Q1. What is double entry system of book keeping? Enumerate its advantage and disadvantage. What is the difference between single entry system and double entry system?

MEANING AND DEFINITIONS OF DOUBLE ENTRY SYSTEM

According to Double Entry System every transactions has two aspects or there are two ways of looking at it. No transactions has only one aspect. For example, in the transaction `Goods Sold' Cash Account is the receiver and Goods Account is the giver. That is, for any transactions two aspects or two sides are required. Thus, in accounting every transactions effects two accounts, so, every single transaction is recorded in two accounts. This does not mean that every transaction is recorded twice but it means each side of a transaction is termed as an account. One side is called debit side or the account which is to be debited while the other is called credit side *i.e.,* the account to be credited. An account book has two sides. The left hand side is the debit side while the right hand side is the credit side. In any business transaction, one account is the receiver while another account is the giver. The receiver is debited and the giver is credited. This can be understood better by the following example :

Example : Received Rs. 500 from Rajeev. Now, here two accounts, Rajeev's Account and Cash Account are affected because Rajeev is the giver while Cash Account is the receiver. So Cash Account will be debited and Rajeev's Account credited. According to Double Entry System when we receive something it means someone is giving it, when something comes, in the business means it goes out of someone else's business. Similarly expense of a business is income for another.

Double Entry System has been defined by many scholars. Some important definitions are given below:

(i) "Every business transactions has two fold effect, and that it affects two accounts in .opposite directions and complete record has to be made of each such transaction, it would be necessary to debit one account and credit another account. It is this recording of the two fold effect of every transaction that has given rise to the term Double Entry'."

CHARACTERISTICS OF DOUBLE ENTRY SYSTEM

Main characteristics of double entry system are as follows:

I. **Dual Effect of Business Transactions:** Every single transaction under this system has two sides or two aspects. There is no such transaction which has only one aspect.

II. **Recording of Personal and Impersonal Aspects:** In this system both sides oraspects of a transaction are recorded whether the accounts are personal or impersonal in nature. Both aspects of a transaction could be personal or one aspect personal and the other impersonal or both aspects could be impersonal.

III. **It Follows Set Rules:** In this system set rules are followed to record both aspects of each transaction.

IV. **Recording in Reverse Side:** In this system every transaction is recorded in two opposite sides of two different accounts *i.e.,* on the debit side of one account and an the credit side of another.

V. **Checking the Accuracy by Preparing a Trial Balance:** In this system arithmetical accuracy can be checked by preparing Trial Balance as equal amounts are written in the debit and credit sides of accounts.

VI. **Preparation of Final Accounts:** In this system final accounts are prepared on the basis of Trial Balance. Final accounts include Trading and Profit and Loss Account to ascertain Gross or Net Profit/Loss and Balance Sheet to know about the financial position of the business.

MERITS OF DOUBLE ENTRY SYSTEM

Double Entry System is the latest, most scientific and the complete system in itself, therefore, it is being used all over the world. Following are its merits:

I. **Scientific System: There** are set rules and principles of Double Entry System. On the basis of which the entries are recorded in accounts books. This system known as scientific system because of the use of rules and principles.

II. **Complete Record of Transactions:**All the three forms of business dealings—personal, impersonal and nominal are recorded in this system. Hence, it is easy tr_ find out complete record of all the accounts.

III. **Knowledge about Different Accounts:** In this system, accounting is done for all types of accounts, so informations regarding any account can easily be obtained at any moment.

IV. **Knowledge of Financial Position:** In Double Entry System, financial: statements are prepared at the end of each year, which provide information about the financial position of the business. Since separate accounts are opened for assets and liabilities the financial position can easily by checked.

V. **Comparative Study:** Profit and Loss Account and other financial statement are prepared every year under this system, which can be easily compared with those of previous years and thus it could be learnt whether the business is progressing or not. This kind of comparative study helps check unnecessary and unproductive expenses.

VI. **Suitability:** This system is suitable for all kinds of business, whether small or big. That is why it is so popular all over the world.
VII. **Less Possibility of Fraud:** This system records both the aspects of every transaction. So, there is hardly any possibility of fraud or error. Still, if there is any mistake or error, the some can be detected easily.
VIII. **Flexible:** This system is flexible as every entrepreneur can keep books and accounts according to the size and requirement of the business.
IX. **Rectification of Errors:** In this system errors can be detected and rectified easily.
X. **Preparation of Personal and Impersonal Account:** Accounting is done **for** both Personal and Impersonal Accounts.
XI. **Capable of correcting this defects of Single Entry System:** This system removes the defects of Single Entry System. This is considered as complete system
XII. **Legal Approval:** This system follows accurate set of rules at all the time therefore, it is legally approved. According to company law, it is mandatory for all: the companies to adopt this system in their accounting works.

Thus, on the basis of the above mentioned merits it can be said that double entrysystem is the most scientific and the best system of accounting.

DEFECTS OR DEMERITS OF DOUBLE ENTRY SYSTEM

Double Entry System is a complete and scientific system because of this it has been adopted the world over. Still, some scholars have mentioned some defects of this systemwhich are as follows:

(i) This system is very expensive.
(ii) Specialised knowledge is required for using this system *i. e.,*qualified accountant&are required for accounting work in this system.
(iii) Errors related to principles are not detected easily.

PRINCIPLES OF DOUBLE ENTRY SYSTEM

Main principles of Double Entry System are as follows:

(i) There are two sides of every transaction, one is the receiver and the other is the giver.
(ii) Each transaction is recorded on the debit side of one account and on the credit side of another.
(iii) Only those transactions are recorded which have a monetary value or can be expressed in terms of money.
(iv) Another principle of double entry system is that all the transactions of a business are between the business and others and not between the proprietors and others.
(v) Each and every transaction is debited or credited on the basis of definite principles and rules. These rules are related to Personal, Real and Nominal Accounts which have been explained ahead under rules for debit and credit.

ERENCE BETWEEN INDIAN AND ENGLISH ACCOUNTING SYSTEM

Basis of Difference	*Indian Accounting System*	*English Accounting System*
1. Register and Book	In this system long books having strong unruled paper are used.	In this system hard bound Registers with ruled pages are used. In this column are made by drawing lines with ink.
2. Columns and Folds	The sheets are folded to make columns.	In this column are made by drawing lines with ink.

DIFFERENCE BETWEEN DOUBLE ENTRY SYSTEM AND SINGLE ENTRY SYSTEM

Basis of Difference	***DOUBLE ENTRY SYSTEM***	***SINGLE ENTRY SYSTEM***
1. Scientific	This system has definite principles and rules therefore is is a scientific system.	This is a unscientific system as there are no definite principles and rules.
2. Records	Both aspects of every transaction are recorded.	For some transactions both aspects are recorded and for some other transactions

		only one aspect and some transactions are completely omitted.
3. Opening of accounts	All the three typoes of accounts personal, real, nominal are opened in this rules	Only personal accounts are opened.
4. Accuracy	Arithmetical accuracy of accounts is checked through trial balance.	Trial balance is not prepared so arithmetical accuracy cannot be judged.
5. Profit and loss	Actual profit or loss is known through profit and loss account.	Position statement is prepared in this to know about the financial position.
6. Financial position	Balance sheet is prepared to know about the financial position.	Position statement is prepared in this to know about the financial position.
7. Adjustment entries	In this adjustment entries are passed	Not much importance is given to adjustment entries.
8. Legal acceptability	Books of accounts and financial statements have a legal status and are acceptance as proof or evidence in the court of law.	Books of accounts and financial statements do no9t have legal status and are not admitted as evidence in the court of law.
9. Suitability	This is useful for all kinds of business.	This is useful only for small firms and educational institutions.
10. Computation of tax	Tax can be computed accurately as the profit shares in the Balance Sheet is actual.	Tax cannot be computed accurately as the profit shares is not actual.

Q2. What do you mean by Imp rest system of petty cash book? What are its advantage? Give its specimen. Differentiate between cash book and cash account.

