting in debit or credit column of cash book, amount entered twice in cash book, wrong amount entered in cash book etc.

(iii) Ascertin the adjusted balance.

(iv) Prepare Bank Reconciliation statement in the usual manner taking adjusted balance as the starting point. Leave those items which have already been considered in adjusted Cash Book.

Illustration 9.8 :

Ram's Cash Book on March 31, 2015 showed an overdraft balance of Rs. 60,500 on his Account No. 1 at the Bank. On investigation you find :

(1) Cheques drawn amounting to Rs. 21,000 had not been presented to the bank for payment.
(2) Cheques, Rs. 18,000 entered in the Cash Book as paid into the Bank had not been credited by the Bank.
(3) The receipt side of the Cash Book had been undercast by Rs. 5,000.
(4) Bank charges of Rs. 250 and dividend Rs. 1,500 collected by Bank entered on the Bank Statement had not been entered in the Cash Book.
(5) A cheque for Rs. 26,000 drawn on the Account No. I had been entered in the Cash Book on Account No 2.
(7) A cheque for Rs. 3,500 received from a debtor paid into the Bank had been dishonoured and shown as such by the Bank but no entry of dishonour had been made in the Cash Book.
(8) A cheque for Rs. 2,100 drawn by Bank's another customer of the same name, had been charged to Ram's Bank Account in error.

You are required (a) to show necesary adjustments to be made in the Cash Book, and (b) to prepare a Bank Reconciliation Statment for the Account No. 1 as on March 31, 2015.

Solution :

Cash Book of Ram
(Bank Column)

Dr. | *Cr.*

Particulars	Rs.	Particulars	Rs.
To Adjustment for under-casting of receipt side	5,000	By Balance b/d	60,500
To Dividend	1,500	By Bank charges	250
To Balance c/d	57,750	By Debtor (dishonoured cheque)	3,500
	64,250		64,250

Bank Reconciliation Statement
for Account No. 1 as on March 31, 2015

Particulars	Details Rs.	Total Rs.
Cr. Balance as per Cash Book (Overdraft)		57,750
Add : Cheques paid in but not yet collected & credited	18,000	
Cheques of another party wrongly debited	2,100	20,100
		77,850
Less : Cheques issued but not presented		
Cheques drawn on Account No. 1	21,000	
wrongly debited to Account No. 2	26,000	(47,000)
Dr. Balance as per Bank Statment (Overdraft)		30,850

Illustration 9.9 :

On 31st March 2015, the Pass Book of Jackson showed a overdraft of Rs. 72,750. But bank column of the Cash Book showed a credit balance of Rs. 43,000. On the basis of following information, prepare a Bank Reconciliation Statement for the month ending 31st March, 2015 :

(i) Bank could not collect the amount of cheques sent for collection 24,500
(ii) Issued cheques but not presented in the bank 3,700
(iii) Bank received interest on our investments which was recorded in the Bank Pass Book but not in the Cash Book. 4,600
(iv) Interest charged on overdraft by the bank which was not recorded in the Cash Book. 2,150
(v) Amount of dishonoured bill showed in the Bank Pass Book but not in the Cash Book 11,400

Solution :

Bank Reconciliation Statement
As on 31st March, 2015
(Taking Bank Pass Book Balance)

Particulars	Details Rs.	Total Rs.
Bank overdraft Dr. Balance as per Pass Book		72,750
Add : (i) Cheques drawn but nor presented before the bank for payment	3,700	
(ii) Interest received by bank on our investments	4,600	8,300
		81,050
Deduct : (i) Cheques sent into the bank but not collected	24,500	
(ii) Interest on overdraft charged by the bank debited into Bank Pass Book.	2,150	
(iii) Bill dishonoured shown in Bank Pass Book.	11,400	(38,050)
Overdrafts (Cr.) Balance as per Cash Book		43,000

Bank Reconciliation Statement as on 31st March, 2015
(Taking Cash Book Balance)

Particulars	Details Rs.	Total Rs.
Bank overdraft as per Cash Book		43,000
Add : (i) Cheques sent into the bank but not colletced.	24,500	
(ii) Interest on overdraft charged by bank.	2,150	
(iii) Bill dishonoured shown in the Bank Pass Book	11,400	38,050
		81,050
Deduct : (i) Cheques drawn but not presented before the bank for payment	3,700	
(ii) Interest on investment received by bank	4,600	8,300
Overdraft as per Bank Pass Book.		72,750

Illustration 9.10 :

Anand & Co. have bank accounts with two banks, viz., Dena Bank and Bank of India. On 31st March 2015, his Cash Book (bank columns) showed balance of Rs. 50,000 with Dena Bank and overdraft of Rs. 22,500 with Bank of India. On further verification, the following facts were discovered :

(a) A deposit of Rs. 15,000 drawn on Dena Bank on 20th March, 2015 has been entered in the column for Bank of India.

(b) A withdrawal of Rs. 5,000 from Bank of India on 2nd February 2015 has been entered in the column for Dena Bank.

(c) Two cheques of Rs. 5,000 and Rs. 7,500 deposited in Dena Bank on 1st March 2015 and entered in the Bank of India column have been dishonoured by the bankers. The entries for dishonour have been made in the Bank of India column.

(d) Cheques were issued on 29th March 2015 on Dena Bank and Bank of India for Rs. 1,00,000 and Rs. 10,000 respectively. These have not been cashed till 31st March, 2015.

(e) Incidental charges of Rs. 100 and Rs. 250 charged by Dena Bank and Bank of India respectively have not been entered in the books.

(f) Dena Bank has credited an interest of Rs. 500 and Bank of Indian has charged interest of Rs. 2,750. These have not been recorded in the books.

(g) The deposits of Rs. 50,000 and Rs. 35,000 made into Dena Bank and Bank of India respectively have not yet been credited by them till 31st March, 2015.

Draw up the two Bank Reconciliation Statements.

Solution :

M/s Anand & Co.
Bank Reconciliation Statement with Dena Bank
As on 31st March, 2015

Particulars	Details Rs.	Total Rs.
Dr. Balance as per Cash Book		50,000
Add: (a) Deposit made on 20.12.2015 but wrongly debited to Bank of India	15,000	
(b) Withdrawal made on 2.11.2015 wrongly entered in this Account	5,000	
(c) No effect of this entry	—	
(d) Cheques issued but not presented for payment.	1,00,000	
(f) Interest credited by Bank.	500	1,20,500
		1,70,500
Less: (e) Incidental charges debited by Bank	100	
(g) Cheques deposited but not yet credited by Bank.	50,000	(50,100)
Cr. Balance as per Bank Pass Book.		1,20,400

Bank Reconciliation Statement with Bank of India
As on 31st March, 2015

Particulars	Details Rs.	Total Rs.
Cr. Balance as per Cash Book (overdraft)		22,500
Add: (a) Deposit made with Dena Bank wrongly entered in this account.	15,000	
(b) Withdrawal made wrongly entered in Dena Bank.	5,000	
(c) No effect	—	
(d) Incidental charges not yet entered.	250	
(e) Interest charged by Bank not yet entered in cash book.	2,750	
(f) Cheques deposited not credited by Bank	35,000	58,000
		80,500
Less: (g) Cheques issued but not presented for payment		(10,000)
Dr. Balance as per Pass Book (overdraft)		70,500

Illustration 9.11 :

On 31st March, 2015, the pass book of a businessman shows a debit balance of Rs. 1,00,000. You are required to prepare a Bank Reconciliation Statement as on 31st March, 2015 for the following particulars :

(a) Cheques amounting to Rs. 8,00,000 drawn on 25th March of which cheques of Rs. 3,00,000 were encashed up to 31st March 2015.

(b) Cheques worth Rs. 5,00,000 were deposited in March, 2015 but cheques of Rs. 2,20,000 could only be collected in this month.

(c) Bank charges Rs. 2,500 and dividend of Rs. 35,000 on shares collected by bank could not be shown in the Cash Book.

(d) A cheque of Rs. 60,000 debited in the cash book was omitted to be banked.

(e) A cheque of Rs. 75,000 was sent to the bank but its entry was omitted to be made in Cash book.

Solution :

Bank Reconciliation
as on 31st March , 2015

Particulars	Details Rs.	Total Rs.
Dr. Balance as per Pass Book		1,00,000
Add : Cheques drawn but not encashed. (Rs. 8,00,000 – 3,00,000)		5,00,000
Cheques sent to Bank but omitted to be banked.		75,000
Dividend Collected by Bank		35,000
		7,10,000
Less : Cheques deposited but not collected (5,00,000 — 2,20,000)	2,80,000	
Bank charges not recorded in Cash Book.	2,500	
Cheques debited in Cash Book but not deposited in Bank.	60,000	(3,42,500)
Cr. Balance as per Cash Book.		3,67,500

Illustration 9.12 :

From the following particulars, prepare a Bank Reconciliation Statement for Mr. Demle as at 31.3.2015:

(i) Bank balance as per cash book (Credit) Rs. 61,000
(ii) Cheques issued but not presented Rs. 3,00,000
(iii) Cheqes deposited but not credited by the Bank Rs. 2,50,000
(iv) A cheques drawn for Rs. 10,000 had been incorrectly entered as Rs. 1,000 in the Cash Book.
(v) A debtor directly deposited cheque to Mr. Dample's Bank Account but this was not recorded in Cash Book Rs. 1,00,000.
(vi) Credit side of the Cash Book (Bank column) was undercast by Rs. 50,000.
(vii) A cheque for Rs. 5,00,000 drawn by Mr. Surve, has been debited to Mr. Damle's Account by error.
(viii) Bank paid a Bill Payable for Rs. 1,45,000 but it was recorded in Cash Book as Rs. 1,54,000.
(ix) The receipts column of the Cash Book has been overcast by Rs. 1,00,000.
(x) Discount allowed Rs. 41,000 has been enterd by mistake in the Bank column of the Cash Book.
(xi) Mr. Damle instructed the Bank on 31st March 2015 to transfer Rs. 10,00,000 to Fixed Deposit A/c. which he entered in his Cash Book immediately. But the Bank acted on the instruction on 5th April, 2015
(xii) Bank debited Mr. Dample's account with Rs. 50,000 being the amount of a cheque deposited by him as it was dishonoured. This was, however, not entered in his Cash Book.
(xiii) Cheques amounting to Rs. 30,000 though actually deposited in the bank, were not recorded in Mr. Damle's Cash Book. *(CAIIB June)*

Solution :

Bank Reconciliation Statement of Mr. Damle
as on 31st March, 2015

Particulars	Amount Rs.	Amount Rs.
Credit Balance as per Cash Book (i.e. overdraft as per Cash Book)		61,000
Add : Cheque deposited but not credited by Bank	2,50,000	
Cheque drawn but incorrectly entered in Cash Book (10,000 – 1,000)	9,000	
Credit side of the Cash Book (Bank Column) is undercast	50,000	
Cheque drawn by other party, but debited to our account by Bank	5,00,000	
Receipt column of Cash Book is overcast	1,00,000	
Discount allowed wrongly entered in Bank Colun of the Cash Book	41,000	
Cheque dishonoured but not entered in Cash Book	50,000	10,00,000
		10,61,000
Less : Cheques issued but not presented for payment	3,00,000	
Cheque directly deposisted by debtor but not recorded recorded in Cash Book	1,00,000	
Bills Payable paid by Bank but entered in Cash Book with wrong figures (1,54,000 – 1,45,000)	9,000	
Amount not transferred to Fixed Deposit by Bank, but entered in the Cash Book.	10,00,000	
Cheques deposited with Bank, but not recorded in Cash Book.	30,000	(14,39,000)
Credit Balance as per Pass Book (Deposit)		3,78,000

Illustration 9.13 :

On 30th November, 2014, the Cash Book of M, showed an overdrawn position of Rs. 36,300 although his bank statement showed only Rs. 21,180 overdrawn. Detailed examination of the two records revealed the following :

(i) The debit side of the Cash Book had been undercast by Rs. 3,000.
(ii) A cheque for Rs. 15,600 in favour of Suppliers Ltd. had been omitted by the Bank from its statement, the cheque having been debited to another Customer's Account.
(iii) A cheque for Rs. 1,820 drawn for payment of telephone bill had been entered in the Cash Book as Rs. 1,280 but was shown correctly in the Bank statement.
(iv) A chqeue for Rs. 2,100 from Mr. A having been paid into Bank was dishonoured and shown as such on the Bank statement, although no entry relating to the dishonoured cheque had been made in the Cash Book.
(v) The Bank had debited a cheque for Rs. 1,260 to Mr. M's Account in error; it should have been debited by them to Mr. K's Account.
(vi) A dividend of Rs. 900 had been collected by the Bank but was not recorded in the Cash Book.
(vii) Cheques totalling Rs. 12,600 drawn in November had not been presented for payment as yet.
(viii) Cheques of Rs. 10,800 deposited on 30th November had not been credited by the Bank as yet.
(ix) Interest amounting to Rs. 2,280 had been debited by the Bank but not entered in the Cash Book.

You are required to prepare a Bank Reconciliation Statement as on 30th November, 2014 after preparing a corrected Cash Book. *(CAIIB May Adapted)*

Solution :

Dr. **CORRECTED CASH BOOK** Cr.

Date	Particulars	Amount	Date	Paticulars	Amount
2014		Rs.	2014		Rs.
Nov. 30	To Debit undercast	3,000	Nov. 30	By Balance b/d	36,300
	To Dividend not recorded	900		By Error in telephone bills (1820–1280)	540
	To Balance c/d (Corrected overdraft balance)	37,320		By Cheque dishonoured	2,100
				By Interest	2,280
		41,220			41,220

BANK RECONCILIATION STATEMENT
as on 30th November, 2014

Particulars	Details Rs.	Amount Rs.
Overdraft as per Cash Book		37,320
Add : Bank wrongly debited a cheque	1,260	
Cheques deposited but not yet collected by the bank.	10,800	12,060
		49,380
Less : Cheque issued but debited by the bank in another customer's account.	15,600	
Cheque drawn but not presented for payment.	12,600	(28,200)
Overdraft as per Pass Book.		21,180

Test Questions

Very Short Questions and Answers. (Not exceeding 40 words)

Q.1. What is meant by Bank Reconciliation Statement ?

Ans. : Bank Reconciliation is a statement which contains a complete and satisfactory explanation of the differences between the two balances as disclosed by Cash Book and Pass Book.

Q.2. Is Bank Reconciliation statement a part of double entry system?

Ans. : Bank Reconciliation Statement is not a part of double entry system. It is only a statement which is prepared only when the balance of Bank column of Cash Book and Customer's balance in Bank Pass Book does not tally.

Q.3. State only four causes of difference between Bank Column of Cash Book and balance as per Pass Book.

Ans. : Causes of difference between Two balances :

(i) When cheques are issued by the customer, but the individuals have not presented in Bank for payment upto the last date.

(ii) When cheques are deposited in Bank for collection but the same are not collected till the date of preparing this statement.

(iii) Interest allowed and credited by Bank.

(iv) Bank charges including interest charged by Bank on overdraft.

Q.4. What is the need of preparing Bank Reconciliation Statement?

Ans. The errors and omissions committed by the Bank or by the customer would be detected and can be rectified accordingly and it also prevents frauds in recording banking transactions.

Q.5. How will direct payment by a customer effect the balance as per Pass Book?

Ans. : Direct payment received by the Bank will be credited in Customer's Account in the Bank, as such balance of Pass Book in Customer's Account will be more than the balance of Bank column of Cash Book.

Q.6. What does a credit balance as per cash book mean?

Ans. : When any amount is deposited, the Bank Account is debited and if withdrawn, it would be credited. It shows that if credit is more than debit, it means overdrawn balance or unfavourable balance of Bank Account in Cash Book.

Q.7. What does a debit balance as per Cash Book mean?

Ans. : Debit balance as per Cash Book means favourable balance in Bank column of Cash Book.

Q.8. What is meant by a debit balance of Pass Book?

Ans. : Debit balance of Pass Book means unfavourable balance or overdraft balance in customer's Account in the Bank.

Q.9. Which balances are called overdraft balances of Pass Book and the Cash Book.

Ans. : Debit balance as per Pass Book and Credit balance as per Cash Book are called overdraft balances or unfavourable balances.

Q.10. Name four items which will increase favourable balance of Bank Column of Cash Book.

Ans. (i) Cheques issued but not presented for payment in the Bank.

(ii) Interest credited by Bank.

(iii) Direct deposit by a customer in Bank Account.

(iv) Dividend collected directly by Bank.

Q.11. Name four items which will decrease favourable balance of Bank column of Cash Book.

Ans. (i) Cheques and Bills sent for collection but not yet collected and credited by Bank.

(ii) Bank charges, charged by Bank for dishonour of a chqeue.

(iii) Locker rent directly debited in Customer's Account under Standing instructions.

(iv) Interest on overdraft if any, charged by Bank.

Q.12. Mention two items which are not to be recorded in an Amended Cash Book balance.

Ans. : (i) Cheques issued by customer but not yet presented for payment in Bank.

(ii) Cheques sent to Bank for collection but not yet collected and credited by Bank.

Q.13. Name two items which are to be entered in Amended Cash Book.

Ans. : (i) Credits granted by the Bank for collecting Interest and Dividend.

(ii) Payment of Insurance premium and locker rent etc. by the Bank on behalf of customer under standing instructions.

Short Questions and Answers : (Not exceeding 80 words)

Q.1. State the meaning of Bank Reconciliation Statement.

Ans. : Meaning of Bank Reconciliation Statement :

It is a statement which contains a complete and satisfactory explanation of the differences in the two balances as per Cash Book and the Bank Pass Book. It is not a part the double entry booking system. It is just a procedure to prove the cash balance. It is important to note that a Bank Reconciliation Statement is to be prepared when a Bank Statement is received on a stated day.

Q.2. State the need or objective of preparing Bank Reconciliation Statement.

Ans. : Need for Preparing Bank Reconciliation Statement :

It is essential to prepare Bank Reconciliation Statement because of the following reasons :

1. The errors and omissions committed by the Bank or the Merchant (customer) would be detected and can be rectified accordingly.
2. It will reflect the actual bank balance position of the customer so as to help him in making the further transactions with the Bank.
3. It facilitates the preparation of revised cash book by making necessary entries as regards bank charges, bank interest allowed or charged by bank, direct payments by bank etc.
4. It prevents frauds in recording banking transactions and reduces the chances of embezzlement by the staff of the firm or of the bank.
5. It helps in revealing the unnecessary delay in the collection of cheques etc. by the bank.

Q.3. Enumerate five reasons for disagreement of Cash Book and Pass Book Balances.

Ans. : Causes of Difference in Cash Book & Pass Book Balances :

The difference in two balances may arise on a specified date because of the following reasons :

1. Cheques issued but not presented for payment in the Bank.
2. Cheques paid into the bank for collection but not yet collected and credited by the Bank.

3. Cheques paid into bank for collection but dishonoured.
4. Interest Credited by Bank but not recorded in Cash Book.
5. Bank charges and Interest on overdraft charged by Bank but not recorded in Cash Book.

Q.4. Enumerate four items which are added in overdraft of Cash Book to reconcile with overdraft balance of Pass Book.

Ans. : Items added in Credit Balance of Cash Book :

(i) Cheques Received and entered in Cash Book but omitted to be banked.
(ii) Credit side of Bank Column of Cash Book is Cast Short
(iii) Insurance premium paid by the Bank under standing instructions.
(iv) Bills Receivable discounted and dishonoured by the Debtor on due date.

Q.5. Give five examples of such items which are recorded by the Bank in Customer's Account but not entered in Cash Book because of lack of Advice.

Ans. : Items entered in Pass Book but not recorded in Cash Book :

(i) Bill Receivable discounted but dishonoured on due date.
(ii) Interest allowed by Bank on deposit balances.
(iii) Interest and dividend on Investments collected by Bank under standing instructions.
(iv) Insurance premium paid by Bank on behalf of the customer.
(v) Deposit by a customer directly in our Bank Account.

Q.7. Enumerate four examples of such items which are recorded in Cash Book but not in Bank Pass Book.

Ans. : (i) Cheques issued to sundry creditors but not yet presented for payment.
(ii) Bills for collection sent to Bank but not yet collected by Bank.
(iii) Cheques received and entered in Cash Book but omitted to be banked.
(iv) Overcast or undercast of Debit or Credit side of Cash Book.

Q.8. Cheques issued for Rs. 9,600 but were presented in the Bank for payment only for Rs. 6,000 Cheques deposited in the bank for Rs. 12,000 could not be collected. Favourable balance as per Cash Book was Rs. 2,000. Find out the balance as per Pass Book.

[Ans. Dr. Bal Pass Book Rs. 6,400]

Ans. : Cash Book (Dr.) Balance Rs. 2,000 + (Rs. 9,600 – 6,000) – Rs. 12,000 = Rs. 6,400. Debit or unfavourable balance of Pass Book.

Q.9. : Favourable balances as per Pass Book is given Rs. 10,000. Bank charges Rs. 3,000. interest on deposit Rs. 30,000, direct payment by Bank Rs. 5,000 under standing instructions are not recorded in Cash Book. Find out the balance as per Cash Book.

[Ans. : Cash Book Credit Balance Rs. 12,000]

	Rs.
Ans. : Cr. Balance as per Pass Book	10,000
Add : Bank Charges	3,000
Direct Payment to a customer	5,000
	18,000

Less : Interest on Bank Deposit	(30,000)
Cr. Balance as per Cash Book	12,000

Q.10. Enumerate four examples of those items which are added in Favourable balance of Cash book, while preparing Bank Reconciliation Statement.

Ans. : The following items are to be added if Dr. balances of Cash Book is the starting point.

(i) Cheques issued but not yet presented for payment.
(ii) Interest credited by Bank in the Pass Book.
(iii) Dividends and Interest on Investments collected by Bank.
(iv) Direct payments by a customer in Bank but not yet recorded in Cash Book.

Essay Type or Long Answers Questions :

1. What do you mean by Bank Reconciliation Statement ? Explain the causes of difference between Cash Book Balance and Pass Book Balance giving examples. (See page nps. 9.1 and 9.3)

Numericals :

When Debit Balance as per Cash Book is Given :

Q1. On 1st March 2015 the Cash Book of M/s Gyan Bros. shows a balances of Rs. 69,000. From the following particulars prepare a Bank Reconciliation Statement showing the balance as per Bank Pass Book as on that date :

(1) The following cheques were paid into the bank on 29th March, 2015 but were credited by the bank on 3rd April, 2015.
(a) Mr. Peters Rs. 12,600; (b) Mr. Madan Rs. 16,650.

(2) The cheques issued to : (i) Gautam Rs. 9,750, (ii) Asif Rs. 40,080, in March 2015 but were presented for payment in April, 2015.

(3) The bank pass book shows a debit of Rs. 360 for bank charges and payment of chamber of commerce fees under standing instructions Rs. 3,000 which were not entered in Cash Book.

(4) The pass book reveals a credit of Rs. 8,550 for interest and dividends realised which has not been entered in Cash Book. [Ans. Bank Pass Book Credit Balance Rs. 94,770]

Hint : Rs. 69,000 + 9,750 + 40,080 + 8,550 = Rs. 1,27,380 – (12,600 + 16,650 + 360 + 3,000) or Rs. 1,27,380 – 32,610 = Rs. 94,770 Cr. Balance as per Pass Book.

Q2. On 31st March, 2015, the balance as per Arif's Cash Book was Rs. 15,000. On comparing with the Pass Book the following information was received :

(i) Cheques amounting to Rs. 72,900 were issued on 28th March of which one cheques of Rs. 13,000 was presented in the bank for payment on 4th April, 2015.
(ii) Cheques deposited into bank for Rs. 1,00,000 but of these cheques for Rs. 60,000 only were cleared and credited in March, 2015.
(iii) Interest and Dividend on investment Rs. 5,800 collected by bank and credited to his account but he did not have any information for this.
(iv) Life Insurance Premium Rs. 7,500 paid by bank according to his standing orders.
(v) Bank Charges Rs. 250 not recorded in the Cash Book.

Prepare a Bank Reconciliation Statement as on 31st. March, 2015.

[Ans. Dr. Balance as per Pass Book Rs. 13,950]

Hint for solution : Rs. 15,000 + Rs. 13,000 +5,800 = Rs. 33,800		
Less : Cheques deposited but not yet collected Rs. 40,000		
Life Ins. Premium paid by Bank	7,500	
Bank Charges	250	(47,750)
Overdraft or Dr. Balance as per Pass Book		13,950

When Credit Balance as per Cash Book is Given :

Q.3. Prepare a Bank Reconciliation Statement from the following particulars as on 30th June, 2015 :

	Rs.
(i) Credit balance as per Bank column of Cash Book	36,000
(ii) Cheques issued to the creditors but not yet presented for payment	7,200
(iii) Cheques deposited into Bank for collection but not collected by the bank upto this date.	15,400
(iv) Bank charges charged by the bank	200
(v) Interest on overdraft charged by the bank	250
(vi) A customer deposited into our bank account without informing us	2,400
(vii) Bank paid house tax on our behalf, but no information was received from Bank till 30th June, 2015.	350

Ans. : [Dr. Balance as per P.B. Rs. 42,600]

Hint : Cr. Balance as per Cash Book Rs. 36,000 + 15,400 + 200 + 250 + 350 = 52,200
(–) Rs. 7,200 (–) 2,400 or – 9,600 = Rs. 42,600 (Dr. Balance as per P.B.)

Q.4. The Cash Book of a trader reveals a bank overdraft of Rs. 25,000 as on 31st March, 2015. The following information is available. Prepare the Bank Reconciliation Statement :

(a) Cheques amounting to Rs. 1,46,000 were deposited into bank, but of these only for Rs. 1,22,000 were credited in the Pass Book.
(b) Cheques for Rs. 1,00,000 were issued but of these only for Rs. 36,000 had been presented for payment.
(c) A cheque for Rs. 5,000 which he had debited to the bank account was omitted to be banked.
(d) A customer paid directly in the bank Rs. 10,000 but was not entered in Cash Book.
(e) There was a debit in Pass Book of Rs. 100 for bank charges and Rs. 500 for bank interest.
(f) Bank had paid insurance premium of Rs. 4,000 as per his instructions but not recorded in the Cash Book.
(g) Interest and divided collected by the bank on behalf of the trader Rs. 3,000.

Ans. : Dr. Balance as per P.B. Rs. 18,400

		Rs.
Ans : Cr. Balance as per Cash Book		25,000
Add : Cheques sent to Bank but not yet collected (1,46,000 – 1,22,000)		24,000
Cheque received and entered in C.B. but omitted to be banked		5,000
Bank Charges Rs. 100 + Rs. 500 (Interest on OD)		600
Insurance Premium paid by Bank		4,000
		58,600

Less : Cheques issued but not yet presented (Rs. 1,00,000 – 36,000) =	64,000	
Direct payment by a customer	10,000	
Interest and Dividend Collected by Bank	3,000	(77,000)
Cr. Balance as per Pass Book (Favourable)		18,400

When Debit Balance as per Pass Book is Given :

Q.5. My Bank Pass Book showed an overdraft of Rs. 13,000 on 31st March, 2015. This does not agree with the Cash Book balance. From the following particulars ascertain the balance as per Cash Book :

Cheques amounting to Rs. 30,000 were paid into Bank in March, out of which, it appears, cheques amounting to Rs. 9,000 only were credited by Bank. Cheques issued during March amounted in all to Rs. 22,000 out of these cheques for Rs. 6,000 were unpaid on 31st March. 2015. The Pass Book stands debited with Rs. 300 for interest and Rs. 60 for bank charges. The Bank had paid the annual subscription of Rs. 200 to my club according to my instructions. The entries for interest, bank charges and subscription have not yet been made in Cash Book.

[Ans : Balance as per Cash Book Rs.2,560]

Hint : Dr. Balance (Overdraft) as per Pass Book		= Rs. 13,000
Add : Cheques issued but not presented for payment		6,000
		19,000
Less : Cheques deposited but not yet collected Rs. 21,000		
Interest, Bank Charges and Subscription paid by Bank (Rs. 300 + 60 + 200)	560	(21,560)
Dr. Balance as per Cash Book		2,560

Q.6. On the basis of the following information available from the books and records of M/s Ravindra and Sons, you are required to prepare a Bank Reconcliation Statement as on 31st March, 2015 :

(i) Overdraft balance as per Pass Books Rs. 1,29,240.
(ii) Cheques amounting to Rs. 2,20,050 were deposited by the firm in its bank account on or before 31st March, but the bank cleared them and credited the account on 3rd April, excepting one cheque for Rs. 8,820 which was returned unpaid on 5th April.
(iii) The Bank debited Rs. 99 on 5th April, towards its charges on the aforesaid cheque.
(iv) Cheques aggregating Rs. 36,990 issued by the firm on or before 31st March, were presented and debited to the account on 3rd April by the bank.
(v) A cheque dated 25th March, issued by the firm for Rs. 27,720 was returned on 28th March on account of a technical defect therein. The firm received the intimation about the return of cheques on 2nd April.
(vi) A cheque for Rs. 12,735 depesited by another firm,was wrongly credited by the Bank to the account of this firm on 25th March and the entry was reversed in April.
(vii) Interest on overdraft amounting to Rs. 1,629 was debited by the bank on 31st March but the advice thereof was received by the firm on 1st April.

You are required to arrive at the balance as per Cash Book on 31st March 2015.

[Ans. Balance as per Cash book Rs. 6,124]

Hint for Solution :

Dr. Balance as per Pass Book		Rs.
Add : Cheques issued but not presented for payment uptill now		1,29,2[illegible]
Cheque issued but not cashed on technical grounds		36,9[illegible]
Cheque deposited by another customer wrongly credited		27,7[illegible]
Less : Cheques deposited but not yet collected		12,7[illegible]
		2,06,6[illegible]
Rs. 2,20,050 – 8,820	= 2,11,230	
Interest on Overdraft	1,629	(2,12,8[illegible])
Dr. Balance as per Cash Book		6,17[illegible]

When Credit Balance of Pass Book is Given :

Q.7. On 30th June, 2015 the Pass Book of Mr. Akbar showed a balance of Rs. 66,000. On comparing the Pass Book with Cash Book the following differences were found :

(i) Mr. Akbar had paid into the Bank on 26th June four cheques for Rs. 9,000 Rs. 18,000; Rs. 24,000 and Rs. 30,000. Of these, the cheque for Rs. 18,000 was credited by the bank in July, 2015.

(ii) On 23rd June three cheques were drawn for Rs. 12,000; Rs. 13,000 and Rs. 32,000. The first two cheques were presented to the bank for payment in June while the third in July, 2015.

(iii) Cheques amounting to Rs. 10,800 were deposited in the bank but no entry was passed in the Cash Book.

(iv) Bank Charges entered in Cash Book twice Rs. 150.

(v) Cheques received and sent to Bank but entered twice in the Cash Book Rs. 9,600.

Prepare a Reconciliation Statement as on 30th June, 2015.

[Ans. Dr. Balance as per Cash Book Rs. 50,650]

Ans. : Cr. Balance as per Pass Book		Rs. 66,000
Add : Cheque deposited in Bank but not yet collected.		18,000
Add : Cheque received & sent to Bank but entered time in Cash Book		9,600
		93,600
Less : Cheques issued but not presented for payment till 30th June	Rs. 32,000	
Less : Cheque deposited in Bank but no entry was made in Cash Book	10,800	
Less : Bank Charges entered twice in Cash Book	150	(42,950)
Dr. Balance as per Cash Book		50,650

Q.8. Prepare Bank Reconciliation Statement for the following particulars of Modi Sons as on 31st March, 2015 :

(i) Balance as per Pass Book on 31st March, 2015 Rs. 60,000

(ii) Out of total cheques issued for Rs. 3,75,000 during the month, cheques for Rs. 50,000 were encashed in March, for Rs. 60,000 in April and the rest were not presented for payment.

(iii) Out of total cheques deposited in Bank for Rs. 1,20,000, cheques of Rs. 75,000 were credited in March, for Rs. 20,000 in April and the rest are yet to be collected.

(iv) Bank has charged for commission Rs. 270 and allowed Interest Rs. 3,300.

(v) Amount of Rs. 24,000 was wrongly debited by Bank.

(vi) A cheque for Rs. 12,000 was received and entered in Cash Book in March, 2015 but was sent to Bank in the month of April, 2015.

(vii) A cheque of Rs. 1,33,000 was paid in Bank but was returned dishonoured no entry was made in cash Book.

Hint for solution :

	Rs.
Rs. 60,000 + 45,000 + 270 + 24,000 + 12,000 + 1,33,000 =	2,74,270
– (Rs. 3,25,000 + 3,300)	= (3,28,300)
Cr. Balance as per Cash Book (Overdrawn balance)	54,030

Note : When nothing is mentioned about Dr. or Cr. balance, usual balance of P.B. is treated as credit.

Adjusted Cash Book :

Q.9. As per the Bank Reconciliation Statement of Rajdhani Traders for the month of February, 2015 the amount of unpresneted cheques was Rs. 4,000 and that of uncollected cheques ws Rs. 7,500. The following additional information is available for the month of February 2015 :

Particulars	As per Cash Book Rs.	As per Bank Pass Book Rs.
Deposits during February	50,000	42,500
Payments during February	60,000	56,000
Collections of Bills	–	6,000
Payments a per standing instructions	–	1,000
Balance as on 28th February	30,000	28,500

You are required (1) to find out the adjusted cash balance and (2) to prepare a Bank Reconciliation Statement. [Ans. Adjusted Cash Balance Rs. 35,000 & (Cr.) Balance P.B. Rs. 31,500]

Ans :

(1) Adjusted Cash Book (Bank Column)

Receipts	Amount	Payments	Amount
To Balance b/d	30,000	By Payment by Bank	1,000
To Bills Collection	6,000	By Balance c/d	35,000
	36,000		36,000

(2) Bank Reconciliation Statement as On 28th February, 2015

	Rs.
Adjusted Dr. Balance as per Cash Book	35,000
Add : Cheques issued but not yet presented for payment	4,000
	39,000
Less : Cheques deposited but not yet collected by Bank	7,500
	31,500
Cr. Balance as per Pass Book	

Q.10. On 31st March, 2015 the bank column of the Cash Book of a merchant shows a debit balance of Rs. 92,200. On examination of the Cash book and the Bank Statement, you find that :

(1) Cheques amounting to Rs. 1,26,000 were issued before 31st March, but were not presented for payment till 31-3-2015.

(2) Cheques worth Rs. 50,000 were entered in Cash Book as sent to bank for collection but were entered in Bank Statement in April, 2015.

(3) A cheque of Ravi Rs. 14,600 had been dishonoured before 31st March but no entry was made in Cash Book.

(4) A dividend warrant for Rs. 7,600 was paid direct in the bank, did not appear in Cash Book.

(5) Bank interest and charges Rs. 8,400 did not appear in Cash Book.

(6) Rotary club membership subscription Rs. 2,000 paid by Bank under standing instructions, did not appear in cash book.

(7) Bank charges for some payments made by bank Rs. 200 was enterest in cash book twice.

(8) A cheques for Rs. 5,400 drawn by him against his Saving Fund Account was wrongly debited to this account by mistake on 20th March, 2015.

(9) Make necessary adjusments in Cash Book to bring down the correct balance and prepare statement reconciling the corrected cash book balance with the balance as per the bank statement.

[Ans. Adjusted Cash Balances Rs. 75,000. (Cr.) Balance as per Pass Book Rs. 1,45,600]

Ans :

(1) Adjusted Cash Book (Bank Column)

Receipts	Amount	Payments	Amount
To Balance b/d	92,200	By Ravi (Cheque dish.)	14,600
To Dividend	7,600	By Interest & Bank charges	8,400
To Bank charges (entered twice)	200	By Rotary Club Subscrip.	2,000
		By Balance c/d	75,000
	1,00,000		1,00,000

Bank Reconciliation Statement as On 28th February, 2015

		Rs.
Dr. Balance (Adjusted) as per Cash Book		75,000
Add : Cheques issued but not yet presented for payment		1,26,000
Less : Cheques deposited but not yet collected	50,000	2,01,000
Less : Cheques of SF A/c wrongly debited to this A/c, now corrected	5,400	55,400
Cr. Balance as per Pass Book		1,45,600

Q.11. Prepare Bank Reconciliation statement for the following details as on 30th June, 2015 :

Date	Particulars	Withdrawals	Deposits	Dr. or Cr.	Balance
2015					
June 1	By Balance b/d	Rs.	Rs.		Rs.
June 4	By Mahesh Bansal's Cheque			Cr.	11,500
June 7	By Santosh Sood's Cheque		750	Cr.	12,250
June 10	To Ved Prakash		1,000	Cr.	13,250
June 15	To Cash	850		Cr.	12,400
June 20	By Vikas Kalra (Cash)	2,400		Cr.	10,000
June 23	To Vishal Tandon		500	Cr.	10,500
June 26	To Insurance Premium	700		Cr.	9,800
June 30	To Bank Charges	500		Cr.	9,300
June 30	By Interest	50		Cr.	9,250
June 30	By Interest on Investments		100	Cr.	9,350
			640	Cr.	9,990

Dr. **Cash Book (Bank Column only)** Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2015		Rs.			Rs.
June 1	To Balance b/d	11,500	June, 10	By Ravi Rai	900
June 1	To Mahesh Bansal	750	June, 12	By Ved Prakash	850
June 5	To Santosh Sood	1,000	June, 15	By Cash	2,400
June 18	To Ramesh Kumar	600	June, 18	By Vishal Tandon	700
June 25	To Vinay Kumar	400	June, 25	By Sunil Gupta	440
			June, 28	By Abhay Kumar	660
				By Balance c/d	8,300
		14,250			14,250
July. 1	To Balance b/d	8,300			

Ans. : On comparing the above two extracts the following facts are revealed – (i) Of the cheques issued, worth Rs. 900, Rs. 440 and Rs. 660 were not presented for payment as yet; (ii) Cheques deposited on June 18 (Rs. 600) and June 25 (Rs. 400) were not yet collected and credited; (iii) Insurance premium paid Rs. 500 and Bank Charges Rs. 50 were not recorded in Cash Book, (iv) Amount of Interest collected Rs. 640 and interest credited by Bank Rs. 100 were also not recorded, (v) direct deposit by Vikas Kalra in our Bank A/c on June 20 was also not entered in Cash Book.

Rs. 8,300, + 900 + 440 + 660 + 640 + 100 + 500 = 11,540 - (600 + 400 + 500 + 50) = Rs. 9,990.