Ans. Imp rest system of petty cash book: This in fact is a system of maintaining petty cash book rather than a chief cashier to the petty cashier at the beginning of the months for daily expenses. This amount called imp rest amount. The petty cashier then pays for such expenses from that account and maintains record of such expenses in the petty cash book. After the end of each month or if the imp rest amount is totally consumed the petty cashier gets the petty cashbook checked by the chief cashier then reimburses the amount spent. Thus, the opening balance of petty cash remains the same every month. This system of maintaining petty cashbook is called Imp rest System of Petty cashbook. This is very scientific system and that is why it is widely used.

1. At the time of implementing this system a fixed amount is given in advance by the chief cashier to the petty cashier to meet the petty
2.

2. Imprest System of Petty Cash Book : This in fact is a system of maintaining petty cash book rather than a type of cash book. In this system a fixed sum is given in advance by the chief cashier to the petty cashier at the beginning of the months for daily expenses. This amount is called Imprest Amount. The petty cashier then pays for such expenses from that account and maintains record of such expenses in the petty cash book. After the end of each month or if the imprest amount is totally consumed the petty cashier gets the petty cash book checked by the chief cashier and the chief cashier then reimburses the amount spent. Thus, the opening balance of petty cash remains the same every month. This system of maintaining petty cash book is called Imprest System of Petty Cash Book. This is a very scientific system and that is why it is widely used.

Essentials of Good Imprest System :

(i) At the time of implementing this system a fixed amount is given in advance by the chief cashier to the petty cashier to meet the petty expenses of a fixed period.
(ii) This amount usually is sufficient for the petty expenses of that period.
(iii) Petty cash book is checked by the chief cashier at the end of the period.
(iv) The amount spent by the petty cashier is reimbursed by the chief cashier to make the balance equal to the initial opening balance.

3. Analytical Petty Cash Book : In lot of business houses expenses of similar nature are incurred again and again because of which lot of entries are made in the cash book. Such large number of entries make the task of posting a very difficult one. So, to avoid this an Analytical Petty Cash Book is maintained in place of the simple cash book. In this book, separate columns are made on the credit side of the book for expenses which are incurred again and again. Expenses vary from business to business according to their nature. For example, in an export house expenses on postage and telegram and stationery are incurred again and again. So, in petty cash books of export houses there will be separate columns for stationery and postage and telegram. Those expenses which are not so frequent in nature are shown in the miscellaneous expenses column. As all the major expenses of daily nature are shown in separate columns, it becomes easy to analyse them.

SPECIMEN OF ANALYTICAL PETTY CASH BOOK

Analytical Petty Cash Book

Dr. Cr.

Amt.	L. B. F.	Date	Particulars	V. N.	L. F.	Amt.	Postage & Telegram	Printing & Stationery	Travelling	Wages & Cartage	Sundry Exp.

Q3. What do u mean by subsidiary books? Explain purchase book and sales book with the help of their format.

A business does not have only cash transactions, it also has credit transactions which are not recorded in the cash book. For that reason, other special purpose subsidiary books are kept in a business for recording credit transactions. A businessman decides to keep only those subsidiary books which he considers necessary for his business. Some special purpose subsidiary books are as follows :

1. Purchases Book
2. Purchases Returns Book
3. Sales Book
4. Sales Returns Book
5. Bills Receivable Book
6. Bills Payable Book
7. Journal Proper

It is not necessary for every business to maintain all the above mentioned special purpose subsidiary books. A separate subsidiary book is maintained to record those transactions which are large in number. There is no need to maintain it if transactions are small in number. All such transactions are recorded in the main Journal. In this chapter, we shall study those special purpose subsidiary books which are associated with non-cash transactions.

1. PURCHASES BOOK OR PURCHASES JOURNAL

Meaning

Goods are purchased on cash and credit in a business. All cash purchases of goods are recorded in the cash book whereas all credit purchases of goods are recorded in the purchase book. 'Goods' here mean only those things in which the firm is dealing. For example, a business concern dealing in cloth purchases cloth, it will be treated as purchases of goods and it will be recorded in the Purchase Book. But if the same business concern purchases furniture, it will not be treated as purchase of good. In other words, only those credit purchases of goods in which business concern deals are recorded in the Purchase Book. Other credit purchases of goods are not recorded in it. Purchase Book is also known as 'Invoice Book', 'Purchases Journal' or 'Purchase Day Book'.

Following transactions are not recorded in the Purchase Book :

(i) **Cash Purchases** : Cash purchases are recorded in the cash book. Only credit purchases of goods are recorded in the purchase book.

(ii) **Purchases of commodities other than goods :** Only those credit purchases of goods in which the business concern deals are recorded in the purchase book. Purchases of commodities other than goods are not recorded in this book. For example, purchase of furniture, machinery, building, etc. purchase of all these things is recorded in the Journal Proper.

FORMAT OF PURCHASES BOOK

Purchases Book

Date	*Particulars*	*Invoice No.*	*L.F.*	*Detailed Amount*	*Total Amount*
Year (1)	(2)	(3)	(4)	(5)	(6)

3. SALES BOOK OR SALES JOURNAL

Meaning

Credit sales are recorded in the Sales Book whereas cash sales are recorded in the Cash Book. It should be kept in mind that only sale of goods is recorded in the Sales Book, not sale of assets. This book is also called Sales Day Book.

The following transactions are not recorded in this book :

(i) **Cash Sales** : Cash sales of a business are recorded in the Cash Book. They are not recorded in the Sales Book.

(ii) **Sale of Assets :** Only the credit sale of goods is recorded in this book. The sale of an asset of business is not recorded in it. Credit sale of an asset is recorded in Journal Proper.

BASIS OF RECORDING

At the time of sale, a businessman prepares two copies of sales invoice. He gives one copy to the customer and keeps other copy safely in a file. Entries in the sales book are recorded on the basis of the sales invoice.

Format of Sales Book

The ruling in the Sales Book is the same as for the Purchase Book and entries are also recorded in the same manner as in Purchase Book. The names of the customers are written in the Particulars column

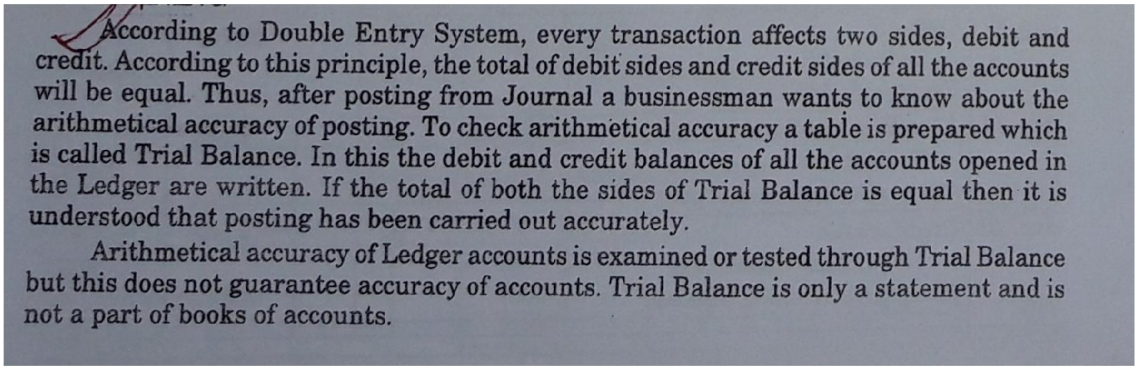
Columnar Sales Book : If Sales Book is prepared in a columnar format, the names of the customers are written in the particulars column whereas other details are written in the same manner as in the Columnar Purchases Book.

LEDGER POSTING FROM SALES BOOK

(i) **Posting to Personal Accounts** : 'To Sales A/c' is written on the debit side of the purchaser's account, the posting is done on the same day on which a credit transaction takes place.

(ii) **Posting to Sales Account** : Posting is done by writing 'By Sundries as per Sales Book' on the credit side of the Sales Account.

Q4. What do you understand by trial balance? Why is it prepared? Explain briefly the different methods of preparing the trial balance.



According to Double Entry System, every transaction affects two sides, debit and credit. According to this principle, the total of debit sides and credit sides of all the accounts will be equal. Thus, after posting from Journal a businessman wants to know about the arithmetical accuracy of posting. To check arithmetical accuracy a table is prepared which is called Trial Balance. In this the debit and credit balances of all the accounts opened in the Ledger are written. If the total of both the sides of Trial Balance is equal then it is understood that posting has been carried out accurately.

Arithmetical accuracy of Ledger accounts is examined or tested through Trial Balance but this does not guarantee accuracy of accounts. Trial Balance is only a statement and is not a part of books of accounts.

➠ DEFINITIONS OF TRIAL BALANCE

Various scholars have defined Trial Balance. Some definitions of Trial Balance are given below :

(i) In the words of ***Carter***, "Trial Balance is the list of debit and credit balances, taken out from Ledger. It also includes the balances of Cash and Bank account taken from Cash Book."

(ii) According to ***Spicer and Peglar***, "A Trial Balance is a list of all the balance standing on the Ledger Accounts and Cash Book of a concern at any given date."

(iii) According to ***J.R. Batliboi***, "Trial Balance is a statement prepared with the debit and credit balances of ledger accounts to verify the arithmetical accuracy of the books."

Thus, on the basis of above definition it can be said that Trial Balance is a list of debit and credit balances of all the ledger accounts and tallying of the totals of both its sides are proof of correct posting of each and every transactions as well as of their arithmetical accuracy.

➠ FEATURES OF TRIAL BALANCE

Main features of Trial Balance are as follows :

(i) Trial Balance is not a part of accounting process. This is prepared to ascertain arithmetical accuracy of Ledger accounts.

(ii) It is prepared on a particular date.

(iii) It contains balance of every account or the total of both the sides of each account,

(iv) Normally, it is prepared at the time of preparing final accounts or Financial Statements.

(v) This could also be prepared on monthly, quarterly or half-yearly basis. But, usually it is prepared at the end of the year.

(vi) The total of both its sides should be equal.

(vii) Tallying of totals of both its sides is proof of arithmetical accuracy.

➠ OBJECTIVE, FUNCTIONS OR NEED OF PREPARING TRIAL BALANCE

Though it is not necessary to prepare Trial Balance, yet, to fulfil following objectives it is prepared :

(i) **To ascertain the arithmetical accuracy of ledger accounts :** Main objective of preparing trial balance is to ascertain arithmetical accuracy of the ledger accounts. Tallying of the totals of both the sides of trial balance is a proof of arithmetical accuracy of ledger accounts.

(ii) **Helpful in detection of errors** : If the totals of both the sides of trial balance do not tally then it is an indication that there is some error in the ledger accounts. Thus, efforts are made to find such errors.

(iii) **Helpful in preparing final accounts** : Every businessman prepares final accounts *i.e.,* Profit and Loss Account and Balance Sheet. Final accounts can be prepared easily with the help of trial balance because trial balance is the summarized form of all ledger accounts.

(iv) **To obtain a summary of ledger accounts** : If the number of ledger accounts is large then it has to be opened again and again to know about balance of various accounts, but, if Trial Balance is prepared it saves time and provides immediate information as it is a summary of all ledger accounts.

➠ FORMAT OF TRIAL BALANCE

Following is the format of Trial Balance which is prepared either on a sheet of Journal or on a plain sheet of paper :

METHODS OF PREPARING TRIAL BALANCE

There are two main methods of preparing Trial Balance :

1. Total Amount Method/Gross Trial Balance,
2. Balance Method/Net Trial Balance.

1. Total Amount Method/Gross Trial Balance : Under this method, all the Ledger accounts are extracted in the Trial Balance with their two totals, debit and credit in two respective money columns. When the book-keeping is arithmetically correct the totals of the two columns must be equal. This method is used before the closing of Ledger Accounts.

2. Balance Method/Net Trial Balance : Under this method, the Ledger accounts are firstly balanced and then the Trial Balance is prepared by extracting merely the balances of Ledger accounts instead of their debit and credit totals. The debit balances are put in the debit money column and the credit balances in the credit money column of Trial Balance. It ignores accounts whose debit and credit totals are equal *i.e.,* accounts which have no balance. Thus, this method is more simple and scientific than the first method and hence, it is widely used. It also corresponds with the help 'Trial Balance'.

DIFFERENCE BETWEEN GROSS TRIAL BALANCE AND NET TRIAL BALANCE

S.No	*Gross Trial Balance*	*Net Trial Balance*
1.	A Gross Trial Balance is prepared with the debit and credit totals of the Ledger Accounts.	A Net Trial Balance is prepared with the balances of the Ledger Accounts instead of their debit and credit totals.

PREPARATION OF TRIAL BALANCE FROM GIVEN LEDGER BALANCE

On the debit side of Trial Balance only those accounts are shown which have a debit balance. Similarly, on the credit side only those accounts are shown which have a credit balance. Only those accounts are not shown in the Trial Balance which do not show any balance. Sometimes account balances are given in the question but it is not known whether the balances are debit balances or credit balances. To write such balances on the correct side of Trial Balance we must know about the nature of balance of different accounts. Nature of balance of various accounts is as follows :

(i) All assets have a debit balance. Such as, Furniture, Bills Receivable, Debtors, Cash, Goodwill, Prepaid Expenses, Accrued Income etc.

(ii) All liabilities have a credit balance. Such as, Bills Payable, Bank Overdraft, Creditors, Expenses, Unaccrued Income etc.

(iii) Capital Account has a credit balance while Drawings Account has a debit balance.

(iv) Purchases Account has a debit balance while Purchases Returns Account has a credit balance.

(v) Sales Account has a credit balance while Sales Returns Account has a debit balance.

(vi) All expenses and losses have a debit balance.

(vii) All incomes and gains have a credit balance.

OR

Q4. What are the mistake on account of which a trial balance does not agree? What step will you take to tally trial balance?

Ans

➠ MEANING

According to Double Entry System, every transaction affects two sides, debit and credit. According to this principle, the total of debit sides and credit sides of all the accounts will be equal. Thus, after posting from Journal a businessman wants to know about the arithmetical accuracy of posting. To check arithmetical accuracy a table is prepared which is called Trial Balance. In this the debit and credit balances of all the accounts opened in the Ledger are written. If the total of both the sides of Trial Balance is equal then it is understood that posting has been carried out accurately.

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Thus, on the basis of above definition it can be said that Trial Balance is a list of debit and credit balances of all the ledger accounts and tallying of the totals of both its sides are proof of correct posting of each and every transactions as well as of their arithmetical accuracy.

FEATURES OF TRIAL BALANCE

Main features of Trial Balance are as follows :

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(ii) It is prepared on a particular date.

(iii) It contains balance of every account or the total of both the sides of each account,

(iv) Normally, it is prepared at the time of preparing final accounts or Financial Statements.

(v) This could also be prepared on monthly, quarterly or half-yearly basis. But, usually it is prepared at the end of the year.

(vi) The total of both its sides should be equal.

(vii) Tallying of totals of both its sides is proof of arithmetical accuracy.

OBJECTIVE, FUNCTIONS OR NEED OF PREPARING TRIAL BALANCE

Though it is not necessary to prepare Trial Balance, yet, to fulfil following objectives it is prepared :

(i) **To ascertain the arithmetical accuracy of ledger accounts :** Main objective of preparing trial balance is to ascertain arithmetical accuracy of the ledger accounts. Tallying of the totals of both the sides of trial balance is a proof of arithmetical accuracy of ledger accounts.

(ii) **Helpful in detection of errors** : If the totals of both the sides of trial balance do not tally then it is an indication that there is some error in the ledger accounts. Thus, efforts are made to find such errors.

(iii) **Helpful in preparing final accounts** : Every businessman prepares final accounts *i.e.,* Profit and Loss Account and Balance Sheet. Final accounts can be prepared easily with the help of trial balance because trial balance is the summarized form of all ledger accounts.

(iv) **To obtain a summary of ledger accounts** : If the number of ledger accounts is large then it has to be opened again and again to know about balance of various accounts, but, if Trial Balance is prepared it saves time and provides immediate information as it is a summary of all ledger accounts.

FORMAT OF TRIAL BALANCE

Following is the format of Trial Balance which is prepared either on a sheet of Journal or on a plain sheet of paper :

IS TRIAL BALANCE A CONCLUSIVE PROOF OF THE ACCURACY OF ACCOUNTS ?