10

Depreciation Accounting

In every business there are some assets of fixed nature. These assets are needed for the conduct of business operations. Such assets are used in business to derive benefits for more than one accounting period. Periodic profit is measured by charging cost against periodic revenue. Since fixed assets are used to generate periodic revenue, an appropriate share of cost of fixed assets needs to be charged as cost. Such an appropriate proportion of the cost of fixed asset is called Depreciation.

Meaning and Definitions :

The fall in the value and utility of fixed assets, for example : **Building, Plant, Machinery, Vehicles, Furniture, Fittings etc.**, due to their constant use and expiry of time is termed as depreciation.

According to Pickles, "Depreciation is the permanent and continuing diminution in the quality, quantity or value of asset." **Spicer and Pegler** has defined it as, "the measure of exhaution of the effective life of an asset from any cause during a given period." In the words of **R.N. Carter**, "Depreciation is the gradual and permanent decrease in the value of an asset from any cause." **J.R. Batliboi** has defined it is, "It is a matter of common knowledge that all fixed assets such as plant, machinery, building, furniture etc. gradually diminish in value as they get older and become worn out by constant use in the business."

From the aforesaid definitions, it can be concluded that depreciation is a gradual decrease in the value of an asset due to wear and tear and effluxion of time.

Causes of Depreciation :

The causes of depreciation are as follows :

(1) Wear and Tear : When fixed assets are put to use, the value of such assets may decrease on account of worn or torn out because of constant use as in case of plant, machinery, furniture etc used in a factory.

(2) Effluxion or Passage of Time : Certain assets decrease in value with the passage of time. This is true in case of assets like leasehold properties, patents and trademark copyrights etc.

(3) Depletion or Exhaustion : An asset may get exhausted by working. This is in case of mineral mines, oil wells, forestries etc.. Due to continuous extraction of minerals or oil or cuting of trees a stage comes when mine or well or the forests gets exhausted and nothing is left therein.

(4) *Obsolescence* : Due to new inventions and improved technology, the old assets become obsolete (out of date). It may be discarded even if it could be put to use and is still workable.

(5) Accident : Sometimes an asset may be destroyed by fire, flood etc. or a vehicle may be damaged due to an accident.

(6) Permanent Fall in Market Price : The fluctuations in the market value of fixed assets are usually not recorded because such assets are not meant for resale. But sometimes the constant fall in the value of certain fixed assets may be treated as depreciation. For example, permanent fall in the value of investments.

Need for Providing Depreciation :

The need for providing depreciation in accounting records arises due to any one or more of the following objectives to be attained :

(1) To ascertain true results of operations : For proper matching of cost with revenue it is necessary to charge the depreciation (cost) against income (revenue) in each accounting period. Unless the depreciation is charged against income, the result of operations would stand overstated. As a result the Income Statement would fail to present a true and fair picture of the result of operations of an accounting entity.

(2) To present true and fair view of the financial position : For presenting a true and fair view of the financial position, it is necessary to charge the depreciation. If the depreciation is not charged, the unexpired cost of the asset concerned would be overstated. As a result, the Position Statement (i.e. the Balance Sheet) would not present a true and fair view of the financial position of an accounting entity.

(3) To ascertain the true cost of production : For ascertaining the cost of production, it is necessary to charge depreciation as an item of cost of production. If the depreciation on fixed assets is not charged, the cost records, would not present a true and fair picture of the cost of production.

(4) To comply with legal requirements : In case of companies, it is compulsory to charge depreciation on fixed assets before it declares dividend [Sec. 205(A) of The Companies Act, 1956].

(5) To accumulate funds for replacement of assets : A portion of profit is set aside in the form of depreciation and accumulated funds each year to provide a definite amount at a certain future date for the specific purpose of replacement of the asset at the end of its useful life.

(6) To prevent the distribution of profits out of capital : If the depreciation is not charged, the profit shown by the Profit and Loss Account will be in excess of the actual profits. Such an excess profit may be wholly withdrawn by the proprietor or may be distributed among the shareholders as dividend. Hence, the amount of dividend distributed will also include the amount of depreciation which is actually a part of capital.

(7) For avoiding over payment of Income Tax : If depreciation is not debited to Profit and Loss Account, the net profit shown by it will be in excess of actual profits. Thus more tax would be payable by the firm.

(8) Other miscellaneous objectives : If proper amount of depreciation is not charged, the net profit as revealed by Profit & Loss Account will be higher than the actual profit. As a result of which :

(a) Employees may demand higher wages and bonus.

(b) It may result in extravagance.

(c) Other parties will be attracted to establish the business which in turn will increase the competition.

(d) Manager of the firm will get higher commission if based on profit.

Basic Factors Determining Depreciation : It is impossible to calculate and estimate the true amount of depreciation. It can only be estimated by keeping the following factors into consideration :

(1) Cost of the Asset : Cost of a fixed asset is determined after adding all expenses incurred for bringing the asset to usable condition, such as freight, transit insurance, installation charges besides its purchase price. If an old asset is purchased, the overhauling charges incurred will also be included in the cost of the asset.

(2) Estimated Useful Life of the Asset : Useful life of an asset is estimated in terms of number of years during which the asset can effectively be used for business operations. In case of longer useful life, amount of depreciation will be lower, while it will be higher in case of shorter useful life.

(3) Estimated Residual Value of the Asset : It is the estimated sale value of the asset at the end of its useful life. It is called as residual value or break-up value. Depreciation is calculated after deducting estimated scrap value from the cost of the asset.

(4) Provision for Repairs and Renewals : Suitable arrangements for repairs and renewals of an asset will automatically increase its useful working life. As a result of which less amount of depreciation shall be provided.

(5) Possibility of New Inventions : Obsolescence of an asset depends upon new inventions expected in future. If the new asset, because of inventions, is expected soon in future, the useful life of the old asset is shorten. Thus higher amount of depreciation need to be provided.

(6) Expansion of Asset : If any capital expenditure is incurred in connection with the expansion of the present asset, the same will be taken into consideration while providing for depreciation.

(7) Legal Laws : If there are some legal laws in existence for making provision for depreciation, such laws are followed. For example, Company Law, Income Tax Law etc. are there for providing depreciation on fixed assets.

(8) Interest on Capital Invested : Interest of Capital invested for the purchase or construction of a fixed asset should also be taken into consideration while making provision for depreciation.

(9) Working Conditions : The working conditions should also be kept in consideration while making provision for depreciation. For example, an asset may be used in one shift or in double or triple shifts. The amount of depreciation shall be higher in case of its use in double or tripple shift rather than its use in one shift.

Depreciation, Depletion and Amortization

The term depreciation is to be distinguished from other terms such as depletion and amortization although, these terms are used interchangeably. **Depletion** means reduction in value of fixed asset on account of exhaustion such as extracting coal from a coal mine, oil out of an oil-well, wood from a forest etc.

Amortization is used for writing off intangible assets like goodwill, copyrights, leaseholds, patents etc. which have a limited useful life. These terms can be distinguished as follows :

Depreciation is concerned with charging the cost of man-made fixed assets to operations. Depletion refers to cost allocation for natural resources, such as oil and mineral deposits. Amortization relates to cost allocation for intangible assets such as patents and leaseholds.

Methods of Accounting for Depreciation :

Depreciation is provided at the end of accounting year. There can be two methods of accounting for depreciation :

(1) When Provision for Depreciation Account Not Maintained :

In case the provision for depreciation account is not maintained in the books, the fixed asset is shown in the books at its written down value. The Journal Entries passed in the books are :

(a) For providing depreciation :

Depreciation A/c ... Dr.
    To Sundry Asset A/c

(b) For transfer of depreciation :

Profit & Loss A/c ... Dr.
    To Depreciation A/c

(c) When an asset is sold or disposed off :

Bank A/c ... Dr.
    To Sundry Asset A/c

(d) For Profit on sale of an asset :

Asset A/c ... Dr.
    To Profit & Loss A/c

(e) For Loss an sale of an asset :

Profit & Loss A/c ... Dr.
    To Asset A/c

(2) When Provision for Depreciation Account is Maintained :

In case of this method, the asset appears at original cost in the books. The following Journal Entries are passed when this method is followed :

(a) For providing depreciation :

Depreciation A/c ... Dr.
    To Provision for depreciation A/c

(b) For transfer of depreciation :

Profit & Loss A/c ... Dr.
    To Depreciation A/c

(c) On sale of fixed asset :

(i) Provision of Depreciation A/c ... Dr.
    To Asset A/c

(ii) Bank A/c ... Dr.
    To Asset A/c

(d) For Profit on sale of fixed asset :

Asset A/c ... Dr.
    To Profit & Loss A/c

(e) For Loss on sale of fixed asset :

Profit & Loss A/c ... Dr.
    To Asset A/c

Methods of Providing Depreciation

There are various methods of providing depreciation. Different methods may be suitable for different assets depending upon the nature and type of asset. These methods are enumerated as under :

(1) Fixed Instalment Method; (2) Diminishing Balance Method;
(3) Annuity Method; (4) Depreciation Fund Method;
(5) Insurance Policy Method; (6) Revaluation Method;
(7) Depletion Unit Method; (8) Machine Hour Rate Method;
(9) Service Hours and Production Output Method.

Out of these methods, Fixed instalment and Diminishing balance methods are provided in the syllabus. Hence only these two methods are discussed in details.

1. Fixed Instalment Method : This method is also called as original cost method or equal instalment method or straight line method. Under this method depreciation is charged at a fixed percentage on the original cost of the asset. Thus the amount of depreciation remains equal from year to year, as such this method is called equal instalment or straight line or fixed instalment method. The amount of yearly depreciation is calculated by the following formula :

$$\text{Annual Depreciation} = \frac{\text{Original Cost of Asset} - \text{Estimated Scrap Value}}{\text{Estimated Life of Asset}}$$

For example, if the purchase price of asset is Rs. 90,000, Rs. 2,000 is incurred for cartage and Rs. 8,000 are the installation charges of the asset, estimated scrap value is likely to be Rs. 15,000 at the end of 10 years, being the life of a asset, the amount of depreciation to be written off will be as follows :

$$\frac{\text{Rs. } 90{,}000 + 2{,}000 + 8{,}000 - 15{,}000}{10 \text{ Years}} = \text{Rs. } 8{,}500 \text{ every year}$$

Rate of depreciation is calculated with the help of the following.

Formula : $$\text{Rate of Depreciation} = \frac{\text{Amount of Depreciation}}{\text{Original Cost}} \times 100$$

Suitability : This method is suitable for those assets which do not require much investment and the amount of repairs and renewals required in also less and which have comparatively shorter life, such as Furniture, Patent, Copyright, Trade mark, Leaseholds etc..

Merits : The main merits of this method are as follows :

(i) This method is simple to understand.

(ii) This method is easy to calculate the amount and the rate of depreciation.

(iii) Under this method the book value of the asset becomes zero or equal to its scrap value at the end of its useful life; which is not possible under other methods.

(iv) Under this method, the original cost of the asset and total depreciation (upto date) is shown as a direct deduction in the Balance Sheet. Thus the information of original cost of the asset and the upto date depreciation is available at any time.

Demerits : The main demerits of the methods are as follows :

(i) When there are different machines having different life-spans, the computation of depreciation becomes complicated because the depreciation on each machine will have to be calculated separately.

(ii) Repair charges go on increasing year after year as the asset becomes older but as the equal depreciation is charged under this method each year, the total burden charged to Profit and Loss Account in respect of depreciation and repairs put together will not be equal each year. The total burden will be lighter in earlier years and heavier during the later years.

(iii) It is a well-known fact that the efficiency and usefulness of a machine is more in the earlier years as compared to later years. As such, more depreciation should be charged in earlier years than in the later years, whereas, depreciation remains constant from year to year under this method.

(iv) This method does not take into consideration the loss of interest on the amount invested in the asset. The amount would have earned interest, had it been invested outside the business.

(v) Sometimes, even after the value of an asset is reduced to zero in the books, the asset continues to be used in the business in actual practice.

Important Note : Generally the rate of depreciation is expressed as 'per annum'. It means if furniture worth Rs. 20,000 was purchased in the middle of the year and rate of depreciation is 10% per annum. The depreciation for the year would be 10% on Rs. 20,000 for 6 months or Rs. 1,000. On the other hand if rate of depreciation given is 10% and not 10% per annum, the depreciation on the asset will be charged for the whole year i.e. 10% of 20,000 = Rs. 2,000. This is irrespective of the date of purchase of an asset. When the asset is disposed of in any year, no depreciation is to be provided for the period it was used before its disposal.

Illustration 10.1 :

A trader has purchased a machine for Rs. 48,200 on 1st January, 2013 and spent Rs. 200 on cartage and Rs. 1,600 on its installation. The useful life of the machine is 10 years. At the end of 10 years the scrap value estimated is Rs. 2,000. Assuming that the trader closes his accounts books on 31st December every year, Prepare Machinery Account for three years.

Solution : Amount of Annual Depreciation will be calculated as under :

$$\text{Depreciation} = \frac{\text{Rs. } 48{,}200 + 200 + 1{,}600 - \text{Rs. } 2{,}000}{10 \text{ years}} = \text{Rs. } 4{,}800$$

Dr. **Machinery Account** Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2013 Jan. 1	To Bank (Machine)	48,200	2014 Dec. 31	By Depreciation	4,800
	To Cash (Installation)	1,800		By Balance c/d	45,200
		50,000			50,000

2014			2014		
Jan. 1	To Balance b/d	45,200	Dec. 31	By Depreciation	4,800
				By Balance c/d	40,400
		45,200			45,200
2015			2015		
Jan. 1	To Balance b/d	40,400	Dec. 31	By Depreciation	4,800
				By Balance c/d	35,600
		40,400			40,400
2016					
Jan. 1	To Balance b/d	35,600			

Illustration 10.2 :

A firm purchased an old machine for Rs. 30,000 on 1st January, 2013. It spent Rs. 6,000 for its overhauling and Rs. 4,000 for installation. It purchased another machine for Rs. 15,000 on 1st July and for Rs. 10,000 on 1st October, 2014. Show Machinery Account for first three years if the depreciation is to be written off @ 10% per annum on fixed instalment method. asuming the book are closed on 31st December, every year.

Solution :

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

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2013			2013		
Jan. 1	To Cash (Cost)	30,000	Dec. 31	By Depreciation	4,000
	To Cash (Expenses)	6,000		(10% on Rs. 40,000)	
	To Cash (Expenses)	4,000		By Balance c/d	36,000
		40,000			40,000
2014			2014		
Jan. 1	To Balance b/d	36,000	Dec. 31	By Depreciation	5,000
July 1	To Cash (Machine No. 2)	15,000		(Rs. 4,000 + 750 + 250 for 6	
Oct. 1	To Cash (Machine No. 3)	10,000		and 3 months respectively	
				By Balance c/d	56,000
		61,000			61,000
2015			2015		
Jan. 1	To Balance b/d	56,000	Dec. 31	By Depreciation	6,500
				(Rs. 4,000 + 1,500 + 1,000)	
				By Balance c/d	49,500
		56,000			56,000
2016					
Jan. 1	To Balance b/d	49,500			

Sale of Asset during the year : When an asset or a part of asset being damaged is disposed off during the year, the following points be kept in mind while preparing accounts :

(i) When the rate of depreciation is expressed as per annum, provide depreciation on the asset for the period it was used in the year of disposal. If the words 'per annum' are not given, no depreciation be provided in the year of disposal.

(ii) When there is a loss on sale of asset, it should be treated as loss of obsolescence which is to be debited to Profit & Loss Account.

(iii) When there is a profit on sale of asset, it should be transferred to the credit of Profit & Loss Account. In case the profit is substantial, it should be treated as a Capital Profit.

Illustration 10.3 :

A firm bought a second hand Machinery on 1st April, 2012 for Rs. 1,40,000. It spent Rs. 20,000 on its overhauling and installation. On 1st October, 2012 another machine costing Rs. 80,000 was purchased. On 1st October, 2014 the machine purchased on 1st April, 2012 was disposted of for Rs. 1,04,000. A new machine costing Rs. 2,00,000 was also installed on the same date. Depreciation was provided @ 10% per annum by straight line method. Give Machinery Account for 3 years. The accounting year of the firm ends on 31st March every year.

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

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2012			2013		
April 1	To Cash (Cost)	1,40,000	Mar. 31	By Depreciation 10% on Rs. 1,60,000	16,000
	To Cash (Overhauling)	20,000		(10%on Rs. 80,000 for 6 months)	4,000
Oct. 1	To Cash (2nd machine)	80,000		By Balance c/d	
			Mar. 31	(Rs. 1,44,000 + 76,000)	2,20,000
		2,40,000			2,40,000
2013			2014		
April 1	To Balance b/d	2,20,000	Mar. 31	By Depreciation	
	(Rs. 1,44,000 + 76,000)			(Rs. 16,000 + 8,000 for one year)	24,000
				By Balance c/d	1,96,000
		2,20,000		(Rs. 1,28,000 + 68,000)	2,20,000
2014			2014		
April 1	To Balance b/d	1,96,000	Oct. 1	By Cash (Sale)	1,04,000
	(Rs. 1,28,000 + 68,000)		2015	By Depreciation on Rs. 1,60,000	
Oct. 1	To Cash (New Machine)	2,00,000	Mar.31	for 6 months	8,000
				On Rs. 80,000 @ 10% for 12 months	8,000
				On Rs. 2,00,000 @ 10% for 6 months	10,000
				By P.&L. A/c (Loss on sale)	16,000
				(1,28,000–1,04,000–8,000)	
				By Balance c/d	
				(Rs. 60,000 + 1,90,000)	2,50,000
		3,96,000			3,96,000

2. Diminishing Balance Method : Under this method depreciation is provided on the written down value of the assets. The value of the asset goes on diminishing year after year. The depreciation charge also goes on declining every year. For example a machine was purchased for Rs. 20,000 and depreciation is to be charged at 10% per annum. The depreciation according to this method will be as under :

		(Rs.)
I year 10% on Rs. 20,000	=	2,000
II year 10% on Rs. 20,000 – 2,000	=	1,800
III year 10% on Rs. 18,000 – 1,800	=	1,620

and so on. As the value of the asset and also the depreciation charges on it goes on reducing year after year, the method is also known as Reducing Instalment Method or Written Down Value Method.

The rate of depreciation be ascertained with the help of following formula :

$$\text{Rate (R)} = 1 - \sqrt[N]{\frac{S}{C}}$$

Where R = Rate of Depreciation,
N = Useful life in years,
S = Scrap Value,
C = Cost of the Asset.

Merits : The main merits of the method are :

(i) It is easy to calculate depreciation.

(ii) The total charge (depreciation + repairs and renewals) remains almost uniform year after year, since the charge of depreciation in initial years is more and the amount of repairs and renewals is less; whereas in later years the amount of depreciation is less and the amount of repairs and renewals shall be more.

(iii) The efficiency and usefulness is more in the earlier years than in the later years. Hence, depreciation in earlier years be charged more than during the later years. This method ensures it.

(iv) Under this method the asset is never reduced to zero, so that some depreciation, however small is debited to Profit & Loss Account so long as asset is in use.

(v) This method of providing depreciation is permissible by the tax authorities in India also.

Demerits : The demerits of this method are as under :

(i) It is difficult to calculate rate of depreciation.