Trial Balance is very useful in checking the correctness or accuracy of posting. If the totals of two sides of Trial Balance tally then it is proved that the posting of two sides of accounts namely debit and credit is complete and there no arithmetical mistake. But the tallying of two sides of Trial Balance does not in any way guarantee accuracy of accounts. Lot of times it is seen that trial balances tallies but there are errors in account books. In fact, there are some errors which do not affect the tallying of Trial Balance. Such errors are not disclosed by Trial Balance. Thus, tallying of Trial Balance is not a conclusive proof of the accuracy of accounts.

ACCOUNTING ERRORS

Accounting errors can be studied under the following two heads :

(i) Errors not disclosed by Trial Balance.

(ii) Errors disclosed by Trial Balance.

ERRORS NOT DISCLOSED BY TRIAL BALANCE

The main objective of preparing Trial Balance is to check the arithmetical accuracy of ledger, but sometimes, some errors are left even though the two sides of Trial Balance tally. Such errors which are not disclosed by Trial Balance are as follows :

(1) **Errors of Omission** : If a transaction has not been entered in the Journal (by mistake) then this error would not affect the Trial Balance because it is neither recorded on the debit side nor on the credit side.

For Example : Purchased furniture for Rs. 500. This was not recorded in subsidiary book and hence no posting. Thus, there would not be any problem in tallying of Trial Balance, but, Furniture Account and Cash Account both are wrong.

(2) **Errors of Commission** : If the amount of any transaction written in the subsidiary book (Journal) is wrong then it won't have any effect on the Trial Balance because same amount will be written both sides.

For Example : Sold Goods to Ram for Rs. 520 but entered in books as Rs. 250. The Trial Balance will tally but Ram's Account and Sales Account both will be wrong.

(3) **Compensating Errors** : Sometimes two errors occur in such a way that each error rectifies or covers up the problem created by the other, such errors are called compensating errors.

For Example : Ram's Account was debited by Rs. 50 in place of Rs. 500. Similarly, Shyam's Account was debited by Rs. 500 instead of Rs. 50. Thus these errors would not have any effect on the Trial Balance but both Ram and Shyam's Accounts will be wrong.

(4) **Errors of Principle** : Sometimes there may be a violation of some basic principle of accounting. Such errors are called Errors of Principle. Such errors also do not effect the Trial Balance. These errors are as follows :

(a) **Capital Expenses recorded as Revenue Expenses : For Example :** Wages paid for installation of Machine recorded in Wages Account, Furniture purchased recorded in Purchases Account.

(b) **Revenue Expenses recorded as Capital Expenses : For Example :** Repairing charges of existing machine recorded in Machine Account.

(c) **Any Income recorded as Amount Payable : For Example :** On receiving rent amount crediting the account of the person who has paid rent.

(5) **Errors of Duplication** : Sometimes a transaction is recorded twice in the books. Such errors are called Errors of Duplication.

For Example : Salary paid to Ram Rs. 500, recorded in the Journal twice. In such a case posting will also be done twice, so there won't be any effect on the Trial Balance.

Thus, from the afore mentioned errors it can be concluded that tallying of Trial Balance is only a proof of arithmetical accuracy and not of accuracy of accounts.

➠ ERRORS DISCLOSED BY TRIAL BALANCE

Sometimes when the two sides of Trial Balance do not tally, it indicates that there is some mistake in the accounts. Such errors which have an effect on the Trial Balance or which affect the total of Trial Balance are as follows :

(1) **Wrong Casting of Subsidiary Books** : If the total of any subsidiary book is wrong, then, on posting that total in the ledger the balance of that account will also be wrong. In such a case the Trial Balance would not tally.

For Example : If Sales Book is undercast by Rs. 1,000, then the credit side of Sales Account will be posted *less* by Rs. 1,000 and the credit side of Trial Balance will also be posted *less* by Rs. 1,000. Thus, the two sides of Trial Balance won't tally.

(2) **Posting to the Wrong Side** : Sometimes posting is done on the wrong side of account. In such a situation the Trial Balance won't tally.

... transaction should be checked.

➠ SUSPENSE ACCOUNT

If the Trial Balance does not tally even after proper checking and preparation of final accounts is urgent then, a separate account is opened with the amount of difference called Suspense Account.

Later on as the errors are found out they are adjusted against this account. When all the errors are found the Suspense Account closes automatically.

Q5. What is depreciation? Discuss the features and causes of charging depreciation.

Every businessman uses assets for the proper conduct of his business operations. He earns profit with the help of these assets. Assets used in a business usually have a span of life which is more than a year. Fall in the value of such assets due to their constant use or obsolescence is termed as depreciation. In commonly the value of fixed assets also falls due to expiry of time, new inventions, change in the price and other causes.

DEFINITIONS OF DEPRECIATION

1. "Depreciation is the gradual and permanent decrease in the value of an asset from any cause." — *R. N. Carter*
2. "Depreciation may be defined as the permanent and continuing diminution in the quality, quantity or the value of asset." — *William Pickles*
3. "Depreciation is the measure of the exhaustion of the effective life of asset from any cause during a given period". — *Spice and Pegler*
4. "Depreciation is the diminution in the intrinsic value of the asset due to use and or lapses of time." —*I.C.M.A., London*

CHARACTERISTICS OF DEPRECIATION

1. Depreciation means decline in the value of an asset.
2. Depreciation is charged on assets of a fixed nature (except land).
3. Depreciation is a gradual and continuing process.

DIFFERENT METHODS OF DEPRECIATION

Various methods are used in business for providing depreciation. The amount of depreciation differs in each method. For that reason, the depreciation is ascertained according to the nature of the business, kinds of assets and business policies. The following are the methods of depreciation :

1. Fixed Instalment Method or Straight Line Method.
2. Diminishing Balance Method or Reducing Balance Method.
3. Annuity Method.
4. Depreciation Fund Method.
5. Insurance Policy Method.
6. Revaluation Method.
7. Depletion Method.
8. Machine Hour Rate Method.
9. Global Method.
10. Sum of Digits Method.
11. Kilometer Method.

Note : According to the Syllabus, only first two methods will be studied.

1. FIXED INSTALMENT METHOD OR STRAIGHT LINE METHOD

Under this method, the depreciation is charged at a fixed percentage on the original cost of the asset. Therefore, a fixed and uniform amount of the depreciation is deducted from the cost of an asset. It is calculated by deducting scrap value from the cost of the asset. Then the balance is divided by number of years of expected life.

$$\text{Amount of Depreciation} = \frac{\text{Cost of Asset} - \text{Scrap Value}}{\text{Expected Working Life of the Asset}}$$

4. Depreciation is a process of allocation of the cost of an asset to its effective span of life.
5. Depreciation reduces only the book value of an assets, not its market value.
6. The term depreciation is used only in respect of tangible fixed assets. The term is not used for wasting and intangible assets.
7. Depreciation is a non-cash expenses which does not involve any cash outflow.

CAUSES OF DEPRECIATION

Main causes of depreciation are as follows :

1. Constant Use : Due to the constant use of fixed assets wear and tear arise in them which results in the diminution in their values. For example, value of furniture, machinery, etc. reduces due to the constant use of them.

2. Expiry of Time : There are certain assets which have a definite span of life whether they are used or not used. In other words, the value of assets reduces with the passage of time. For example, a lease obtained for a term, patent, etc.

3. Obsolescence : Due to new inventions, new machines are installed in place of old ones. The value of old machines decreases when they become obsolete.

4. Accidents : The value of assets also decreases due to breakages or accidents happened to them.

5. Depletion : There are certain assets which have limited stocks which deplete due to the constant extraction of materials from them. This results in the reduction of their values. For example, mines, oil-wells, etc.

6. Permanent Fall in Market Price : Sometimes the permanent fall in the value of certain fixed assets is treated as depreciation. For example, permanent fall in the value of investment.

7. Change in Economic Environment : Sometimes the value of fixed assets falls due to changes in economic environment such as technical changes in an industry, changes in the habits of the customers, etc.

NEED AND OBJECTIVES OF PROVIDING DEPRECIATION

Depreciation is charged on the fixed assets of a business due to the following causes :

1. For ascertaining true Profit or Loss : The depreciation in the value of an asset is as much a business expenses as any other, such as salary, wages, etc. As all other business expenses are debited to the Profit and Loss Account for ascertaining the net profit or loss, the depreciation is also debited to it. If depreciation is not recorded in the Profit and Loss Account, net profit or loss cannot be ascertained.

2. Presentation of True Financial Position : If the depreciation is not charged, the fixed assets will be shown in the Balance Sheet at an amount which is in excess of their true values. In this situation, the Balance Sheet will not present the 'true and fair view' of the financial position of a business.

3. For Replacement of Assets : The provision of depreciation provides an amount for replacement of obsolete or useless assets. If the depreciation is not debited to the Profit and Loss Account, a large amount will be arranged or the replacement of fixed assets after the expiry of their estimated span of life. This will have an adverse effect on economic condition of the business.

4. To ascertain the Actual Production Cost : Fixed assets are used for manufacturing a business product. For that reason, it is highly imperative to include the amount of depreciation for ascertaining the actual production cost.

OR

Q5. What are the need and significance of depreciation? Describe the merits and demerits of any two method depreciation.

For example, if an asset is purchased for Rs. 10,000 and has a working life of 10 years and scrap value Rs. 10,000, the amount of depreciation will be :

$$\left[\frac{1,00,000-10,000}{10}\right] = \text{Rs. } 9,000$$

Merits of Fixed Instalment Method

(i) It is the most easy method for ascertaining the amount of depreciation,

(ii) Under this method, fixed assets can be depreciated up to the zero value or estimated scrap value,

(iii) It is not necessary to ascertain the amount of depreciation every year because it remains uniform from year to year.

(iv) There is the same impact on the Profit and Loss Account every year.

Demerits of Fixed Instalment Method

(i) Due to the constant use, work efficiency of assets decreases whereas the amount of depreciation is same every year.

(ii) Under this method, there is no arrangement of interest on capital invested in fixed assets.

(iii) It is very difficult to estimate the exact amount of scrap value.

(iv) Under this method, there is no arrangement for purchasing a new asset when the working life of the old asset is over.

(v) The value of assets becomes zero or equal to scrap value in this method, still the assets are used in the business operations.

2. DIMINISHING BALANCE METHOD

Diminishing Balance Method is also known as Reducing Balance Method or Written Down Value Method. Under this method, the amount of depreciation is charged at a fixed percentage on the book value of the asset at the beginning of the year. Thus the amount of depreciation goes on reducing year after year whereas the rate of percentage of depreciation remains the same. This method is need more for those assets whose value diminishes as they become old and useless with the passage of time. The expenses on repairs go on increasing on these assets. For example, if the value of a machine is Rs. 10,000 and depreciation is to be charged at 10% p.a. according to 'Written Down Value Method', the depreciation will be charged as under :

Year	*The Amount of Depreciation*	
First	10,000 × 10% = 100	10,000 – 1,000 = 9,000
Second	9,000 × 10% = 900	9,000 – 900 = 8,100
Third	8,100 × 10% = 810	8,100 – 810 = 7,290

Merits of Diminishing Balance Method

(i) In this method, the burden on Profit and Loss Account in respect of depreciation and repairs remain equal year after year. This is so because in the initial years the amount of depreciation is more in comparison to repair charges.

(ii) The calculation of the amount of depreciation is easy under this method. For that reason, it is not difficult to calculate the amount of depreciation for the expansion of assets.

(iii) The value of asset is never written off to zero in this method.

(iv) This method of providing depreciation on assets is permissible under Income-tax regulations.

Demerits of Diminishing Balance Method

(i) It is difficult to decide the proper rate of providing depreciation in this method.

(ii) Under this method, the calculation of interest on the amount invested in the assets is not considered.

(iii) Under this method, the value of an asset cannot be completely written off even if it becomes absolutely useless.

BETWEEN STRAIGHT LINE METHOD AND WRITTEN

Q6. What is hire purchase system? What are its characteristics? Give its merits and demerits. What is the difference between hire purchase system and installment purchase system?

Ans .

I. HIRE PURCHASE SYSTEM

➠ MEANING

Hire purchase is the system under which the property is acquired by the payments made in instalments. These instalments may be monthly, quarterly, half-yearly or yearly. Every hire purchase agreement shall state the number of instalments by which the hire purchase price is to be paid and each amount of each of those instalemnts. Under this system, the possession of the goods is transferred to the hire purchaser (as he is called), on signing the agreement but the hire purchaser does not become owner of the goods till he has paid the stipulated number of instalments. If the hire purchaser makes default in payment of any instalment, the hire vendor (seller) can take back the goods from the hire purchaser without requiring to refund the amount already received by him because the amount is considered to be the hire charges (rent) of the goods for the period for which the goods have already been with the hire purchaser. Therefore, this system is known as *Hire Purchase System,* Thus, seller is called as *Hire Vendor* and buyer as *Hire Purchaser.*

DEFINITIONS OF HIRE PURCHASE SYSTEM

According to ***J.R. Batliboi***, *"Under the Hire Purchase System, goods are delivered to a person, who agrees to pay the owners by equal periodical instalments, such instalments to be treated as hire of those goods, until a certain fixed amount has been paid, when these goods become the property of the hirer."*

According to ***Pickles***, *"Hire purchase is the system under which the property is acquired by payments made in instalments, during the period of which the title in the property remains with the hire vendor. The payments prior to the final are regarded as being purely in respect of hire and the title of the property does not pass to the hire purchaser until such final payment or some other consideration provided for in the contract has been fulfilled."*

CHARACTERISTICS OF HIRE PURCHASE SYSTEM

The following are the salient characteristics of hire purchase system :

1. Payment is made in Instalments : Under hire purchase system, purchaser pays the agreed amount in periodical instalment. These instalments may be monthly, quarterly, semi yearly, yearly or of any other period.

2. Right to Use the Goods by Buyer : At the time of agreement to sale is entered, goods are delivered to the buyer and he has a right to use these goods.

3. Seller remains the Owner of the Goods : Goods are delivered to the purchaser but the seller remains the owner of the goods upto the time of payment of the last instalment.

4. Default made in Payment of Instalment :

(i) **Right to Recover the Goods :** If default is made in payment of instalment to the seller, the seller can take possession of the goods subject to legal requirements because ownership is transferred after payment of the last instalment.

(ii) **Forfeiture of Instalments paid :** If the hire purchaser makes default in payment, the instalments already paid by hire purchaser are forfeited because the amount is considered to be the hire charges of the goods for the period for which the goods have already been with the hire purchaser.

(iii) **Right to Sue for Outstanding Instalment :** The seller can also sue for outstanding instalment. Outstanding instalment means those instalments which have been due upto the date of taking goods back.

5. Duty to take Reasonable care of Goods Delivered to Hire Purchaser : Hire purchaser becomes the owner of the goods on payment of the last instalment. He is just like bailee of the goods. It is the duty of the hire purchaser to keep the goods in good condition upto the date of payment of last instalment.

6. Better Title : If hire purchaser sells or mortgage the goods before payment of the last instalment, the new buyer or mortgagee does not get better title.

ADVANTAGES OF HIRE PURCHASE SYSTEM

The following are the main advantages of the hire purchase system :

(A) Advantages to Hire Purchaser

1. Use of Expensive Goods Possible : The hire purchase system enables people to fulfil their long-cherished dream of owning expensive items like TV, VCR, Car, etc.

2. Easy Payment : Under this method, price of goods is paid easily because payment of price is always made by instalments.

3. Encouragement to Savings : The price of the goods under this method is to be paid over a long period, the buyer will require to curtail his other expenses so as to pay the instalments. It encourages savings habits among them.

4. Facility of Free Repairs : If the goods are used carefully by the buyer, it is the responsibility of the owner to make normal repairs free of cost in 'those goods upto the date of payment of last instalment.

(B) Advantages to Seller

1. **Increase in Sales** : Even people who would not otherwise even dream of buying valuable goods are tempted to buy them because of the hire purchase facility. This results in a wider market for the goods and increase in sales.

2. **Recovery of Instalment Easily** : Under this method, if the purchaser makes default in payment, the hire vendor can take back the goods from buyer without requiring to refund the amount already received by him, so the buyer pays the instalment himself in time.

3. **Good relation between Buyer and Seller :** Due to regular transaction between buyer and seller, good relation is created between them and seller is enable to get the information in respect of goods. If there is any defect in goods, it may be removed.

4. **Possibility of Sales of other Goods** : When buyer comes for the payment of instalment, other goods may also be sold to them.