(ii) It does not take into consideration the interest on capital invested for the asset.

(iii) It does not provide for the replacement of the asset on the expiry of its useful life.

(iv) It takes a very long time to write down an asset to its break-up value, unless a very high rate is used.

Suitability : This method is suitable for those assets in relation to which the amount of repairs and renewals goes on increasing as the asset grows older and the possibilities of obsolescence are more. This method is suitable for Plant, Machineries and Building etc.

Difference between Original Cost-Method and Diminishing Balance Method :

The following are the main points of differences between the two methods :

Basis of Difference	Original Cost Method	Diminishing Balance Method
Amount of depreciation	Equal depreciation is charged every year.	Depreciation goes on decreasing year after year.
Depreciation Charge	Depreciation is charged on the original cost of the asset.	Depreciation is charged on the reducing balance of the asset.
Zero level	The book value of the asset can be reduced to zero.	The book value of the asset can never be reduced to zero.
Combined effect on Profit & Loss A/c	Combined burden "on account of depreciation and repairs will be lighter in earlier years and heavier during the later years.	Combined burden on account of depreciation and repairs will be almost uniform over different years.
Rate of depreciation	Rate of depreciation is kept low in comparison to diminishing balance method.	Rate of depreciation is kept high in comparison to original cost method.
Approval	This method is not approved by Tax authorities	This method is approved by Tax authorities.

In practice, the diminishing balance method is more widely used. This is so because the depreciation in this method goes on reducing according to the shrinking value of the asset.

Illustration 10.4 :

A manufacturing concern, whose books are closed on 31st March, purchased a Machinery for Rs. 1,00,000 on 1-4-2011 Additional machinery was acquired for Rs. 20,000 on 1-10-2012. One of the machine purchased for Rs. 20,000 on 1-4-2011 was sold for Rs. 10,000 on 30-9-2013. Prepase Joint machinery account for four years when depreciation will be charged as follows :

(a) 10% per annum on straight line method.

(b) 20% per annum on written down value method. [R.U. B.B.A. 2003]

Solution :

Joint Machinery Account

Date	Particulars	Straight Line	W.D.V. Method	Date	Particulars	Straight Line	W.D.V. Method
		Rs.	Rs.			Rs.	Rs.
2011 April 1	To Bank I Machine	20,000	20,000	2012 Mar. 31	By Depreciation I Machine	2,000	4,000
	II Machine	80,000	80,000		II Machine	8,000	16,000
					By Balance c/d I Machine	18,000	16,000
					II Machine	72,000	64,000
		1,00,000	1,00,000			1,00,000	1,00,000

2012 April 1	To Balance b/d			2013 Mar. 31	By Depreciation		
	I Machine	18,000	16,000		I Machine	2,000	3,200
	II Machine	72,000	64,000		II Machine	8,000	12,800
Oct. 1	To Bank (III)	20,000	20,000		III Machine (6 months)	1,000	2,000
					By Balance c/d		
					I Machine	16,000	12,800
					II Machine	64,000	51,200
					III Machine	19,000	18,000
		1,10,000	1,00,000			1,10,000	1,00,000
2013 April 1	To Balance b/d			2014 Mar.31	By Depreciation		
	Machine I	16,000	12,800		I Machine	2,000	2,560
	Machine II	64,000	51,200		II Machine	8,000	10,240
	Machine III	19,000	18,000		III Machine	2,000	3,600
					By Balance c/d		
					I Machine	14,000	10,240
					II Machine	56,000	40,960
					III Machine	17,000	14,400
		99,000	82,000			99,000	82,000
2014 April 1	To Balance b/d			2014 Sept 1	By Cash Sale of		
	Machine I	14,000	10,240	2015	Machine I	10,000	10,000
	Machine II	56,000	40,960	Mar.31	By Dep. for 6 months)	1,000	1,024
	Machine III	17,000	14,400	Mar.31	By Profit & Loss A/c (Loss)	3,000	-
	To Profits Loss A/c (Profit on sale (11,024 – 10,240)	–	784	Mar.31	By Depreciation		
				Mar.31	Machine II	8,000	8,192
					Machine III	2,000	2,880
				Mar.31	By Balance c/d		
					Machine II	48,000	32,768
					Machine III	15,000	11,520
		87,000	66,384			87,000	66,384

Illustration 10.5 :

A firm purchased a machine on 1st October, 2010 for Rs. 1,00,000 which includes a Boiler worth Rs. 10,000. On 1st July, 2014 the boiler was damaged and sold for Rs. 3,000. On the same date another boiler was bought for Rs. 50,000. Accounts are closed on 31st March every year and depreciation is charged @ 10% per annum on written down value. Prepare Machinery Account for the year ending 31st March, 2015 and give working notes. Calculations are to be made nearest to Rupee.

Solution :

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

Date	Particulars	Amount	Date	Particulars	Amount
2014		Rs.	2014		Rs.
April 1	To Balance b/d	69,255	July 1	By Bank (Sale)	3,000
July 1	To Bank A/c	50,000	July 1	By Profit & Loss A/c (Loss)	3,752
			2015 Mar. 31	By Depreciation : On 6,925 for 3 months	173
				On 62,330 for one year	6,233
				On 50,000 for 9 months	3,750
			Mar. 31	By Balance c/d	1,02,347
		1,19,255			1,19,255

Working Note : The written down value of the Machine and the Boiler are calculated as under :

Particulars	Machine Rs.	Boiler Rs.
Original Value as on 1–10–2010	1,00,000	10,000
Less : Depreciation for 6 months	5,000	500
Written down value as on 1–4–2011	95,000	9,500
Less : Depreciation for 12 months	9,500	950
W.D.V. as on 1–4–2012	85,500	8,550
Less : Depreciation for 12 months	8,550	855
W.D.V. as on 1–4–2013	76,950	7,695
Less : Depreciation for 12 months	7,695	770
W.D.V. as on 1–4–2014	69,255	6,925
Less : Depreciation for 3 months on boiler	–	173
W.D.V. of Boiler	W.D.V.	6,752
Less : Sale Price of Boiler		3,000
Loss on Sale of Boiler		3,752

Residual value of Machine excluding Boiler is Rs. 69,255 – 6,925 = Rs. 62,330.

Change in the Method of Depreciation from Ensuing Date :

Sometimes a firm changes the rate as well as the method of providing depreciation. For example, a firm charged @ 10% depreciation on original cost method but changes the method of charging depreciation on written down value @ 15% per annum with effect from a particular year. Under such a case depreciation be charged at the changed rate by the changed method.

Illustration 10.6 :

Sachin and Company purchased on 1st April, 2009, a second hand Machine for Rs. 90,000 and immediately spent Rs. 60,000 on its overhanding. On October 1, 2009 additional Machinery at a cost of Rs. 75,000 was purchased. On 1st October, 2012, Machine purchased on 1st April 2009 became obsolete and was sold for Rs. 30,000. On that date new Machinery was purchased for Rs. 18,000. Depreciation was provided annually on 31st March at 10% per annum on original cost of the Asset. From 2013-14, the company, however changed the method of providing depreciation and adopted the method of writing off 15% on diminishing value. Show the Machinery Account as it would appear in the books of the company for, the years 2009-10 to 2014-15.

Solution : **Machinery Account in the Ledger of Sachin & Company**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2009	Rs.		**2010**		
April 1	To Bank (I) 90,000		Mar. 31	By Depreciation A/c	
	To Cash +60,000	1,50,000		(15,000 + 3,750)	18,750
Oct. 1	To Bank (II)	75,000		By Balance c/d	2,06,250
				(Rs. 1,35,000 + 71,250)	
2010		2,25,000	**2011**		2,25,000
April 1	To Balance b/d		Mar. 31	By Depreciation	
	Machine I 1,35,000			15,000 + 7,500	22,500
	Machine II 71,250	2,06,250		By Balance c/d	
				1,20,000 + 63,750	1,83,750
2011		2,06,250	**2011**		2,06,250
April 1	To Balance b/d		Oct. 1	By Bank (Sale)	30,000
	Machine I 1,20,000		2012	By Depreciation (I)	7,500
	Machine II 63,750	1,83,750	Mar.31	By Profits Loss A/c (Loss)	82,500
Oct. 1	To Bank (III)	18,000		By Depreciation	
				II 7,500	
				III 900 (6 months)	8,400
				By Balance c/d.	
				56,250 + 17,100	73,350
2012		2,01,750	**2013**		2,01,750
Apr. 1	To Balance b/d		Mar. 31	By Depreciation	11,003
	(Rs. 56,250 + 17,100)	73,350		(15% on Rs. 73,350)	
				By Balance c/d	62,347
2013		73,350	**2014**		73,350
Apr. 1	To Balance b/d	62,347	Mar. 31	By Depreciation	
				(15% on Rs. 62347)	9,352
				By Balance c/d	52,995
2014		62,347			62,347
Apr. 1	To Balance b/d	52,995			

Illustration 10.7 :

A firm purchased on 1st March, 2012 a machinery for Rs. 70,000 and spent Rs. 2,000 on its erection. In the same year on 1st September an additional Machinery was purchased for Rs. 60,000. On 30th June, 2014, the Machinery purchased on March, 2012 was sold for Rs. 40,000 and on the same day another machinery costing Rs. 80,000 was purchased. The firm charged depreciation every year on 31st December @ 10% per annum on the original cost method, but from the year 2014 it changed the policy and decided to charge depreciation @ 15% per annum on diminishing balance method. Prepare Machinery Account from 2012 to 2015.

Solution :

Dr. **Machinery Account** Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2012			**2012**		
Mar. 1	To Bank (I)	70,000	Dec. 31	By Depreciation 10% on Rs. 72,000 for 10 months	6,000
	To Bank (Expenses)	2,000		10% on 60,000 for 4 months	2,000
Sept. 1	To Bank (II)	60,000		By Balance c/d	1,24,000
		1,32,000		(Rs. 66,000 + 58,000)	1,32,000
2013			2013	By Depreciation 10% on Rs.	
Jan. 1	To Balance b/d	1,24,000		72,000 = 7,200	
	(Rs. 66,000 + 58,000)		June 30	10% on Rs. 60,000 6,000	13,200
				To Balance c/d (58,800 + 52,000)	1,10,800
2014		1,24,000	**2014**		1,24,000
Jan. 1	To Balance b/d	1,10,800	June 30	By Bank (Sale)	40,000
	(58,800 + 52,000)			By Profit & Loss A/c (Loss)	14,390
June 30	To Bank	80,000	Dec. 31	By Depreciation 15% on 58,800 for 6 months = 4,410	
				15% on 52,000 = 7,800	
				15% on 80,000 for 6 months 6,000	18,210
				By Balance c/d	
				(44,200 + 74,000)	1,18,200
		1,90,800			1,90,800
2015		Rs.	**2015**		
Jan. 1	To Balance c/d	1,18,200	Dec. 31	B Depreciation 15% on 1,18,200	17,730
	(44,200 + 74,000)		Dec. 31	By Balance c/d	1,00,470
				(37,570 + 62,900)	
		1,18,200			1,18,200

Illustration 10.8 :

A firm purchased an old machine for Rs. 3,70,000 on 1st April, 2012 and immediately spent Rs. 30,000 on its repairs. On 1st October, 2013, it purchased another machine for Rs. 1,00,000. The Machine purchased on 1st April, 2012 was sold for Rs. 2,80,000 on 1st October, 2014. On 1st October, 2014 it purchased another machine for Rs. 2,50,000. On 1st October, 2015, the second machine which was purchased on 1st October, 2013 was sold for Rs. 20,000. The depreciation was charged @ 10% per annum on fixed installment basis but from 1st April, 2013, the rate was changed to 15% per annum and diminishing balance method was adopted. Prepare Machinery Account for 4 years w.e.f. 1st April, 2012. Calculations should be nearest to Rupee.

Dr. **Machinery Account** Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2012			**2013**		
April 1	To Bank A/c	3,70,000	Mar. 31	By Depreciation A/c	40,000
April 1	To Cash A/c (Exps.)	30,000	Mar. 31	By Balance c/d	3,60,000
		4,00,000			4,00,000
2013			**2014**		
April 1	To Balance b/d (A)	3,60,000	Mar.31	By Depreciation A/c (on Rs. 3,60,000 for one year) = 54,000 (On 1,00,000 for 6 months) = 7,500	61,500
Oct. 1	To Bank A/c (B)	1,00,000	Mar. 31	By Balance c/d (A) = Rs. 3,06,000 (B) = 92,500	3,98,500
		4,60,000			4,60,000
2014			**2014**		
April 1	To Balance b/d (A) = Rs. 3,06,000 (B) = 92,500	3,98,500	Oct. 1	By Bank A/c (Sale of A)	2,80,000
			2015		
Oct. 30	To Bank A/c (C)	2,50,000	Mar. 31	By Depreciation A/c (A : (on 3,06,000 for 6 months	22,950
			Mar. 31	By P&L A/c (Loss) (A)	3,050
			Mar. 31	By Depreciation A/c (B) (on Rs. 92,500 for one year) Rs. 13,875 (on Rs. 2,50,000 for 6 months (C) = Rs. 18,750	32,625
			Mar. 31	By Balance c/d B = 78,625 C = 2,31,250	3,09,875
		6,48,500			6,48,500
2015			2015		
Apr. 1	To Balance b/d B = 78,625 C = 2,31,250	3,09,875	Oct. 1	By Bank A/c (B)	20,000
			2016		
			Mar. 31	By Depreciation A/c (B) (on 78,625 for 6 months)	5,897
			Mar. 31	By P& L A/c (Loss) on 'B'	52,728
			Mar. 31	By Depreciation A/c (C) (on 2,31,250 for one year)	34,688
			Mar. 31	By Balance c/d C)	1,96,562
		3,09,875			3,09,875
2016					
April 1	To Balance b/d	1,96,562			

Change in the Method of Deprecation with Retrospective effect :

Sometimes the change in the method of providing depreciation is made with retrospective effect i.e. from back date. Under such circumstances the depreciation according to new method and changed rates be calculated separately. Then compare the total depreciation already provided according to old rates. If the amount of depreciation is more by revised rates and revised method such excess be debited to depreciation account as additional depreciation and credited to asset account.

Journal Entries

If depreciation is underchaged	Profit & Loss A/c To Asset A/c (For adjustment of depreciation undercharged)	Dr.
If depreciation is overchaged	Asset A/c To Profit & Loss A/c (For adjustment of depreciation overcharged)	Dr.

Illustration 10.9

Mohan Bro.s commenced Business from April 1, 2011, when they bought machinery for Rs. 14,00,000. They adopted the policy of charging depreciation @ 15% per annum on written down value method and charging full year's depreciation on additions. Over the years their purchases or machines have been as under :-

On November 1, 2012 Rs. 3,00,000 and on December 31, 2015 for Rs. 4,00,000.

On April 1, 2015 it was decided to change the method and rate of depreciation to 10% on straight line or original cost basis with retrospective effect from April 1, 2011, the adjustment being made in Accounts in the beginning of 2015-16. Calculate the difference in the amount of depreciation to be adjusted in the Machinery Account to be closed on March 31, 2016. Show Machinery Account for 2015-16 year.

Solution :

Calculation of Depreciation by written down value Method

Particulars	Machine No. 1 (Rs.)	Machine No. 2 (Rs.)
Purchase on Machinery No. 1 (1-4-2011)	14,00,000	–
Less : Depreciation for 2011-12 @ 15% per annum	2,10,000	–
W.D.V. as on 31-3-2012	11,90,000	
Purchase of New Machinery (1-11-2012)		3,00,000
Less : Depreciation for 2012-13 @ 15% W.D.V.	1,78,500	45,000
W.D.V. as on 31-3-2013	10,11,500	2,55,000
Less : Depreciation for 2013-14 @ 15% on W.D.V.	1,51,725	38,250
W.D.V. as on 31-3-2014	8,59,775	2,16,750
Less : Depreciation for 2014-15 @ 15% per annum	1,28,966	32,513
W.D.V. as on 31-3-2015	7,30,809	1,84,237

Depreciation already charged upto 31-3-2015 = Rs. 2,10,000 + 1,78,500 + 1,51,725 + 1,28,966 + 45,000 + 38,250 + 32,513 = Rs. 7,84,954.

Depreciation by new method @ 10% p.a = from 2011-12 to 2014-15, 4 years on Machine No 1 (Rs. 1,40,000 × 4 = Rs. 5,60,000) + for 3 years on Machine No. 2 (30,000 × 3 = Rs. 90,000)

Thus, depreciation already charged =	Rs. 7,84,954
Depreciation to be charged under changed method (Rs. 5,60,000 + 90,000) =	6,50,000
Thus, Machinery A/c will be debited and P&L A/c be credited with	1,34,954

Dr. **Machinery Account** Cr.

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2015				2016			
Apr. 1	To Balance b/d (Rs. 7,30,809 + 1,84,237)		9,15,046	Mar. 31	By Depreciation A/c I Rs. 1,40,000 II Rs. 30,000 III Rs. 40,000		2,10,000
Apr. 1	To P&L A/c (Difference)		1,34,954		By Balance c/d		12,40,000
Dec. 31	To Bank A/c		4,00,000				
			14,50,000				14,50,000
2016							
Apr. 1	To Balance b/d		12,40,000				

Illustration 10.10 :

A Joint Stock Company, which depreciates its Machiery at 10% per annum on diminishing balance method, had on 1st April, 2014, Rs. 9,72,000 to the debit side of Machinery Account. During the year 2014-15 part of machinery purchased on 1st April, 2012 for Rs. 80,000 was sold for Rs. 45,000 and on 1st October, 2014 and a new machinery at a cost of Rs. 1,50,000 was purchased and installed on the same date, instalation charges being Rs. 8,000.

On 1st April, 2014, the company wanted to change the method of providing depreciation from diminishing balance method to straight line method with effect from 1st April, 2012 and adjust the difference before 31st March, 2015. The rate of depreciation remains the same as before. Show the Machinery Account and ascertain the amount chargeable to Profit & Loss account as depreciation during 2014-15.

[R.U. BCA, 2014]

Solution :

Before we prepare Machinery Account for the year 2014-15, the following amount is to be ascertained :

1. Additional Depreciation for change of Method

	Rs.
On 1.4.2014 W.D.V. of Machine	9,72,000
On 1.4.2013 W.D.V. of Machine $= \frac{9,72,000 \times 100}{90} =$	10,80,000
On 1.4.2012 W.D.V. of Machine $= \frac{10,80,000 \times 100}{90} =$	12,00,000
Less : W.D.V. as on 1.4.2014	9,72,000
Total depreciation provided according to old method	2,28,000
Depreciation under original cost method (1,20,000 + 1,20,000)	2,40,000
Additional Depreciation to be charged on 31.3.2014	12,000

2. Loss on Sale of Machine :

	Rs.
Cost of Machine as on 1.4.2012	80,000
Less : Depreciation (new method for $2\frac{1}{2}$ years i.e.(8,000 + 8,000 + 4,000)	(20,000)
	60,000
Less : Sale proceeds of this machine	(45,000)
Loss on sale of Machine	15,000

3. Depreciation on old Machine for the year 2014-15

Rs. 12,00,000 – 80,000 = Rs. 11,20,000 × 10% 1,12,000

Machinery Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2014			2014		
April 1	To Balance b/d	9,72,000	Oct. 1	By Bank	45,000
Oct. 1	To Bank Rs. 1,50,000 To Cash 8,000	1,58,000	Oct. 1	By Profit Loss A/c (Loss on sale)	15,000
			2009	By Depreciation @ 10% on Rs. 80,000 (6 months)	4,000
			Mar. 31	By Additional Dep. (Due to changes of method)	12,000
			Mar. 31	By Depreciation 10% on Rs. 11,20,000	1,12,000
				10% on Rs. 1,58,000 for 6 months	7,900
			Mar. 31	By Balance c/d	9,34,100
		11,30,000			11,30,000
2015					
April 1	To Balance b/d	9,34,100			

Second Method of Accounting for Depreciation : (i) In this case, depreciation is credited to Provision for Depreciation A/c in place of Asset A/c. (ii) Asset A/c always appear in the Ledger at its original cost. (iii) the balance on credit side of provision for depreciation A/c or Accumulated Depreciation A/c shows that total amount of depreciation accumulated to date. (iv) When the asset is sold or discarded, the relevant amount of accumulated depreciation for that assets is transferred to the credit side of Asset A/c after transfer of sale proceeds to the credit side of Asset A/c.