5. **Facility for getting Capital at Lower Rate** : The capital is available to the seller at lower rate because creditors are in confidence that amount of instalments can be recovered regularly from buyer.

(C) Advantages to Society ;

1. **More Production :** Under hire purchase, sales is Increased Consequently production, employment and income are also increased.

2. **Facilitate in Business** : Under hire purchase, the payments are made in instalments, in which less capital is needed in the business. So it enables to do business " easily.

3. **Increase in Standard of Living :** A person can use valuable goods, hence his standard of living is increased.

➠ DISADVANTAGES OF HIRE PURCHASE SYSTEM

The following are the main disadvantages of the hire purchase system :

(A) Disadvantages to Buyer :

1. **Costly** : For goods acquired on hire purchase basis, one has to pay much more than the actual price of such goods. This is because the hire purchase price also includes interest on the unpaid instalments.

2. **Risky for Hire Buyer** : It is true that in the event of non-payment of any instalment, the seller can take back the goods sold by him on hire purchase basis without requiring to refund the amount already paid by him.

3. **Promotion of Wasteful Competition** : As even expensive things can be had easily from hire purchase traders, people are tempted to live beyond their means. Often this encourages extravagance and wasteful competition among them.

4. **No Right to Sale or Mortgage the Goods** : Ownership is transferred after payment of the last instalment. If the buyer sells or mortgages the goods, the new party does not get better title.

(B) Disadvantages to Vendor

1. **Large Capital**: Hire purchase trading concerns have to arrange large capital to finance their business because sizable part of their capital is tied up in the form of bookdebts (Debtors).

Q7. Mention the entry in the books of buyer as well as the seller necessary when the goods are sold on hire purchase system and instalment payment system ?

Ans –

Books of Hire Purchaser

The system of maintaining accounting records for hire purchase transactions is different in each of the following circumstances :

1. When **goods of considerable value** are the subject-matter of sale, *e.g.*, car, truck, plant, machinery, etc.

2. When **goods of small value** are the subject-matter of sale, *e. g.*, radio, cycle, television sets, etc.

Accounting Entries for Goods of Considerable Value : There are two methods for making accounting entries of the hire purchase transactions in the books of the hire purchaser :

FIRST METHOD : Total Assets Value Method : Under this method, the transactions are recorded as ordinary sale and hence the Assets Account is debited and Hire Vendor's Account is credited for total cash price at the time of agreement.

SECOND METHOD : Assets Accrual Value Method : This method recognizes the fact that the hire purchaser does not become the owner of the assets till he makes the payment of the final instalment. In this method, the buyer debits Assets Account with the proportionate amount of each instalment becomes due.

For example, cash price of truck is Rs. 5,00,000. The buyer will pay five instalments of Rs. 1,00,000 each. According to first method, Truck Account will be debited by Rs. 5,00,000 at the time of agreement whereas, according to the second method, Truck Account will be debited by Rs. 1,00,000 of each year's instalment.

Note : On the basis 'Substance over form' the first method is more appropriate since the intention is to buy the assets. In the absence of information, the first method will be applied.

Entries in the Books of Buyer	Entries in the Books of Vendor
At the time of agreement : Asset A/c Dr. (Total Cash Value) Interest Suspense A/c Dr. (Total Interest) To Vendor A/c (H.P.P.) (For asset purchased on instalment system)	*At the time of agreement :* Purchaser's A/c Dr. (H.P.P.) To Sales A/c (Total Cash Price) To Interest Suspense A/c (Total Interest) (For goods sold on instalment system)
Down Payment : Vendor's A/c Dr. To Cash A/c (For amount paid on delivery)	*Down Receipt :* Cash A/c Dr. To Purchaser's A/c (For amount received on delivery)
At the end of each year : Interest A/c Dr. To Interest Suspense A/c (For interest due)	*At the end of each year :* Interest Suspense A/c Dr. To Interest A/c (For interest due)
Vendor's A/c Dr. To Cash A/c (For the payment of instalment)	Cash A/c Dr. To Purchaser's A/c (For the amount of instalment received)
Depreciation A/c Dr. To Asset A/c (For depreciation charged)	No Entry
P & L A/c Dr To Interest A/c To Depreciation A/c (For the transfer of the interest and depreciation to P & L A/c)	Interest A/c Dr. To P & L A/c (For the amount of interest transferred to P & L A/c)

Q 8. What is forfeiture of share ? How the share of a company are forfeited ? Explain with tha help of journal entries .

Ans -

If a shareholder does not pay the allotment money or any call money within 12 months, in such condition, the Directors of the company can forfeit those share, that is, the Directors have the right to strike off the names of such shareholders from Shareholder's or Member's Register and forfeit the amount received on these shares. Forfeited shares can be reissued to someone else. A specific legal procedure has to be followed to forfeit shares. It is necessary to follow the rules mentioned in company's Articles of Association regarding forfeiture of shares. If no such rules are mentioned then the rules of Table A of Companies Act are applicable.

In short, forfeiture of shares means to cancel their allotment and forfeit the amount received on them.

EFFECT OF FORFEITURE OF SHARES

The main effects of forfeiture of shares are following :

(i) Name of the shareholder is removed from member's register.

(ii) The amount received on the forfeited shares is also forfeited by the company.

(iii) The amount received on these shares is transferred to Share Forfeiture Account and is shown on the liabilities side of Balance Sheet.

(iv) Forfeited shares can be reissued and such issue could be at par, at premium or at discount.

(v) Forfeiture of shares can be done only after giving proper intimation to the shareholders and giving them enough time to pay the arrears.

PROCESS OF FORFEITURE

The rules related to forfeiture of shares are mentioned in company's Articles of Association. If no such rules are mentioned and the rules of Table A of Companies Act are also prohibited, then shares can not be forfeited. But, if the company has the right to forfeit shares, the process of forfeiture will be as follows.

1. Sending Memorandum : Those shareholders who are guilty of not paying due amounts on their shares are allowed a certain time period to pay the due amounts with interest. A memorandum is sent to this effect.

2. Preparing List of Unpaid Calls : After the due date for payment the Company Secretary makes a list of those shareholders who have not paid any amount. This list is presented in the meeting of Board of Directors.

3. Issuing Last Warning : A 14 day notice is sent by registered post to the shareholders who have not paid the amounts due as a last opportunity to pay the dues within 14 days of receipt of notice. It is also mentioned in the notice that their shares can be forfeited in case of non-payment.

4. Taking Action : If the shareholders fail to honour the last warning too, the company can start the process of forfeiture of shares but, before that another notice for payment has to be issued.

5. Passing of Resolution for Forfeiture : A resolution regarding forfeiture of shares is passed in Board of Directors meeting. Shares cannot be forfeited without passing a resolution.

6. Demand for Share Certificate : After passing a resolution, shareholders are informed that their shares have been forfeited, thus, they have to return their share certificates to the company.

7. Strike off Name from Shareholder's Register : Once the shares are forfeited, the names of holders of these shares are struck off from the shareholder's register.

8. Transfer of Amount : The amount received on forfeited shares is not returned to shareholders but transferred to Share Forfeiture Account.

9. Declaration in Writing : At the end, the company has to declare in writing about the shares which have been forfeited.

ACCOUNTING ENTRIES ON FORFEITURE OF SHARES

The entries passed at the time of forfeiture of shares depends upon whether the shares had been issued at par, at discount or at premium. When shares are forfeited, share capital decreases, thus, share capital should be debited with the amount that has been called on those shares whereas, the Share Forfeiture Account should be credited by the amount received (except premium) and calls-in-arrear should be credited separately.

OR

Q8. Can forfeited share be reissued at discount of yes to what extent ? Give Journal Entries regarding forfeiture and reissue of share ?

Ans.

(ii) When Forfeiture takes place after the Premium is Received

When forfeiture takes place after the premium is received then, Share Premium Account is not debited when entries of forfeiture are made. According to *Section* 78 of Companies Act, once the premium amount is received on the shares, the premium can not be written off while forfeiting those shares. Thus, the Journal entries for forfeiture of shares in this condition is similar to forfeiture of shares issued at par.