After transfer of this amount, the balance in Provision A/c shows accumulated depreciation for those Assets which are in service.

Illustration 10.11

ABC Ltd. purchased a second hand plant on April 1, 2011 for Rs. 8,00,000 and immediately spent Rs. 1,60,000 for its overhauling and Rs. 40,000 for its installation. On October 1, 2014, the plant became obsolete and was sold for Rs. 4,00,000. Depreciation is provided @ 10% per annum on original cost method. Accounts are closed on 31st March every year. Show necessary Ledger Accounts assuming that Provision for Depreciation Account is maintained.

Solution :

Dr. **Plant Account** Cr.

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2011				2012			
Apr. 1	To Bank A/c		8,00,000	Mar. 31	By Balance c/d		10,00,000
Apr. 1	To Cash (Expenses) (Rs. 1,60,000 + 40,000)		2,00,000				
			10,00,000				10,00,000
2012				2013			
Apr. 1	To Balance b/d		10,00,000	Mar. 31	By Balance c/d		10,00,000
2013				2014			
Apr. 1	To Balance b/d		10,00,000	Mar. 31	By Balance c/d		1,00,000
2014				2014			
Apr. 1	To Balance b/d		10,00,000	Oct. 1	By Bank A/c (Sale)		4,00,000
				Oct. 1	By Provision for Dep. A/c		3,50,000
				Oct. 1	By Profit & Loss A/c		2,50,000
			10,00,000				10,00,000

Dr. **Provision for Depreciation Account** Cr.

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2012				2012			
Mar. 1	To Balance c/d		1,00,000	Mar. 31	By Depreciation		1,00,000
2013				2012			
Mar.31	To Balance c/d		2,00,000	Apr. 1	By Balance b/d		1,00,000
				2013			
				Mar. 31	By Depreciation		1,00,000
			2,00,000				2,00,000
2014				2013			
Mar. 31	To Balance c/d		3,00,000	Apr. 1	By Balance b/d		2,00,000
				Nov. 31	By Depreciation		1,00,000
			3,00,000				3,00,000
2014				2014			
Oct. 1	To Plant A/c		3,50,000	Apr. 1	By Balance b/d		3,00,000
				Oct. 1	By Depreciation		50,000
			3,50,000				3,50,000

Illustration 10.12

On April 1, 2011 XYZ purchased a Machinery for Rs. 5,00,000 and on October 1, in the same year additional machinery costing Rs. 2,00,000 was bought. On 1st October, 2012 the machinery purchased on 1st April, 2011 was discarded and sold for Rs. 2,65,000. On 1st July, 2013, new machinery was bought for Rs. 8,00,000 and on the same date machinery purchased on October 1, 2011 was sold for Rs. 1,70,000. The firm provides depreciation @ 10% per annum on original cool on 31st March, every year.

You are required to Prepare Machinery Account and Provision for Depreciation Account for 3 Accounting years ending 31st March, 2014.

Solution :

Dr. **Machinery Account** Cr.

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2011				2012			
Apr. 1	To Bank A/c (A)		5,00,000	Mar. 31	By Balance c/d		7,00,000
Oct. 1	To Bank A/c (B)		2,00,000				
			7,00,000				7,00,000
2012				2012			
Apr. 1	To Balance b/d		7,00,000	Oct. 1	By Bank A/c		2,65,000
				2013			
				Mar. 31	By Provision for Depreciation A/c		75,000
					By P&L A/c (Loss)		1,60,000
					By Balance c/d		2,00,000
			7,00,000				7,00,000
2013				2013			
Apr. 1	To Balance b/d		2,00,000	July 1	By Bank A/c		1,70,000
July 1	To Bank A/c		8,00,000		By Privison for Depreciation A/c (Rs. 10,000 + 20,000 + 5,000)		35,000
July 1	To P&L A/c (Profit on Sale)		5,000	2014			
				Mar. 31	By Balance c/d		8,00,000
			10,05,000				10,05,000

Dr. **Provision for Depreciation Account** Cr.

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2012 Mar.31	By Balance c/d		60,000	2012 Mar. 31	By Depreciation (Rs. 50,000 + 10,000)		60,000
2012 Oct. 1	To Machinery A/c		75,000	2012 Apr. 1	By Balance b/d		60,000
				Oct. 1	By Depreciation A/c (A)		25,000
2013 Mar 31	To Balance c/d		3,00,000	2013 Mar.31	By Depreciation A/c (B)		20,000
			1,05,000				1,05,000
2013 July 1	To Machinery A/c		35,000	2013 Apr. 1	By Balance b/d		30,000
				July 1	By Depreciation A/c		5,000
2014 Mar.31	To Balance c/d		60,000	2014 Mar. 31	By Depreciation A/c		60,000
			95,000				95,000

III. Method

When Disposal Account is maintained along with Provision fo Depreciation Account.

Sometimes, when an asset is not in use, it is disposed off. Cost of asset in such cases is transferred to Asset Disposal Account and following entries are made :

(i) Asset not in use (Cost Price of asset) :

Asset Disposal A/c Dr.
To Asset A/c

(ii) By Total amount of depreciation charged :

Provision for Depreciation A/c Dr.
To Asset Disposal A/c

(iii) By Sale price of asset :

Bank A/c Dr.
To Asset Disposal A/c

(iv) Loss on sale of asset :

Profit & Loss A/c Dr.
To Asset Disposal A/c

(v) Profit on sale of asset :

Asset Disposal A/c Dr.
To Profit & Loss A/c

Note : Asset Disposal Account should be opened only when it is specifically asked. Otherwise normal procedure as discussed earlier should be followed.

Illustration 10.13

On 1st April, 2012 Amar Chand purchased five machines for Rs. 60,000 each. Depreciation at the rate of 10% p.a. on initial cost has been charged from P. &L. A/c and credited to Provision for Depreciation Account.

On 1st April, 2013 one machine was sold for Rs. 50,000 and on 1st April, 2014 a second machine was sold for Rs. 50,000. An improved model which costs Rs. 1,00,000 was purchased on 1st October, 2013. Amar Chand closes his books on 31st March each year. You ac required to show :

(i) Machinery Account; (ii) Machinery Disposal Account; (iii) Provision for Depreciation Account.

Solution :

Dr. **Machinery Account** Cr.

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2012 Apr. 1	To Bank A/c		3,00,000	2013 Mar. 31	By Balance c/d		3,00,000
2013 Apr. 1	To Balance b/d		3,00,000	2013 Apr. 1	By Machinery Disposal A/c		60,000
Oct. 1	To Bank A/c		1,00,000	2014 Mar. 31	By Balance c/d		3,40,000
			4,00,000				4,00,000
2014 Apr. 1	To Balance b/d		3,40,000	2014 Apr. 1	By Machinery Disposal A/c		60,000
				2015 Mar. 31	By Balance c/d		2,80,000
			3,40,000				3,40,000
2015 Apr. 1	To Balance b/d		2,80,000				

Dr. **Machinery Disposal Account** Cr.

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2012 Apr. 1	To Machinery A/c		60,000	2012 Apr. 1	By Provision for Depreciation A/c		6,000
				Apr. 1	By Bank A/c		50,000
				2013 Mar.31	By P. & L. A/c (Loss)		4,000
			60,000				60,000
2012 Apr. 1	To Machinery A/c		60,000	2012 Apr. 1	By Provision for Depreciation A/c		12,000
2014 Mar.31	To P. & L. A/c (Profit)		2,000	Apr. 1	By Bank A/c		50,000
			62,000				62,000

Dr. **Provision for Depreciation Account**

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
2012 Mar.31	To Balance c/d		30,000	2012 Mar. 31	By P. & L. A/c (Depreciation)		30,000
2012 Apr. 1	To Machinery Disposal A/c (transfer)		6,000	2012 Apr. 1	By Balance b/d		30,000
2013 Mar.31	To Balance c/d		53,000	2013 Mar. 31	By P. & L. A/c (Rs. 24,000 + Rs. 5,000)		29,000
			59,000				59,000
2013 Apr. 01	To Machinery Disposal A/c (transfer)		12,000	2013 April 1	By Balance b/d		53,000
2014 Mar.31	To Balance c/d		69,000	2014 Mar.31	By P. & L. A/c (Rs. 18,000 + Rs. 10,000)		28,000
			81,000				81,000
				2014 Apr.	Balance b/d		69,000

3. Annuity Method : This method considers that the business, loses interest on amount invested besides losing the original cost of the asset also, since the amount used for buying the Asset, which would have earned in case the same amount would have been invested in some other form of Investment. As such (purchase price) the Asset account is debited with the amount of interest also which is ultimately credited to Profit and Loss Account and is credited with amount of depreciation which remains fixed year. After year the annual amount of depreciation is determined with the help of annuity table. The amount of total depreciation is determined by adding the cost of the asset i.e. Purchase price and interest thereon at an expected rate. The Journal entries are as under :

(a) Asset A/c ... Dr. (Purchase price)
  To Bank A/c
 (For purchase of asset)

(b) Asset A/c ... Dr. (Amount of Interest)
  To Interest A/c
 (For charging interest to asset)

(c) Depreciation A/c ... Dr. (Fixed amount as extracted from the Annuity Table)
  To Asset A/c
 (For depreciation charged on asset)

Appraisal : (i) This method takes into account interest on capital invested in the asset, (ii) It is most scientific as it considers the amount of depreciation from Annuity table. (iii) Too much calculation work makes it cumbersome, (iv) In case the asset requires frequent additions or extensions the calculations have to be revised quite often which leads to overburdening the calculation work, (v) Like the straight line method, it also has tendency to inequalise the charge to profit and loss account in respect of depreciation and repairs put together because the amount of depreciation remains fixed over the life of the asset.

Suitability : This method is much suited to those assets which require considerable investment and where frequent additions are not made. It is not suited for plant and machinery where additions are usually made quite often.

4. Sinking Fund Method : Under this method this fund is created so as to make provision of a specified amount at a future certain date for the purpose of replacement of the Asset at the end of its useful or usable life. The working of this method in brief is as follows :

(i) A Sinking Fund Depreciation Fund is established for the purpose which is also called accumulating sufficient funds to replace the asset at the end of its useful life.

(ii) An amount equal to the annual depreciation of the asset is charged against the profits every year and accumulated in the form of Depreciation Fund.

(iii) An equivalent amount of cash (or in the multiples of a specific denomination say Rs. 10 or Rs. 100 if so required) is withdrawn from the business and is invested in the outside securities which are readily convertible into cash.

(iv) At the time of replacement of the asset, the investments made are realised and the available money is used in replacing the asset concerned.

The Journal entries under this method are as under :

At the end of first year :

(1) For setting aside the amount of depreciation (to be found out from Sinking Fund tables)
 Depreciation A/c ..... Dr.
  To Depreciation Fund or Sinking Fund A/c

(2) For transfer of Depreciation to Profit and Loss A/c
 Profit and Loss A/c .... Dr.
  To Depreciation A/c

(3) For investing the amount outside the business :
 Sinking Fund Investment A/c .... Dr.
  To Bank A/c

At the end of second and subsequent years :

(1) For receiving interest on investments :
 Bank A/c ... Dr.
  To Sinking Fund A/c

(2) For setting aside the depreciation amount
 Depreciation A/c ... Dr.
  To Sinking Fund or Depreciation Fund A/c

(3) For investing the amount of depreciation plus interest received
 Sinking Fund Investment A/c ... Dr.
  To Bank

(4) For transfer of Depreciation to Profit and Loss A/c

Profit and Loss A/c ... Dr.
To Depreciation A/c

At the end of Last year : The amount of interest and annual instalment not to be invested since the money will be required to purchase new asset. However, all investments will be sold away.

(1) For sale of Investments (Actual amount realised)

Bank A/c ... Dr.
To Sinking Fund Investment A/c

(2) For transfer of Profit on sale of Investments (if credit side more)

Sinking Fund Investment A/c ... Dr.
To Sinking Fund A/c

or (3) For transfer of loss on sale of Investments (if debit side more)

Sinking Fund A/c ... Dr.
To Sinking Fund Investment A/c

(4) The old asset is sold out and whatever is realised in credited to Asset A/c

Bank A/c ... Dr.
To Asset A/c

(5) Balance of Sinking Fund or Depreciation Fund A/c is transferred to Asset Account and any balance left in the Asset account (old) is transferred to Profit and Loss account :

(6) For transfer of Loss in Asset Account

Profit & Loss A/c ... Dr.
To Asset A/c

or

(7) For transfer of Profit on Asset Account

Asset A/c ... Dr.
To Profit & Loss A/c

(8) For purchasing the new asset :

(New) Asset Account ... Dr.
To Bank A/c

Appraisal : (i) The asset is shown in the Balance Sheet at its original value throughout its life. The amount of depreciation accumulated is shown on the liabilities side under Depreciation Fund or Sinking Fund.

(ii) Under this method, due provision is made for replacement of asset at the end of its working life. This is besides making provision for depreciation on the asset every year. This feature is not found in other methods.

(iii) The principal limitation of the Depreciation Fund method is that, as depreciation amount remains fixed throughout the life of the asset, it has a tendency to place unequal burden on Profit and Loss Account over different years in respect of depreciation and repairs put together. The consequence is that the burden on Profit and Loss Account in earlier years is light while in later years it is heavy.

Suitability : This method is suitable for Plant and Machinery and also for many Wasting Assets requiring replacement which involve very large amount.

5. Insurance Policy Method : Under this method the business takes a Policy from an Insurance Company. The amount of the policy is such that it is sufficient to replace the asset when it is worn

out or discarded. The amount (cash) equal to the amount of depreciation is paid by way of premium every year. The amount goes on accumulating with the insurance company at a certain rate of interest and is paid back to the Insured at the lime of maturity of the Policy. The amount so made available by the Insurance Company is used for purchasing a new asset. This method to a great extent is similar to sinking fund method; of course, procedure is a little different. Cash, in this method, instead of being used for buying securities, is used for paying premium on the Policy.

This method is hardly used by the business houses.

6. Revaluation Method : This method, also called 'Appraisal System' is adopted only where the Asset in represented by a large number of small and diverse items such as Tools or Lose tools etc. In such case, it is not possible to depreciate each item separately. As such under this method :

(a) At the end of financial year (Accounting year) all the items, which are in good and usable condition are valued at cost.

(b) The cost under (a) above is compared with the opening balance. The difference, if any, is charged as depreciation.

(c) Whenever, additional assets are purchased, the amount is debited to Assets Account as usual.

Note : Please note that under this method the total amount depreciation charge is written off in the Asset account itself and not to an accumulated depreciation account.

7. Depletion Method of Depreciation of Natural Resources : Natural resources include physical assets like mineral deposits, oil and gas resources, and timber stands. These natural resources get exhausted by exploitation. In some cases the reduction in physical deposits is offset by growth (accretion) of development of additional deposits. The cost of the natural resources is the price paid for its **Acquisition plus Price paid for Development** of such Asset in order to bring it to a state suitable for production. The periodic depletion is better "not calculated in terms of year. Rather it is better to calculate the cost per unit and then multiply the cost of units produced in that particular year. Depletion for each unit extracted is determined as follows :

$$\text{Depletion per unit (U)} = \frac{\text{Acquisition Cost (C)} - \text{Residual Value(S)}}{\text{Estimated life in terms of production units (N)}}$$

8. Machine Hour Rate Method : In this method, the life of a machine is estimated in hours instead of years. Proper records are maintained for running hours of the Machine and depreciation is computed accordingly. For example the cost of a Machine is Rs. 10,00,000 and life of the machine is estimated at 50,000 hours. The hourly depreciation will be calculated as :

$$\frac{\text{Cost of Machine}}{\text{Machine Hours}} = \frac{\text{Rs. 10,00,000}}{50{,}000} \text{ or Rs. 20 per hour}$$

If the machine runs for say, 2,000 hours in a particular year depreciation for the period will be 2,000 hours × Rs. 20 = Rs. 40,000.

Machine hour rate means the cost of running a machine for an hour. This is an ideal method for calculating depreciation where costly and different machines are used in production.

Test Questions

Very short Questions and Answers : (Not exceeding 40 words)

Q.1. **What is meant by Depreciation ?**

Ans. Depreciation is a gradual or permanent decrease in the quality, quantity or value of Asset due to wear and tear and effluxion or passage of time.

Q.2 Enumerate four main causes of depreciation.

Ans. : The causes of depreciation are

(i) Wear and tear because of constant use.

(ii) Effluction or passage of time, for patents, leasehold etc.

(iii) Obsolescence due to new inventions and new technology.

(iv) Fall in market price of assets.

Q.3. What is the need for providing depreciation ?

Ans. : Objectives are

(i) To ascertion true and correct results of operation

(ii) To present true and fair view of the financial position of business enterprise.

(iii) To ascertain the true cost of production of articles manufactured.

(iv) To comply with legal requirements

Q.4. State the main factors for determining the amount of Depreciation.

Ans. : Factors for determining the amount of depreciation :

(i) Cost of the Asset including expenses incurred to bring the asset in usable condition

(ii) Estimated useful life of the Asset

(iii) Estimated Residual or scrap value of the Asset

(iv) Existence of Legal Laws.

Q.5. What are the methods of accounting for depreciation ?

Ans. : Methods of Accounting for Depreciation are

(i) When provision for depreciation A/c is not maintained

(ii) When provision for depreciation A/c is maintained

(iii) When Asset Disposal Account is opened in addition to provision for depreciation A/c.

Q.6. Enumerate five methods of providing Depreciation.

Ans. : Methods of providing Depreciation

(i) Fixed Instalment or original cost method

(ii) Diminishing balance or written down value method

(iii) Annuity method

(iv) Depreciation Fund or Insurance policy method.

(v) Revaluation method.

Q.7. What do you understand by original cost method of providing Depreciation.

Ans. : Under original cost method, depreciation is charged at a fixed percentage on the original cost of the Asset. The amount of annual depreciation remain equal or uniform from year to year as such this method is also called as equal instalment method or graphically it is called straight line method.

Q.8. State four merits of original cost method of providing Depreciation.

Ans. : Merits ?

(i) This method is simple to understand.

(ii) This method is easy to calculate depreciation

(iii) Under this method, the book value of the asset can be reduced to zero or equal to is scrap value.

(iv) Under this method information regarding orginal cost of the assets along with upto date amount of depreciation is available at all times.