Share Capital A/c Dr.
To Share First Call A/c
To Share Final Call A/c
To Share Forfeiture A/c
(Being share forfeited for non-payment of calls)

Example

Roopa has 500 shares of Rs. 10 each, which were issued at a premium of Rs. 2 each. Amounts were payable as follows : Rs. 2 on application, Rs. 5 on allotment (including *premium*), Rs. 3 on first call and Rs. 2 on final call. Roopa paid only application and allotment money. After final call shares were forfeited. Give Journal entries.

Solution

Date	*Particulars*	*L.F.*	*Amount*	*Amount*
	Share Capital A/c (500 × Rs. 10) Dr.		5,000	
	To Share First Call A/c (500 × Rs. 3)			1,500
	To Share Final Call A/c (500 × Rs. 2)			1,000
	To Share Forfeiture A/c (500 × Rs. 5)			2,500
	(Application Rs. 2 + Rs. 3 on Allotment excluding premium)			
	(Being forfeiture of 500 shares for non-payment of calls)			

Note : In this example Roopa has paid the allotment money and hence she has ultimately paid the amount of premium. Therefore, no entry has been made for premium at the time of forfeiture of shares.

Q 9. Discuss the various types of debentures ? Discuss the meaning , nature and characteristics of debenture ? What is the difference between share and debenture ?

Ans.

MEANING OF DEBENTURE

A company can issue debentures also for long-term loans besides issue of shares, to arrange capital. Debentures are issued to receive loans from the public in the same way as shares. The amount received by issuing debentures is also called Debt Capital. Thus, a debenture is a certificate which is issued to creditors of a company as an acceptance of loan received from them. Common seal of the company is stamped on this document and all the conditions related to the loan are also mentioned on it. The conditions are related to return of principal amount, payment of interest and the debentureholder's charge on company's assets etc. Thus debenture is a written evidence of a loan received by a company as it is issued under the common seal of the company.

DEFINITIONS OF DEBENTURE

Some of the main definitions of Debenture are as follows :

1. "An instrument under seal evidencing a deed, the essence of it being the acceptance of indebtedness."
   —**Palmer**
2. "A debenture is a document given by a company as evidence of debt to the holder usually arising out of a loan and most commonly, secured by a charge." —**Topham**
3. "Debenture includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of the company or not."
   —**Indian Companies Act, 1956,** ***Sec.*** **2(12)**

In other words, **when a company takes loan from public, it gives a certificate of acceptance which is called a debenture.** The amount received from issue of debentures is called long-term debt capital. Debentureholders are creditors of the company.

They are regularly paid a fixed rate of interest on their debentures. The rate is written before debenture, for example, 10% Debentures. Paying of interests to debentureholders is given preference over the dividend of shareholders and at the time of winding-up of the company too their debts are cleared before paying anything to shareholders. But debentureholders cannot participate in the management of the company and have no right to vote.

FEATURES OF DEBENTURE

The main features of Debenture are as follows :

(i) Debenture is issued under the common seal of a company.
(ii) It is a certificate of loan taken by the company.
(iii) The period of repayment is mentioned in it.
(iv) Debentureholders are creditors of the company.
(v) Debentures can be issued at par, at premium or at discount.
(vi) Debentures cannot be forfeited.
(vii) Interest is paid at a predetermined rate on debentures.
(viii) Debentures often have a floating charge on the assets of company.
(ix) Interest on debentures is usually paid half-yearly at a fixed rate.
(x) The capital received from issue of debentures is called Debt Capital.
(xi) A company can purchase its own debentures.
(xii) Interest is paid on debentures irrespective of profit or loss of a company.
(xiii) Debentureholders do not have the right to vote.
(xiv) Debentures are long-term loans.
(xv) Debentures can also be issued for considerations other than cash.

TYPES OF DEBENTURES

Debentures are of different types on the basis of investment preferences. A company can issue following types of debentures :

1. FROM SECURITY POINT OF VIEW

(i) **Mortgage Debentures** : Mortgage Debentures are also called Secured Debentures. Mortgage debentures are those debentures whose holders have a particular asset or all the assets of the company pledged to them as security. If the company fails to pay interest and amount of debentures then the debentureholders have the right to sell the assets pledged as security and realise their payment. These debentures can be first or second debentures. First debentures have a preferential right on company's assets in comparison to other debentures.

(ii) **Unsecured or Naked Debentures** : Unsecured Debentures are the debentures which are not secured by any asset of a company, which means, these debentures do not have any asset as a security. The principal amount as well as the interest both are unsecured in such debentures.

2. FROM REDEMPTION POINT OF VIEW

There are two types of debentures from Redemption point of view :

(i) **Redeemable Debentures** : These are those debentures the amount of which is returned by the company at a pre-determined date.

(ii) **Irredeemable Debentures** : The amount of these debentures is not paid during the life-time of the company and is only paid at the time of winding-up of the company.

3. FROM CONVERTIBILITY POINT OF VIEW

(i) **Convertible Debentures** : The debentures which can be converted into shares or new debentures, after a particular period of time are called convertible Debentures. These can be of two types : (i) when only a part of the amount of debentures is convertible into shares or new debentures, such debentures are called Partly Convertible debentures, (ii) when the entire amount of debentures is convertible into shares or new debentures, such debentures are called Fully Convertible Debentures. These debentures are more popular presently as these debentures provide more liquidity, security and safe and reliable returns to the investors.

(ii) **Non-convertible Debentures** : The debentures which cannot be converted into shares or new debentures of a company are called non-convertible debentures.

4. FROM PREFERENCE POINT OF VIEW

Debentures can be of two types from prefernce point of view :

(i) **First Debentures** : The debentures which are paid (redeemed) before any other type of debentures are called first debentures.

(ii) **Second Debentures** : Those debentures which are paid (redeemed) after first debentures are called second debentures.

5. FROM RECORDS POINT OF VIEW

There are two types of debentures from records point of view :

(i) **Registered Debentures** : Registered Debentures are those debentures which can be transferred from one person to other person only through a transfer deed. The names and addresses of the debentureholders are recorded in the debentureholders' register and the principal amount and interest on these debentures are paid only to the holders whose names are in the register.

(ii) **Bearer Debentures** : The debentures which can be transferred simply by handing over to another person are called bearer debentures. There is no record of the holders of these debentures in company's register. Coupons are attached to these debentures for the payment of interest.

6. FROM COUPON RATE POINT OF VIEW

Debentures are of two types from coupon rate point of view :

(i) **Specific Coupon Rate Debentures** : These debentures are issued at a mentioned rate of interest which can be fixed or floating. Normally, floating rate is related to bank rate of interest. Usually, a company issues these type of debentures.

(ii) **Zero Coupon Debentures** : These debentures are not issued at any specific rate of interest. These are usually issued at sufficient discount. The difference between the face value and issued price of the debenture gives the total amount of interest which is related to the period of debentures.

7. COLLATERAL DEBENTURES

Collateral Debentures are the debentures which are issued to banks and financial institutions as collateral security besides the main security. If a company does not pay the loan amount and the amount of main security also decreases, then the lending institution can get its right as debentureholder.

ADVANTAGES OF DEBENTURES

Debentures have following advantages :

(i) **Availability of Funds** : When financial needs of a company are not completely met by issue of shares, then the company issues debentures to make up the deficiency, which solves the financial problem. The productivity of a company is adversely affected by financial problems and thus this serious problem is solved by issuing debentures.

(ii) **Managerial Freedom** : As explained earlier, debentureholders do not have the right to vote and thus they can not participate in the management of a company. As a matter of fact they are only creditors of the company and they do not interfere in the management of the company. Thus, the shareholders have managerial freedom.

(iii) **Fixed Rate of Interest (Income)** : Debenture is a debt for a company on which a fixed rate of interest is paid. This interest is payable under all conditions irrespective of profit or loss. It means the income of interest from debentures is certain.

(iv) **Return of Funds** : Since debentures are redeemable thus liabilities of a company decrease after payment of debentures. This means when the financial position of a company is weak debentures help stablize it. The payment of debentures is usually made, when the financial position is strong.

(v) **More Dividend to Shareholders** : A good company which generally pays high rate of interest to its debentureholders, also pays dividend to shareholders at high rate. The financial stability and profitability increase with debt capital which makes it possible for a company to pay high rate of interest on debentures, high rate of dividend to shareholders.