Q.9. Give the formula for calculating annual amount of depreciation under straight line method.

Ans. : The formula to calculate Annual Depreciation is

$$\text{Amount of Depreciation} = \frac{\text{Cost of Asset} - \text{Estimated Scrap Value}}{\text{Estimated life of the Assets in Years.}}$$

Q.10. State two demerits of original cost method.

Ans. : (i) This method does not take into consideration the loss of interest on the amount invested for the asset.

(ii) Repairing charges go on increasing year after year as the asset become older but equal depreciation is charged under this method, as such total burden charged will not be equal every year.

Q.11. What do you understand by Diminishing balance method of providing depreciation.

Ans. : Under this method, depreciation is provided on the written down value of the asset. The value of the asset goes on diminishing year after year and the amount of depreciation also goes on declining every year.

Q.12. State two main merits of written down value method of providing Depreciation.

Ans. : Merits :

(i) This method of providing depreciation is permissible by the tax authorities in India.

(ii) Total charge as regards depreciation and Repairs and renewals also remain almost uniform year after year since depreciation in initial years is more and the amount spent on repairs is less and in later years depreciation is less but the amount of repairs and renewals is more.

Q.13. Narrate at least two demerits of written down value method of providing depreciation.

Ans. Demerits :

(i) This method does not take into consideration the interest on the amount invested for the Asset.

(ii) It is difficult to calculate the rate of depreciation and takes a long time to write down an asset to its break up value unless a very high rate is used.

Q.14. State two points of difference between original cost method and diminishing balance method of providing depreciation.

Ans. : Difference between original cost method and written down value method.

(i) Equal Depreciation is charged every year under original cost method, whereas the amount of depreciation goes on declining year after year, under written down value method.

(ii) Book value of the assets is reduced to zero under straight line method, whereas it can never be zero under W.D.V. method even if the rate of depreciation is quite high.

Short Questions and Answers : (Not exceeding 80 words)

Q.1 Stable briefly the necessity of providing Depreciation.

Ans. : Need or Necessity of providing Depreciation is as follows :

(i) to ascertain true results of operations by matching of cost with revenue properly.

(ii) To present true and fair picture of the financial position of the enterprise.

(iii) To find out the actual and true cost for the output produced.

(iv) To comply with legal requirements in case of companies.
(v) To accumulate funds for replacement of assets by setting aside a portion of profits in the form of depreciation.
(vi) For avoiding over payment of Income tax.
(vii) To prevent distribution of Profit out of capital.

Q.2. Narrate the main factors determining Depreciation ?

Ans. The basic factors determining the amount of depreciation are as follows :

(i) Cost of the fixed asset after adding all expenses incurred for bringing the asset in usable condition.
(ii) Estimated useful life of the asset in terms of number of years.
(iii) Estimated residual or scrap value of the Assets at the end of its useful life.
(iv) Possibility of new Inventions and improved technology.
(v) Position for repairs and renewals properly.
(vi) Interest on capital to be invested in the construction of fixed asset.
(vii) Capital expenditure to be incurred in connection with the expansion of asset.
(viii) When there are some legal laws in existence for providing depreciation, the same to be followed.

Q.3. Differentiate between Depreciation, Depletion and Amortization.

Ans. : **Depreciation, Depletion and Amortization**

The term depreciation is to be distinguished from other terms such as depletion and amortization although, these terms are used interchangeably. **Depletion** means reduction in value of fixed asset on account of exhaustion such as extracting coal from a coal mine, oil out of an oil-well, wood from a forest etc.

Amortization is used for writing off intangible assets like goodwill, copyrights, leaseholds, patents etc. which have a limited useful life. These terms can be distinguished as follows :

Depreciation is concerned with charging the cost of man-made fixed assets to operations.
Depletion refers to cost allocation for natural resources, such as oil and mineral deposits.
Amortization relates to cost allocation for intangible assets such as patents and leaseholds.

Q.4. What is meant by fixed installment method of providing depreciation and give the formula for ascertaining rate of depreciation.

Ans. : **Fixed Instalment Method :** This method is also called as original cost method or equal instalment method or straight line method. Under this method depreciation is charged at a fixed percentage on the original cost of the asset. Thus the amount of depreciation remains equal from year to year, as such this method is called equal instalment or straight line or fixed instalment method. The amount of yearly depreciation is calculated by the following formula :

$$\text{Annual Depreciation} = \frac{\text{Original Cost of Asset} - \text{Estimated Scrap Value}}{\text{Estimated Life of Asset}}$$

For example, if the purchase price of asset is Rs. 90,000, Rs. 2,000 is incurred for cartage and Rs. 8,000 are the installation charges of the asset, estimated scrap value is likely to be Rs 15,000 at the end of 10 years, being the life of a asset, the amount of depreciation to be written off will be as follows :

$$\frac{\text{Rs. } 90{,}000 + 2{,}000 + 8{,}000 - 15{,}000}{10 \text{ Years}} = \text{Rs. } 8{,}500 \text{ every year}$$

Rate of depreciation is calculated with the help of the following.

Formula : $\text{Rate of Depreciation} = \frac{\text{Amount of Depreciation}}{\text{Original Cost}} \times 100$

Q.5. What is meant by written Down value method of providing depreciation. How is the rate of depreciation ascertained ?

Ans. : **Diminishing Balance Method :** Under this method depreciation is provided on the written down value of the assets. The value of the asset goes on diminishing year after year. The depreciation charge also goes on declining every year. For example a machine was purchases for Rs. 20,000 and depreciation is to be charged at 10% per annum. The depreciation according to this method will be as under :

I year 10% on Rs. 1,20,000 = Rs. 12,000
II year 10% on Rs. 1,20,000 – 12,800 = Rs. 10,800
III year 10% on Rs. 1,08,000 – 10,800 = Rs. 9,720

and so on. As the value of the asset and also the depreciation charges on it goes on reducing year after year, the method is also known as Reducing Instalment Method or Written Down Value Method.

The rate of depreciation be ascertained with the help of following formula :

$$\text{Rate (R)} = 1 - \sqrt[N]{\frac{S}{C}}$$

Where R = Rate of Depreciation,
N = Useful life in years,
S = Scrap Value,
C = Cost of the Asset.

Q.6 : Differentiate between original cost method and written down method.

Ans. : Difference between Original Cost-Method and Diminishing Balance Method :

The following are the main points of differences between the two methods :

Basis of Difference	Original Cost Method	Diminishing Balance Method
Amount of depreciation	Equal depreciation is charged every year.	Depreciation goes on decreasing year after year.
Depreciation Charge	Depreciation is charged on the original cost of the asset.	Depreciation is charged on the reducing balance of the asset.
Zero level	The book value of the asset can be reduced to zero.	The book value of the asset can never be reduced to zero.
Combined effect on Profit & Loss A/c	Combined burden "on account of depreciation and repairs will be lighter in earlier years and heavier during the later years.	Combined burden on account of depreciation and repairs will be almost equal different years.

Rate of depreciation	Rate of depreciation is kept low in comparison to diminishing balance method.	Rate of depreciation is kept high in comparison to original cost method.
Approval	This method is not approved by Tax authorities	This method is approved by Tax authorities.

In practice, the diminishing balance method is more widely used. This is so because the depreciation in this method goes on reducing according to the shrinking value of the asset.

Q.7. What are the merits of written down value method ? Given its suitability.

Ans. : Advantages or Merits of W.D.V. Method

The main merits of the method are :

(i) It is easy to calculate depreciation.

(ii) The total charge (depreciation + repairs and renewals) remains almost uniform year after year, since the charge of depreciation in initial years is more and the amount of repairs and renewals is less; whereas in later years the amount of depreciation is less and the amount of repairs and renewals shall be more.

(iii) The efficiency and usefulness is more in the earlier years than in the later years. Hence, depreciation in earlier years be charged more than during the later years. This method ensures it.

(iv) Under this method the asset is never reduced to zero, so that some depreciation, however small is debited to Profit & Loss Account so long as asset is in use.

(v) This method of providing depreciation is permissible by the tax authorities in India also.

Suitability : This method is suitable for those assets in relation to which the amount of repairs and renewals goes on increasing as the asset grows older and the possibilities of obsolescence are more. This method is suitable for Plant, Machineries and Building etc.

Essay Type or Long Answers Questions :

(See page nps. 10.1 and 10.3)

Q.1. Enumerate the various methods for calculating depreciation and mention the circumstances under which each method can be used advantageously. **(R.U. BCA, 2007)**

(See page nps. 10.6, 10.9, 10.23, 10.24)

Q.2. Explain the causes for providing Depreciation and discuss the factors for determining depreciation on fixed assets.

(See page nps. 10.1 and 10.2)

Q.3. Define depreciation and distinguish the same from depletion amortization and obsolescence.

(See page nps. 10.1 and 10.3)

Numericals :

Q.1. Bhanu Pratap a trader purchased a Machine for Rs. 5,60,000 on 30th September, 2011. Its estimated life is 10 years and scrap value is Rs. 60,000. Depreciation is charged on straight line method. Prepare Machine Account for first four years. Books are closed on 31st March every year.

[Ans. Balance at the end of 2014-15 Rs. 3,85,000]

Ans. : Annual deprecation$= \dfrac{\text{Rs. } 5{,}60{,}000 - 60{,}000}{10}$ or **Rs.50,000**

Dep., for 2011-12 = Rs. 25,000, 2012-13 = Rs. 50,000, 2013-14 = Rs. 50,000 and for 2014-15 = Rs. 50,000. Total depreciation charged and Balance is, Rs. 1,75,000 and Rs. 3,85,000.

Q2. A firm purchased Machine on 1st October, 2011 for Rs. 1.08,000 and its estimated life is 10 years and residual value Rs. 8,000. The firm purchased another machine on 1st January, 2013 for Rs. 65,000. Its estimated life is 10 years and residual value Rs. 5,000. depreciation is charged on fixed instalment method. Prepare Machinery Account for the year ended 31 March, 2012, 2013 and 2014.

[Ans. Depreciation Rs. 5,000 (2011-12), Rs. 11,500 (2012-13) and Rs. 16,000 (2013-14)]

Hint : Annual depreciation I. Machine : $= \dfrac{\text{Rs. } 1{,}08{,}000 - 8{,}000}{10}$ or **Rs. 10,000**

II. Machine : $= \dfrac{\text{Rs. } 65{,}000 - 5{,}000}{10}$ **Rs. 6,000.**

Q3. A plant was purchased on 1st April, 2010 for Rs. 40,000. It was depreciated by written down value method @ 5% per annum for five years. At the end of 5th year the plant became useless because of new techniques of production and was sold for Rs. 10,771. Prepare Plant Account for five years.

[Ans. Loss Rs. 20,180 at the end of 5th year]

Hint : Depreciation 2010-11 =Rs. 2,000, 2011-12 = 5% of 40,000 – 2,000 or Rs. 1,900, 2012-13 : 5% × 36,100 = Rs. 1,805, 2012-13 = 5% × (36,100 – 1,805) = Rs. 1,715, 2014-15 = 5% of 32,580 = Rs. 1,629, W.D.V. 30,951 – Sale Rs. 10,771 = Loss Rs. **20,180.**

Q4. On 1st January, 2012 a firm purchased furniture for Rs. 1,10,000. Its useful life is estimated for 10 years and the residual values Rs. 10,000. On 1st July, 2013 and on 1st October, 2014 additional furniture costing Rs. 19,000 and Rs. 16,800 respectively were purchased. The residual value estimated was Rs. 1,000 and Rs. 800 respectively and the useful life 10 years. Depreciation is written off at fixed instalment method. Prepare furniture account for four years (from 2012 to 2015) assuming that books of accounts are closed on 31st December every year.

[Ans. Depreciation Rs. 10,000, 10,900, 12,200, 13,400 respectively for first four years.]

Hint. : Annual depreciation on Furniture 1st lot : $= \dfrac{\text{Rs. } 1{,}10{,}000 - 10{,}000}{10}$ = **Rs. 10,000,**

2nd lot $= \dfrac{\text{Rs. } 19{,}000 - 1{,}000}{10}$ = **Rs. 1,800**, 3rd lot : $= \dfrac{\text{Rs. } 16{,}800 - 800}{10}$ = **Rs. 1,600.** Solve the questioon accordingly.

Q5. A company whose books are closed on 31st March, purchased a Machinery for Rs. 6,00,000 on 1st April, 2011. Additional machinery were acquired for Rs. 1,60,000 on 30th September, 2012 and for Rs. 1,00,000 on 1st April, 2015. Certain Machinery which was purchased for Rs. 1,60,000 on 30th September, 2012, was sold for Rs. 1,36,000 on 30th September, 2014. Depreciation is charged at 10% per annum on written down value method. Prepare the Machinery Account for the year ended 31 st March, 2015.

[Ans. Balance of Machinery on 1st April, 2014 Rs. 5,74,200, depreciation Rs. 60,580 (Rs. 6,840 + 43,740 + 10,000), Profit on sale Rs. 6,040,]

Ans. : Working Note :

Machinery Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2015 Apr. 1	To Bank A/c (A)	6,00,000	2012 Mar.31	By Depreciation 10% By Balance c/d	60,000 5,00,000
2012 Apr. 1 Sept. 12	To Balance b/d (A) To Bank (B)	5,40,000 1,60,000	2013 Mar. 31 Mar. 31	By Dep. (A) 54,000 For 6 months (B) 8,000 By Balance c/d (A) 4,86,000 (B) 1,52,000	62,000 6,38,000
		7,00,000			7,00,000
2013 Apr. 1	To Balance b/d A 4,86,000 B. 1,52,000	6,38,000	2014 Mar. 31 Mar. 31	By Dep. (A) 48,600 (B) 15,200 By Balance c/d A 4,37,400 B 1,36,800	63,800 5,74,200
		6,38,000			6,38,000

Machinery Account for 2014-15

Date 2014	Particulars	Amount Rs.	Date 2014	Particulars	Amount Rs.
Apr. 1 April 1 2015 Mar. 31	To Balance b/d (A) 4,37,400 (B) 1,36,800 To Bank (C) To P & L A/c (Profit) (1,42,840 – 1,36,800)	 5,74,200 1,00,000 6,040	Mar.31 30-1-09 2015 Mar. 31 Mar. 31	By Bank A/c By Depreciation (6 months) on B By Dep. : (A) 43,740 (C) 10,000 By Balance c/d (A) 3,93,660 (B) 90,000	1,36,000 6,840 53,740 4,83,660
		6,80,240			6,80,240

Q6. A firm purchased two Machines for Rs. 5,00,000 on 1st April, 2011. It purchased another machine for Rs. 2,00,000 on 1st April, 2012. It sold off one Machine on 1st October, 2013 for Rs. 2,00,000 which was purchased in April, 2011 for Rs. 3,00,000. On the same day it purchased another Machine for Rs. 2,00,000. On 31st March, 2015 it sold for Rs. 75,000 the second Machine purchased in April, 2011. Depreciation is charged @ 10% per annum on written down

value method, Prepare Machinery Account for four years. Account books are closed on 31st March each year.

[**Ans.** Depreciation (2011-12) Rs. 50,000; (2012-13) Rs. 65,000; (2013-14) Rs. 56,350; 2014-15 Rs. 49,780; Loss on sale in 2013-14 Rs. 30,850, in 2014-15 Rs. 56,220.]

Ans. :

Machinery Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2011 Apr. 1	To Bank A/c (A) 3,00,000 (B) 2,00,000	5,00,000	2012 Mar.31	By Depreciation (A) 30,000 (B) 20,000 By Balance c/d (A) 2,70,000 (B) 1,80,000	50,000 4,50,000
		5,00,000			5,00,000
2012 Apr. 1 Apr. 1	To Balance b/d (A) 2,70,000 (B) 1,80,000 To Bank (C)	4,50,000 2,00,000	2013 Mar. 31 Mar. 31	By Depreciation (A) 27,000 (B) 18,000 (C) 20,000 By Balance c/d A 2,43,000 B 1,62,000 C 1,80,000	65,000 5,85,000
		6,50,000			6,50,000
2013 Apr. 1 Oct. 1	To Balance b/d A 2,43,000 B 1,62,000 C 1,80,000 To Bank (D)	5,85,000 2,00,000	2013 Oct. 1 2014 Mar. 31 Mar. 31	By Bank A/c (A) By Dep. (6 months on A) By P&L A/c (Loss) By Depreciation B 16,200 C 18,000 D (6 months) 10,000 By Balance c/d B 1,45,800 C 1,62,000 D 1,90,000	2,00,000 12,150 30,850 44,200 4,97,800
		7,85,000			7,85,000

2014 Apr. 1	To Balance b/d 1,45,800 + 1,62,000 + 1,90,000	4,97,800	2015 Mar. 31	By Bank (B)	75,000
				By Depreciation (B)	14,580
				By P&L A/c (Loss)	56,220
				By Depreciation (C) 16,200 (D) 19,000	35,200
				By Balance c/d	3,16,800
		4,97,800			4,97,800

Q.7. A company purchased a Machine on 1st January, 2012 for Rs. 4,00,000. On 1st July, 2014 the company further purchased a Machine for Rs. 1,00,000. On 1st July, 2015, the company sold off its first Machine purchased on 1st January, 2012 for Rs. 2,50,000. On the same day, it purchased a new Machine for Rs. 2,50,000. Depreciation was charged on Machinery every year @ 10% per annum by **fixed instalment method.** In 2014, however, the company changed the method of providing depreciation and adopted the written down value method, the rate of depreciation being 15% per annum. Give Machinery Account for the first four years from 2012 to 2015. Books are closed on 31st December every year.

[**Ans.** Depreciation 2012 Rs. 40,000; 2013 Rs. 40,000; 2013 Rs. 55,500; 2015 Rs. 53,025 (Rs. 20,400 + 13,875 + 18,750); Loss on Sale Rs. 1,600]

Ans. : Dr. **Machinery Account** Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2012 Jan. 1	To Bank A/c (A)	4,00,000	2012 Dec. 31	By Depreciation	40,000
				By Balance c/d	3,60,000
		4,00,000			4,00,000
2013 Jan. 1	To Balance b/d	3,60,000	2013 Dec. 1	By Depreciation	40,000
				By Balance c/d	3,20,000
		3,60,000			3,60,000
2014 Jan. 1	To Balance b/d	3,20,000	2014 Dec. 31	By Depreciation (A) 48,000 (15%) (B) 7,500 (6 months)	55,500
July 1	To Bank A/c (B)	1,00,000		By Balance c/d A 2,72,000 B 92,500	3,64,500
		4,20,000			4,20,000
2015 Jan. 1	To Balance b/d (A) 2,72,000 (B) 92,500	3,64,500	2015 July 1	By Bank A/c (Sale)	2,50,000
July 1	To Bank A/c (C)	2,50,000		By Depreciation (A) (for 6 months @ 15%	20,400
				By P&L A/c (Loss)	1,600
			Dec. 31	By Depreciation B (13,875) + C (18,750)	32,625
				By Balance c/d (78,625 + 2,31,250)	3,09,875
		6,14,500			6,14,500

Q.8. On 1st April, 2011 a Company purchased a Machinery worth Rs. 2,60,000 and a Boiler for Rs. 4,00,000. On 1st April, 2013, the boilder being damaged and was sold for Rs. 1,00,000 and a new boilder was purchased for Rs. 6,00,000 on the same day. Depreciation is provided at 10% per annum on diminishing balance method. From the year 2014-15 it was decided to change the diminishing balance method to fixed instalment method of depreciation at 10 percent per annum. Prepare Machinery Account from 2011-12 to 2014-15. Books of accounts are closed on 31st March each year.

[**Ans.** Depreciation Rs. 66,000, 59,400, 81,060 and 86,000 respectively. Loss on sale Rs. 2,24,000.]

Ans. : Dr. **Machinery Account** Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2011 Apr. 1	To Bank A/c (A) (2,60,000 + 4,00,000)	6,60,000	2012 Mar. 31	By Depreciation (26,000 + 40,000)	66,000
				By Balance c/d (2,34,000 + 3,60,000)	5,94,000
		6,60,000			6,60,000
2012 Apr. 1	To Balance b/d (2,34,000 + 3,60,000)	5,94,000	2013 Mar. 1	By Depreciation A/c (23,400 + 36,000)	59,400
				By Balance c/d (2,10,600 + 3,24,000)	5,34,600
		5,94,000			5,94,000

2013 Apr. 1 Apr. 1	To Balance b/d (2,10,600 + 3,24,000) To Bank A/c (New Boiler)	 5,34,600 6,00,000	2013-14 Apr. 1 Mar. 31 Mar. 31 Mar. 31	By Bank (Sale) By P&L A/c (Loss) By Depreciation (21,060 + 60,000) By Balance c/d (1,89,540 + 5,40,000)	1,00,000 2,24,000 81,060 7,29,540
		11,34,600			11,34,600
2014 Apr. 1	To Balance b/d (1,89,540 + 5,40,000)	7,29,500	2015 Mar. 1	By Depreciation (10%) or original cost) (26,000 + 60,000) By By Balance c/d	 86,000 6,43,500
		7,29,500			7,29,500

Q.9. On 1st July, 2011 a company purchased an old machine for Rs. 68,000, Rs. 10,800 were spent on its repairs for making it serviceable and Rs. 1,200 on its installation. On 1st April, 2012 another machine was purchased for Rs. 40,000. On 1st October, 2012 the first machine being damaged was sold for Rs. 58,000. On the same day a new machine was purchased for Rs. 1,20,000. On 1st January, 2014 the Machine purchased on 1-04-2012 becoming obsolete was sold for Rs. 35,000. Upto 31st March, 2014 depreciation was provided @ 10% per annum on fixed instalment method. From 1st April, 2014 Diminishing Balance Method of depreciation @ 20 percent per annum was adopted in place of fixed instalment method. Prepare Machinery Account for four years ended 31st March, 2015.

[**Ans.** Depreciation Rs. 6,000, 14,000, 15,000, 20,400, respectively Loss on sale in 2012 Rs. 12,000. Profit in 2013 Rs. 2,000. Balance of Machinery at the end Rs. 81,600]

Ans. : Dr. **Machinery Account** Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2011 July 1	To Bank (Purchase) A/c To Cash (Expenses) (10,800 + 1,200)	68,000 12,000	2012 Mar. 31	By Depreciation (9 months) By Balance c/d	 6,000 74,000
		80,000			80,000

2012 Apr. 1 Apr. 1 Oct. 1	To Balance b/d To Bank (B) To Bank (C)	74,000 40,000 1,20,000	2012 Oct. 1 2013 Mar. 31 Mar. 31	By Bank (Sale) By Dep. (6 months) By P&L A/c (Loss) By Depreciation (4,000 + 6,000) By Balance c/d (B) 36,000 + (C)1,14,000)	58,000 4,000 12,000 10,000 1,50,000
		2,34,000			2,34,000
2013 Apr. 1 Apr. 1	To Balance b/d (36,000 + 1,14,000) To P&L A/c (Profit)	 1,50,000 2,000	2014 Jan. 1 Mar. 31	By Bank (Sale) By Dep. (9 months) By Depreciation By Balance c/d	35,000 3,000 12,000 1,02,000
		1,52,000			1,52,000
2014 Apr. 1	To Balance b/d	1,02,000	2015 Mar. 31	By Depreciation (20% on Rs. 1,02,000) By By Balance c/d	 20,400 81,600
		1,02,000			1,02,000

Q.10. On 1st January 2013 machinery account showed a debit balance of Rs. 48,600. Depreciation being charged at 10% per annum on written down balance. On 31st December, 2015, the proprietor decides to change its method of depreciation from written down value method to straight line method with retrospective effect from 1st January, 2013 and adjust the difference on 31st December, 2015. The rate of depreciation remains as before.

[**Ans.** Depreciation to be adjusted 6,600; In Balance Sheet, Machinery A/c will appear at Rs. 42,000 (48,600 − 6,600).]

[**Hint :** Machinery balance as on 1st January 2014 = 48,600 × $\frac{10}{9}$ = Rs. 54,000. On 1st January, 2013, it will be Rs. 54,000 × $\frac{10}{9}$ = Rs. 60,000. Balance of depreciation to be charged in 2015 due to change in method (12,000 − 11,400) = Rs. 600. Total depreciation (6,000 + 600) = 6,600 to be charged in 2015.]

Q.11. Syam Sunder who depreciates its Machines @ 10% per annum on written down value method provides the following information :-

Machinery Account as on 1-4-2010 Rs. 5,00,000

Provision for Depreciation Account as on 1-4-2010 Rs. 1,35,500

No depreciation is charged on the year of sale of Machinery but full amount of depreciation is charged in the year of purchase.

On July 1, 2011, one new Machinery was purchased for Rs. 80,000 and old Machinery purchased on July 1, 2008 for Rs. 60,000 was discarded but could not be sold immediately. However, it was expected to realise Rs. 10,000. Prepare Provision for Depreciation Account, Machinery Account and Machinery Disposal Account for the year 2010 and 2011.

Ans. :

Machinery Account

2010 Jan.	To Balance b/d	Rs. 5,00,000	2010 Dec. 31	By Balance c/d	Rs. 5,00,000
2011 Jan. 1	To Balance b/d	5,00,000	2011 July 1	By Machinery Disposal A/c	60,000
July 1	To Bank A/c	80,000		By Balance c/d	5,20,000
		5,80,000			5,80,000

Provision for Depreciation Account

2010 Dec. 31	To Balance c/d	Rs. 1,71,950	2010 Jan. 1	By Balance b/d	Rs. 1,35,500
			Dec. 31	By Depreciation A/c 10% on 5,00,000 – 1,35,500 = 3,64,500	36,450
		1,71,950			1,71,950
2011 Jan. 1	To Machinery Disposal A/c	16,260	2011 Jan. 1	By Balance b/d	1,71,950
Dec. 1	To Balance c/d	1,92,121	Dec. 1	By Depreciation 10% of (5,20,000 – 1,71,950 + 16,260) = 3,64,310	36,431
		2,08,381			2,08,381

Note : Depreciation is Computed as under :

Particulars	Book Value (Rs.)	Accumulated Depreciation (Rs.)
Original Cost 1-7-2008	60,000	
Less : Depreciation for 2008 (full one year)	6,000	6,000
Less : Depreciation for 2009 (10% of Rs. 54,000)	54,000 5,400	5,400
Less : Depreciation for 2010 (10% of Rs. 48,600)	48,600 4,860	4,860
Total	43,740	16,260

Ans. :

Machinery Disposal Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2011 July 1	To Machinery A/c	60,000	2011 July 1	By Provision for Dep. A/c	Rs. 16,260
				By P&L A/c (Loss) (Rs. 60,000 – Rs. 16,260 – 10,000)	33,740
				By Balance c/d	10,000
		60,000			60,000

Q.12 : The following balances appear in the books of Modi Bros. as on January 1, 2011 :

Machinery A/c Rs. 8,00,000, Provision for Depreciation Rs. 3,18,000. On January 1, 2011, the firm decided to sell a Machine for Rs. 34,500 which was bought for Rs. 1,20,000 on January 1, 2007. Show provision for depreciation A/c and the Machinery A/c for the year ending 31st December, 2011 assuming that the depreciation in charged at 10% perannum on written down value method.

Ans. :

Provision for Depreciation Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2011 Jan. 1	To Machinery A/c	41,268	2011 Jan. 1	By Balance b/d	Rs. 3,18,000
Dec. 31	To Balance c/d	3,17,059	Dec. 31	By Depreciation (10% on Rs. 6,80,000 – 3,18,000 + Rs. 41,268 = 4,03,268	40,327
		3,58,327			3,58,327

	Rs.	
Note : Original Cost (1-1-2007)	**1,20,000**	**Total Accumulated Dep.**
Less dep. on 31-12-07	12,000	12,000 + 10,800 + 9,720
	1,08,000	+ 8,748 = Rs. 41,268
Less dep. on 31-12-08	10,800	
	97,200	
Less dep. on 31-12-09	9,720	
	87,480	
Less : dep. on 31-12-10	8,748	
W.D.V. On 1-1-12	78,732	

Ans. :

Machinery Account as on Dec. 31, 2011

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2011 Jan. 1	To Balance b/d	8,00,000	2011 July 1	By Bank A/c (Sale)	34,500
				By Prov. for Dep.	41,268
				By P&L A/c (Loss) (1,20,000 – 34,500 – 41,268)	44,232
				By Balance c/d	6,80,000
		8,00,000			8,00,000

Note : Depreciation for 2011 : Balance of Machinery Rs. 6,80,000

Less : Balance of Provision for Dep. 2,76,732

W.D.V. of Machinery 4,03,268

10% Depreciation to be credited to Provision for depreciation A/c **Rs. 40,327.**

11

Reserves and Provisions

Reserves

Meaning and Definition of Reserves :

Reserves mean amount set aside out of Profit and other surpluses to meet the future contingencies. It consists of transfer from Profit and Loss Appropriation to add to the working capital of the company with a view to strengthen the financial position of the business.

In the words of **William Pickles**, *"Reserves mean the amounts set aside out of Profits and other surpluses, which are not earmarked in any way to meet any particular liability, known to exist on the date of Balance Sheet."* Similarly, it has also been defined in **Part III of schedule VI to the Companies Act 1956 as not including**, "any amount written or retained by way of providing for depreciation, renewal or diminution in the value of Assets or retained by way of providing for any known liability." *Examples of Reserves are,* General Reserve, Capital Reserve, Reserve for Dividend Equalisation, Contingency Reserve, Reserve for Expansion etc.

Characteristics or Features of Reserves :

The principal features of reserves are :

(i) Since these are set aside out of distributable profits, reserves are also termed as *'Retaine Earnings'* or *'Undistributed Profits'*.

(ii) The reserves are created voluntarily for strengthening the financial position of the Business.

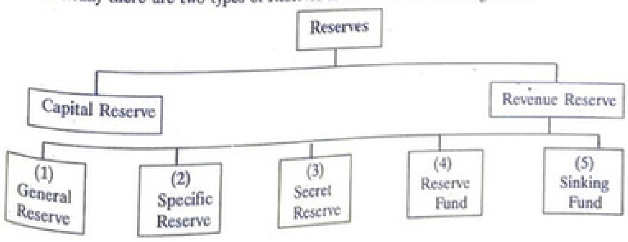
(iii) It is not created to meet any known liability or depreciation but for meeting an unknown liability or loss in future.

(iv) Reserves are accumulated or undistributed profits belonging to the owners of the bùsiness just as capital does. These are shown on the liabilities side of the Balance Sheet.

(v) When the Reserves are invested in outside securities they are called *'Reserve Fund'*.

Classification of Reserves or Types of Reserves :

Bisically there are two types of Reserves as shown in the following chart :



Capital Reserve :

In addition to normal profits, capital profits are also earned in a business from several sources. The reserves created out of such sources are known as Capital Reserve. Such Reserves are generally not available for distribution as cash divided among the shareholders of a company. Thus, the term 'Capital Reserve' does not "include any amount regarded as free for distribution through the Profit and Loss Account.' A Capital Reserve is generally created out of profits or gains of a capital nature such as :

(i) Capital profit on reissue of forfeited shares, (ii) Profit on sale of fixed assets. (iii) Profits prior to incorporation, (iv) Profit on revaluation of Assets and Liabilities. (v) Premium on issue of shares or debentures, (vi) Profit on redemption or discount on cancellation of debentures.

Since these profits are not earned in regular course of the business and hence cannot be distributed by way of dividend amongst the shareholders. However, these may be used for writing off capital losses for example, Preliminary expenses, discount on issue of shares or debentures, underwriting commission etc. They may also be utilized for writing off Intangible assets for example Goodwill, Patents, Copyrights etc.

However, some capital reserve may be utilized to distribute dividend among the shareholders subject to fulfilment of the following conditions :

(i) Articles of the company should not prohibit such distribution;

(ii) Capital profits must have been realised in Cash, and

(iii) Such profits remains after a fair revaluation of assets and liabilities.

All the same, it would be prudent on the part of the management not to distribute such profits to shareholders. These profits should be kept in the business to strengthen the financial position of Business.

Revenue Reserve :

A Revenue Reserve is that which is not a Capital Reserve. Therefore, these are available for dividends for example, General Reserves. Dividend Equalisation Reserve Reserve, Fund etc.

General Reserve :

A general reserve is created by appropriation of profits. This reserve is created without any specific or particular purpose. The aim is to provide additional working capital or to strengthen the cash resources of the business, out of profits of the company, from profit and loss appropriation account. They may be utilised for meeting any unknown liability It is also known as 'Free Reserve'. General reserve is created only when sufficient profits are there in an enterprise.

Purpose or Object :

(i) To strengthen the liquid resources of a business.

(ii) To make available additional working capital.

(iii) To meet any known liability, contingency or similar other commitment.

(iv) To equalise the rate of dividend in the years in which profits are inadequate (in the absence of dividend equalisation reserve),

(v) To conceal actual profits in the years in which profits are excessive so as to use them in future years for maintaing dividend rate when profits are inadequate.

(vi) To comply legal requirement. For example Debenture Redemption Reserve, Capital Redemption Reserve (under company's Act, 1956); Investment Allowance Reserve, Development Allowance Reserve, Foreign Project Allowance Reserve etc. [Under I Tax Act, 1961]

Specific Reserve :

A specific reserve is created for some specific purpose. It is created by debiting profit and loss appropriation account. Normally, such a reserve is available to use for the purpose for which it has been created, examples of specific reserves are : (I) Dividend Equalisation Reserve; (2) Investment Fluctuation Reserve; (3) Debenture Redemption Reserve.; (4) Plant and Machinery Replacement Reserve or for any other fixed asset, (5) Workmen Compensation Reserve to meet compensation payable to employees for unknown event of an accident.

Reserve Fund :

The 'fund' in relation to any reserve must be used only where such a reserve is specifically represented by earmarked investments for it. In other words, a reserve fund is the sum set aside out of 'Divisible Profits' and retained to provide for unknown future contingencies or to equalise dividends or to strengthen the financial position of a business undertaking.

Distinction between General Reserve and Specific Reserve :

(1) **General Reserve** is created for a general purpose of strengthening the financial position of a business; whereas a **Specific Reserve** is restricted to a specific purpose and is ordinarily not used for any other purpose.

(2) **General Reserve** is created out of divisible profits to provide for unexpected or unknown future losses or to strengthen the financial position of the business; whereas **Specific Reserve** is created to meet a further liability or loss such as Investment Fluctuation Reserve to provide for loss in fluctuation in value of long-term liability or replacement of a fixed assets.

(3) **General Reserve** can-be utilised for payment of dividends or for any other purpose at the discretion of Board of Director; whereas **Specific Reserves**, are generally used for the purposes for which they are created. However, in certain cases, the Board may utilise them for any other purpose also.

The students should note that both General Reserve and Specific Reserve are created out of profits by debiting Profit and Loss Appropriation Account and not Profit & Loss Account.

Difference Between Revenue Reserve and Capital Reserve

S.No.	Basis	Revenue Reserve	Capital Reserve
1.	Creation or Source	These reserves are created out of revenue profits which arises out of normal operating activities of Business	These reserves are created out of capital profits which do not arise out of normal operating activities of Business.
2.	Use of Reserve or Usage	Specific reserves can be used only for earmarked or specfic purpose, while General Reserve may be used for any purpose including distribution of dividend to shareholders without any imposed condition.	These reserves cannot be used for distribution of dividends to the shareholders, however, some part may be used to distribute as dividend subject to fulfilment of certain conditions.
3.	Object	The purpose of creation of such reserves is to meet unforeseen losses and also for strengthening the financial position of the Business.	The purpose of creation of these reserve is to meet capital losses or may be used for purposes laid down by companies Act.

Secret Reserves :

The term 'Secret Reserves' is applied to reserve the existence of which does not appear on the face of the Balance Sheet. They are also called 'Hidden Reserve' or 'Internal Reserve'. Such a reserve is not disclosed on the Balance Sheet. It can be said that there is a surplus of assets over liabilities and that surplus is not disclosed by the Balance Sheet.

Under the provisiona of the companies Act, 1956, no company (other than a Banking Company or Insurance Company) is allowed to maintain secret reserves.

Creation of Secret Reserve :

Such reserves may be created in the following ways :

(1) Proving excessive depreciation on Fixed Assets.

(2) Undervaluing the Goodwill.

(3) Undervaluing Stock, Investments etc.

(4) Not accounting for appreciation in the value of fixed assets.

(5) Making excessive provision for bad and doubtful debts etc. or for any other expenses.

(6) Showing contingent liabilities as real liabilities.

(7) Overstating liabilities or inducting fictitious liabilities.

(8) Writing off excessive depreciation on fixed assets.

(9) Charging Capital expenditure to Profit & Loss Account (such as addition to fixed asset or overhauling charges of an old plant purchased).

Merits of Secret Reserve

(i) **Helpful in Recovering unforseen Losses** – The presence of such reserve will enable a business enterprise to absorb unforseen and unexpected losses without any difficulty.

(ii) **Financial Stability of the Business** – Creation of such reserve strengthen the financial position of a business enterprise without disclosing the fact to shareholders of the company or the public in general.

(iii) **Helpful in Maintaining Regularity of Dividends** – Secret Reserve help the enterprise in maintaining the uniform rate of dividend during adverse trading conditions or recession period.

(iv) **Avoidence of unwanted competition** – On account of secrecy of actual profitability of the Business enterprise, the entry for competitors in that particular Lines of Business is avoided.

Demerits of Secret Reserve :

(i) **Misuse by Management** – The management may take undue advantage by creating such reserve. Profits may be supressed to unable them to buy the shares of the company at a lower prise and then selling the same in the market at a higher rate on elimination of such reserves.

(ii) **Unfair to Shareholders** – Shareholders who wish to sell their shares may not receive the fair price of their shares on account of under statement of Profits.

(iii) **Untrue and unfair presentation of Financial Statements** – On account of understatment of Profits, Profit & Loss A/c fails to disclose true profits and the Balance Sheet fails to disclose a true and fair financial position of the business enterprise.

(iv) **Misdeeds of Management are Hidden** – Such reserves may be used by the management to cover their misdeed.

On account of aforesaid demerits, the creation of Secret Reserves is not allowed under the Companies Act, 1956 since it requires full disclosure of all material facts.

Sinking Fund :

It is a fund created with a specific objective which may be as under :

(1) To redeem or repay a long-term liability, for example debentures etc.

(2) To replace a wasting asset for example, a mine or a oil well.

(3) To replace an asset of depreciable nature.

(4) To renew a Lease.

Difference between Sinking Fund and a Reserve Fund :

(1) **Sinking Fund** is always created for a specific purpose; whereas **Reserve Fund** is usually built up as a measure of prudence to strength the financial position of the business.

(2) **Sinking Fund** is created to meet a known liability at a future date (almost definite); whereas **Reserve Fund** may be created for the purpose of equalising dividends or such other objectives.

Characteristic of Sinking Fund :

The principal features of this fund are as under :

(i) It is always specific and not general.

(ii) It is created by setting aside a certain sum every year (Annually).

(iii) Money set aside is invested in first class (gilt-edged) securities, which are easily saleable in the market. (iv) It is created for definite objective or purpose :

(a) to replace a worn-out and obsolete fixed or wasting asset;

(b) to repay a long-term liability.

Difference between a Sinking Fund created to Redeem a Liability or to Repay a Loan and a Sinking Fund to Replace a Wasting Asset :

A sinking fund is mainly created for two purposes :

(1) To redeem or repay the Long Term Liability.

(2) To replace a Wasting Asset.

Following are the points of difference between these two types of sinking funds :

(i) When a sinking fund is created for repaying a liability or a loan, the annual contribution is an appropriation of profit and thus is debited to profit and loss appropriation account. On the contrary annual contribution to sinking fund created to replace a wasting asset at the end of its useful life is in the nature of depreciation and is a charge against profit. Thus, it is debited to profit and loss account.

(ii) When a sinking fund is created for redemption of a liability, the sinking fund investments account and the liability or debentures or loan account is closed by paying off the loan or debentures out of sale proceeds of the investments; the balance of in Sinking Fund Account is transferred to General Reserve. In case of a Sinking Fund to replace a wasting asset, the old assets account is transferred to sinking fund account and it is thus closed. The new asset is purchased out of the sale proceeds of the sinking fund investments.

The following ledger accounts at the end of 5th years will illustrate the difference between :

(a) a Sinking fund to replace a Plant & Machinery valued Rs. 5,00,000 at the end of 5th year; and

(b) a Sinking fund to redeem (or repay) Debentures of Rs. 5,00,000 at the end of 5th year.

(a) Sinking Fund to replace Plant & Machinery :

Machine Account

Dr. Cr.

		Rs.			Rs.
5th year (beginning)	To Balance b/d	5,00,000	5th year (end)	By Sinking Fund Account – (Transfer)	5,00,000

Sinking Fund Account

Dr. Cr.

		Rs.			Rs.
5th year (end)	To Plant & Machinery A/c – (Transfer)	5,00,000	5th year (end)	By Balance b/d (Instalments debited to Profit and Loss A/c)	5,00,000

Sinking Fund Investment Account

Dr. Cr.

		Rs.			Rs.
5th year (beginning)	To Balance b/d	5,00,000	5th year (end)	By Bank – (Sale of investments)	5,00,000

New Machine Account

Dr. Cr.

		Rs.			Rs.
6th year (beginning)	To Bank	....	5th year (beginning)	By Balance c/d	....

(b) For Repayment of Liability :

Debentures Account

Dr. Cr.

		Rs.			Rs.
5th year (beginning)	To Bank (redemption)	10,00,000	5th year (beginning)	By Balance b/d	5,00,000

Sinking Fund Account

Dr. Cr.

		Rs.			Rs.
5th year (end)	To General Reserve (Transfer)	5,00,000	5th year (end)	By Balance b/d (instalment debited to Profit & Loss Appropriation A/c)	5,00,000

Sinking Fund Investment Account

Dr. Cr.

		Rs.			Rs.
5th year (end)	To Balance b/d	5,00,000	5th year (end)	By Bank (Sale)	5,00,000

Provisions

Meaning of Provision : According to Companies Act the term provision refers to any of the following amount :

(1) The amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets; or

(2) The amount retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy.

It should be clearly understood that if the amount of known liability can be determined with reasonable accuracy, it must be classified as an outright liability and not a provision. Also if any excess provision is made knowingly or intentionally, the amount in excess of the actual need will be treated as 'Reserve'.

Examples : Provisions are created for the fulfilment of various objectives :

(1) Provision for Depreciation, Repairs and Renewals of Assets.
(2) Provision for Taxation.
(3) Provision for Bad and Doubtful Debts.
(4) Provision for Discount on Debtors.
(5) Provision for Fluctuations in the value of Investments.

Characteristics or Features of Provisions :

(1) Provision is made to meet a known liability.
(2) The liability is known but the amount of such liability cannot be determined even with reasonable accuracy for example, contingencies or Bad debts provision etc.
(3) It is a charge against profits thus reduces the profits for the year in which, it is created.

Oject of Purpose of Provision :

(1) To Ascertain the true net profit of the business – In order to ascertain the true profit of a business it is necessary that all expenses pertaining to that year, whether paid or outstanding, must be debited to Profit and Loss account and a provision should also be made for expenses or liabilities the amount of which cannot be estimated with reasonable accuracy. For example, the provision should be made for doubtful debts, because the amount of such bad-debts cannot be estimated very accurately.

(2) To ascertain the true financial position of the business – The Balance Sheet will depict the true and fair view of the financial position of the business only if adequate provision is made for all the anticipated losses and expenses.

(3) To provide for known losses in the future – Funds will be required to meet the losses and liabilities that are likely to occur in the near future. As such, provisions are made to provide funds for meeting those losses such as provision for taxation, provision for repairs, provision for damages likely to arise from a pending suit and such others.

(4) For the equitable distribution of expenses – For example, if a machine is estimated to run for 10 years and the total amount of repairs expected to be incurred during its entire life span is Rs.

40,000, a 'provision for repairs a/c' will be created by debiting Rs. 4,000 to each year's Profit & Loss Account. Actual expenses of repairs incurred each year will be debited to this account. Hence, it will put equal burden on the Profit & Loss Account of each year in respect of expenses of repairs which will be very light in the earlier years but definitely heavy in the later years.

Difference between Reserve and Provision

	Basis of Difference	Reserve	Provision
1.	**Meaning**	It is created to meet an unknown liability.	It is created to meet a known liability.
2.	**Object or purpose**	The object of reserves is to strengthen the financial position of the business.	The object is to provide for depreciation, doubtful debts and other specific liabilities.
3.	**Necessity**	Creation of reserves is discretionary, it can be created only if adequate profits have been earned.	Creation of provision is a legal necessity, provisions have to be provided for even if there are no profits.
4.	**Creation**	It is created not by debiting to Profit & Loss Account but through Profit & Loss Appropriation Account. As such its creation does not reduce the net profit but reduces the divisible profit.	It is created by debiting to P&L A/c and its creation reduces the net profit. As such it is a charge against Profits.
5.	**Presentation in Balance Sheet**	It is shown on the liabilities side under the head 'Reserves and Surplus'.	It is either shown on the assets side by way of deduction from the asset for which it is created or as a separate item on the liabilities side.
6.	**Investment outside the business.**	Reserves may be invested outside the business.	Provisions are never invested outside the business.
7.	**Utilisation for dividends**	It can be utilised for distribution as dividends among shareholders	It cannot be utilised for distribution as dividends among shareholders.
8.	**Utilisation for other purposes.**	It is not created to provide for a specific loss and hence can be used for any purpose or contingency.	It is created to provide for a specific loss and hence can only be used for meeting that loss.

Test Questions

Very Short Questions & Answers : (Not exceeding 40 words)

Q.1. What are Reserves?

Ans : Reserves mean amount set aside out of Profits and other surpluses to meet future necessities or a reserve means the amount set aside out of Profits and other surpluses, which are not earmarked in any way to meet any particular liability known to exist, on the date of Balance Sheet.

Q.2. Give five examples of Reserves

Ans. : **Examples of Reserves :**

(i) General Reserve, (ii) Capital Reserve,

(iii) Dividend Equalisation Reserves (iv) Workmen's Compensation Fund,

(v) Debenture Redemption Reserve (vi) Investment Fluctuation Fund.

Q.3. What is meant by Provision?

Ans. : According to Companies Act, 1956, 'Provision' refers to any of the following amount – (i) The amount written off or retained by way of providing depreciation, renewals or diminution in the value of asset, or (ii) The amount retained by way of providing for any known liability.

Q.4. Give a few examples of Provision.

Ans. : **Examples of Provision :**

(i) Provision for Depreciation of Assets

(ii) Provision for Bad and Doubtful Debts

(iii) Provision for Discount on Debtors.

(iv) Provision for Repairs and Renewals

(v) Provision for Taxation.

Q.5. State two main features of Reserve

Ans. : **Features of Reserve :**

(i) Reserves are created voluntarily for strengthening the financial position of the Business.

(ii) Reserves are not created to meet any known liability or depreciation but for meeting an unknown liability or loss in future.

Q.6. What is meant by Specific Reserve ?

Ans. : Specific Reserve is a reserve which is created for some specific purpose and can be utilized only for that purpose e.g. Dividend Equalisation Reserve, Reserve for Replacement of Asset etc.

Q.7. What is meant by Capital Reserve ?

Ans. : The reserve created out of capital profits are known as capital reserve. Capital profits are also earned in a business from many sources apart from normal profits. Generally, these reserves are not available for distibuting Dividends to the share holders of a company.

Q.8. Give a few examples of Capital Profits

Ans. : **Examples of Capital Profits are :**

(i) Profit from sale of fixed assets

(ii) Profit on the revaluation of fixed assets and liabilities.

(iii) Securities Premium received on Issue of Shares and Debentures.

(iv) Profit on the purchase of a running business.

(v) Profit on redemption of debentures.

Q.9. What is meant by Secret Reserve?

Ans. : A secret reserve is one which is not disclosed by the Balance Sheet. These reserves are created by showing Profit at a figure much lower than that of the Actual profits or by showing the assets at a lower figure and liabilities at a higher figure.

Q.10. How are Secret Reserve Created ? Give at least five examples.

Ans. : **Creation of Secret Reserve :**

(i) Charging capital expenditure to Profit & Loss A/c

(ii) Under valuation of assets or by writing off excessive depreciation.

(iii) Showing an actual asset as contingent asset.

(iv) Over valuation of Liabilities.

(v) Showing contingent liability as an Actual Liability.

Q.11. What do you mean by Dividend Equalisation Reserve?

Ans. : Dividend Equalisation Reserve is created to maintain steady and uniform rate of dividend on shares issued by a company. In those years in which the profits are adequate, a part by the same is transferred to such reserve and is utilized to keep and maintain rate of dividend in those years in which the profits are inadequate.

Q.12. What is meant by Reserve for Replacement of an Asset ?

Ans. : The reserve for replacement of an asset is created to provide finances for the replacement of an asset at the end of its serviceable life. The amount of annual depreciation charged on assets is only capable of providing the original cost of the asset but replacement may require large sum of money due to inflationary trend of prices. As such, a reserve for replacement of asset is created.

Q13. What are the objectives of creating General Reserve ?

Ans. Objectives of creating General Reserve are :

(i) For meeting unforseen losses

(ii) For expansion of business with internal resources. It is called ploughing back of profits

(iii) For equalization of dividends over subsequent years.

(iv) For strengthening of financial position of Business.

Short Questions and Answers : (Not exceeding 80 words)

Q.1. Differentiate between reserve and provision

Ans. : **Difference between Reserve and Provision**

	Basis of Difference	Reserve	Provision
1.	**Meaning**	It is created to meet an unknown liability.	It is created to meet a known liability.
2.	**Object or purpose**	The object of reserves is to strengthen the financial position of the business.	The object is to provide for depreciation, doubtful debts and other specific liabilities.
3.	**Necessity**	Creation of reserves is discretionary, it can be created only if adequate profits have been earned.	Creation of provision is a legal necessity, provisions have to be provided for even if there are no profits.
4.	**Creation**	It is created not by debiting to Profit & Loss Account but through Profit & Loss Appropriation Account. As such its creation does not reduce the net profit but reduces the divisible profit.	It is created by debiting to P&L A/c and its creation reduces the net profit. As such it is a charge against Profits.
5.	**Presentation in Balance Sheet**	It is shown on the liabilities side under the head 'Reserves and Surplus'.	It is either shown on the assets side by way of deduction from the asset for which it is created or as a separate item on the liabilities side.
6.	**Investment outside the business.**	Reserves may be invested outside the business.	Provisions are never invested outside the business.
7.	**Utilisation for dividends**	It can be utilised for distribution as dividends among shareholders	It cannot be utilised for distribution as dividends among shareholders.
8.	**Utilisation for other purposes.**	It is not created to provide for a specific loss and hence can be used for any purpose or contingency.	It is created to provide for a specific loss and hence can only be used for meeting that loss.

Q2. State the meaning of provision and give few examples.

Ans. : Provision : According to Companies Act the term provision refers to any of the following amount :

(1) The amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets; or

(2) The amount retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy.

It should be clearly understood that if the amount of known liability can be determined with reasonable accuracy, it must be classified as an outright liability and not a provision. Also if any excess provision is made knowingly or intentionally, the amount in excess of actual need will be treated as 'Reserve'.

Examples : Provisions are created for the fulfillment of various objectives :

(1) Provision for Depreciation, Repairs and Renewals of Assets.

(2) Provision for Taxation.

(3) Provision for Bad and Doubtful Debts.

(4) Provision for Discount on Debtors.

(5) Provision for Fluctuations in the value of Investments.

Q3 Define Secret Reserve. How is it created ?

Ans. : Meaning of Secret Reserves :

The term 'Secret Reserves' is applied to reserve the existence of which does not appear on the face of the Balance Sheet. They are also called 'Hidden Reserve' or 'Internal Reserve'. Such a reserve is not disclosed on the Balance sheet. It can be said that there is a surplus of assets over liabilities and that surplus is not disclosed by the Balance Sheet.

Under the provision of the companies Act. 1956, no company (other than a Banking Company or Insurance Company) is not allowed to maintain secret reserves.

Creation of Secret Reserve :

Such reserve may be created in the following ways :

(1) Proving excessive depreciation on Fixed Assets.

(2) Undervaluing the Goodwill.

(3) Undervaluing Stock, Investments etc.

(4) Not accounting for appreciation in the value of fixed assets.

(5) Making excessive provision for bad and doubtful debts etc. or for any other expenses.

(6) Showing contingent liabilities as real liabilities.

(7) Overstating liabilities or inducting fictitions liabilities.

Q.4. What is mean by Sinking Fund ? State its characteristics.

Ans. : Meaning of Sinking Fund :

It is fund created with a specific objective which may be as under :

(1) To redeem or repay a long-term liabilities, for example debentures etc.

(2) To replace a wasting assets for example, a mine or a oil well.

(3) To replace a asset of depreciable nature.

(4) To renew a Lease.

Characteristic of Sinking Fund :

The principal features of this fund are as under :

(i) It is always specific and not general.

(ii) It is created by setting aside a certain sum every year (Annually).

(iii) Money set aside is invested in first class (gilt-edged) securities, which are easily saleable in the market.

(iv) It is created for definite objective of purpose.

(a) To replace a worn-out and obsolete fixed or wasting asset;

(b) To repay a long-term liability.

Q.5. Differentiate Between Sinking Fund to Redeem a liability or to Replace a Wasting Asset.

Ans. : Following are the point of difference between the two :

(i) When a sinking fund is created for repaying a liability or a loan, the annual contribution is an appropriation of profit and thus is debited to profit and loss appropriation account. On the contrary annual contribution to sinking fund created to replace a wasting asset at the end of its useful life is in the nature of depreciation and is a charge against profit. Thus, it is debited to profit and loss account.

(ii) When a sinking fund is created for redemption of a liability, the sinking fund investments account and the liability or debentures or loan account is closed by paying off the loan or debentures out of sale proceeds of the investments; the balance of in Sinking Fund Account is transferred to General Reserve. In case of a Sinking Fund to replace a wasting asset, the old assets account is transferred to sinking fund account and it is thus closed. The new asset is purchased out of the sale proceeds of the sinking fund investments.

(iii) The following ledger accounts are opened under the above two :

(a) For repayment of liability ?

(i) Sinking fund account (ii) Sinking fund investment account

(iii) Debentures or liabilities account

(b) For Replacement of an Asset

(i) Asset Account (ii) Sinking fund Account

(iii) Sinking fund Investment Account (iv) New Asset Account.

Q.6. Distinguish Between General Reserve and Specific Reserve

Ans. : Distinction between General Reserve and Specific Reserve :

(1) **General Reserve** is created for a general purpose of strengthening the financial position of a business; whereas a Specific Reserve is restricted to a specific purpose and is ordinarily not used for any other purpose.

(2) **General Reserve** is created out of divisible profits to provide for unexpected or unknown future losses or to strengthen the financial position of the business; whereas Specific Reserve is created to meet a further liability or loss such as Investment Fluctuation Reserve to provide for loss in fluctuation in value of long-term liability or replacement of a fixed assets.

Q.7. What is meant by General Reserve ? What are the objectives of its creation ?

Ans. : Meaning of General Reserve :

A general reserve is created by appropriation of profits. This reserve is created without any specific or particular purpose. The aim is to provide additional working capital or to strengthen the cash resources of the business, out of profits of the company, from profit and loss appropriation account. They may be utilized for meeting any unknown liability It is also known as 'Free Reserve'. General reserve is created only when sufficient profits are there in an enterprise.

Purpose of Objectives of Creation

(i) To strengthen the liquid resources of a business.

(ii) To make available additional working capital.

(iii) To meet any known liability, contingency or similar other commitment.

(iv) To equalise the rate of dividend in the years in which profits are inadequate (in the absence of dividend equalization reserve).

(v) To conceal actual profits in the years in which profits are excessive so as use them in future years for maintaning dividend rate when profits are inadequate.

(vi) To comply legal requirement. For example Debenture Redemption Reserve, Capital Redemption Reserve (under company's Act, 1956); Investment Allowance Reserve. Development Allowance Reserve, Foreign Project Allowance Reserve etc. [Under Tax Act. 1961].

Q.8. Differentiate Between Revenue Reserve and Capital Reserve ?

Ans. : Difference Between Revenue Reserve and Capital Reserve

Baas of difference	Revenue Reserve	Capital Reserve
1. Creation	These reserves are created out of revenue profits or normal profits.	These reserves are created out of capital profits which are not normal profits.

2. Object	The main objective of these reserves is to strengthen the financial position of the Business or to meet unforseen losses.	The main objective of creation of these reserves is to meet capital losses or for the purpose laid down in Companies Act.
3. Usage	These reserves may be used for earmarked or specific purpose and General Reserve may be used for any purpose even for distribution of dividends.	These reserves cannot be used for distribution as dividend among shareholders. However, some portion of it may be distributed subject to fulfilment of certain condition.

Essay Type or Long Answers Questions :

1. What is meant by Reservese ? What are its characteristics ? Explain different types of reserves. (See page nps. 11.1 and 11.2)
2. What do you understand by provisions. Explain their importance. (See page nps. 11.7)
3. Differentiate Between :
   (i) Reserves and Provisions (See page nps. 11.8)
   (ii) Revenue Reserves and capital reserves (See page nps. 11.3)
   (iii) General reserve and specific reserve (See page nps. 11.3)
4. State the meaning or Secret Reserve. How are such reserve created ? Give their merits and demerits. (See page nps. 11.4)
5. Distinguish between Sinking Fund to replace an Asset and Sinking Fund to repay the Liabilities. (See page nps. 11.5 and 11.6)