DIFFERENCE BETWEEN SHARE AND DEBENTURE

S. No.	Basis of Difference	Share	Debenture
1.	Nature	Share is ownership capital of a company.	Debenture is debt capital.
2.	Status	Shareholders are owners of a company.	Debentureholders are creditors of a company.
3.	Holder	The holders of shares are called share holders.	The holders of debentures are called debentureholders.
4.	Return	Shareholders are paid dividend on their investments.	Debentureholders are paid interest on their investments.
5.	Dividend/ Interest Rate	It keeps on changing.	It is fixed.
6.	Safety	Shareholders are not safe.	Debentureholders are safe.
7.	Payment	The payment of equity share is not made in company's life time.	Debentures are issued for a fixed period and thus their payment is made after the period.
8.	Discount	The issue of shares at discount has some restrictions according to *section* 79 of Companies Act.	There is no restriction on issue of debentures at discount.
9.	Voting Power	Shareholders have the right to vote.	Debentureholders do not have the right to vote.
10.	Participation in Manage-ment	Shareholders have the right to participate in management.	They do not have the right to participate in management.
11.	Priority	Their payment is made after debentureholders payment and other claims.	The payment is made before shareholders.
12.	Mortgage	There is nothing called mortgage share.	Mortgage debenture is a type of debenture.
13.	Elasticity	There is less elasticity in shares as there number are limited.	Debentures have more elasticity there numbers are not limited.
14.	Cost	The cost is usually more due to high rate of dividend.	The cost is less due to low rate of interest.
15.	Kinds.	These are usually of two types.	The debentures are of different types.
16.	Convertibility	Shares cannot be converted into debentures.	Debentures can be converted into shares.

BOND

Q 10 . What is the different method of issue of share and debenture ?

Ans.

ISSUE OF DEBENTURES

Debenture like share also has a face value. The issue of debentures is same as issue of shares. A company issues prospectus for the issue of debentures through which applications are invited from the public to puchase debentures. Then debentures are allotted and allotment money is asked. The balance amount is demanded through calls. A company can demand the amount in lump-sum, at the time of application. The applicants whose applications are not accepted fully *i.e.* they are not allotted as many debentures as they have applied for, their excess amount is either returned or adjusted with allotment or calls. Debentures like shares can also be issued at par, at premium or at discount.

The accounting entries for issue of debentures are divided into following three categories :

I. Issue for consideration in cash price.

II. Issue for consideration other than cash.

III. Issue as collateral security.

Q 11 . Write short notes :

1 . Trade discount and cash discount and its difference .

Ans .

TRADE DISCOUNT AND CASH DISCOUNT

There are two types of discount in business, trade discount and cash discount. Explanation of both the discounts is as follows :

1. Trade Discount : Trade discount is that which is given to the persons engaged in the same trade. This discount is allowed without any condition. It is given by producer or whole seller to the retailer on the List Price of the goods. No accounting treatment is made of trade discount because it is allowed both types of customers, cash customers and credit customers. This discount is deducted from the bill of the goods and accounting treatment is made of net amount.

2. Cash Discount : Cash discount is that which is given to the customers to receive payment from them as soon as possible. Cash discount is given with a object to encourage the customers to make prompt payment. This discount is calculated on net List Price (*i.e.* List Price—Trade discount). Account treatment of cash discount is necessary. When we receive discount, it is called discount received and when we allow discount to our customers, it is called discount allowed.

DIFFERENCE BETWEEN TRADE DISCOUNT AND CASH DISCOUNT

Following are the differences between Trade Discount and Cash Discount

S.No.	*Trade Discount*	*Cash Discount*
1.	T.D. is unconditional. The buyer is entitled to it or he is not.	C.D. is conditional. The buyer must do something to earn it *i.e.* settle the amount within the time allowed.
2.	T.D. is allowed by the manufacturer or wholeseller to the retailer.	C.D. is allowed by a creditor to his debtor.
3.	T.D. is a reduction in the catalogue price or invoice price of the goods bold.	C.D. is reduction is amount due from a debtor.
4.	T.D. is calculated at a fixed percentage on the catalogue price.	C.D. is calculated at a fixed percentage on the amount payable after deduction of T.D.
5.	T.D. helps to the retailer to make some profit even if he sells the goods at catalogue price.	C.D. encourages the debtor to make prompt payment.
6.	T.D. is allowed at the time of sale.	C.D. is allowed at the time of payment.
7.	T.D. does not appear in the books of accounts.	C.D. appears in the books of account either as gain or an expense.
8.	The object of T.D. is to increase sales volume.	The object of C.D. is to make the payment secured.
9.	The rate of T.D. differs from trade to trade and even on different articles of the same trade or on different quantities of the same article.	C.D. is offerred almost at the same rate in all the trade. However, it varies according to the duration of the period of credit.

2 . What is golden rule .

Ans .

RULES OF JOURNALISING

Every transaction has two aspects, *i.e.* debit and credit. The rules regarding debiting and crediting accounts of a particular transaction have been described in detail in previous chapters. The same rules are being described in simple form here. The rules for debiting and crediting accounts based on double entry system are as follows :

(i) **For Personal Accounts** : The person whom we give money or goods is debited. On the other hand, the person who gives us money or goods is credited.

[Dr. (Debit) the receiver; Cr. (Credit) the giver]

(ii) **For Real Accounts** : Money or thing that comes in a business concern is debited. On the other hand, money or thing that goes out from it is credited.

[Dr. (Debit) What comes in; Cr. (Credit) What goes out]

(iii) **For Nominal Accounts** : All expenses and losses of a business concern are debited. On the other hand, all incomes and gains of it are credited.

[Dr. (Debit) all expenses and losses; Cr. (Credit) all incomes and gains]

IMPORTANT POINTS TO BE CONSIDERED BEFORE RECORDING CORRECT ENTRIES IN THE JOURNAL

1. Which are the two accounts of a transaction to be recorded in the Journal.
2. Types of accounts.
3. Rules which will be applicable to debit and credit accounts.
4. To ascertain which account will be debited and which account will be credited in a particular transaction.

3 . Analytical petty cash book .

Ans .

PETTY CASH BOOK

Lot of small expenses of a daily nature are incurred in a business like cartage, stationery, refreshments, coolie charges, post and telegraph charges etc. All such expenses are paid in cash and if these expenses are recorded in the cash book then it will consume a lot of time and labour. So, to save all this, another cash book is maintained for such expenses of daily nature which is called Petty Cash Book.

TYPES OF PETTY CASH BOOK

Petty Cash Book normally is of three types :

1. Simple Petty Cash Book,
2. Imprest System of Petty Cash Book,
3. Analytical Petty Cash Book.

1. Simple Petty Cash Book : Its format is same as that of a simple cash book. On its debit side the opening petty cash balance and the amount received from chief cashier is recorded and expenses are recorded on the credit side. Its balance is calculated after fixed time intervals.

FORMAT OF SIMPLE PETTY CASH BOOK

Dr. **Simple Petty Cash Book** Cr.

Date	*Particulars*	*V.N.*	*L.F.*	*Amount*	*Date*	*Particulars*	*V.N.*	*L.F.*	*Amount*
				Rs.					Rs.

2. Imprest System of Petty Cash Book : This in fact is a system of maintaining petty cash book rather than a type of cash book. In this system a fixed sum is given in advance by the chief cashier to the petty cashier at the beginning of the months for daily expenses. This amount is called Imprest Amount. The petty cashier then pays for such expenses from that account and maintains record of such expenses in the petty cash book. After the end of each month or if the imprest amount is totally consumed the petty cashier gets the petty cash book checked by the chief cashier and the chief cashier then reimburses the amount spent. Thus, the opening balance of petty cash remains the same every month. This system of maintaining petty cash book is called Imprest System of Petty Cash Book. This is a very scientific system and that is why it is widely used.

Essentials of Good Imprest System :

(i) At the time of implementing this system a fixed amount is given in advance by the chief cashier to the petty cashier to meet the petty expenses of a fixed period.

(ii) This amount usually is sufficient for the petty expenses of that period.

(iii) Petty cash book is checked by the chief cashier at the end of the period.

(iv) The amount spent by the petty cashier is reimbursed by the chief cashier to make the balance equal to the initial opening balance.

3. Analytical Petty Cash Book : In lot of business houses expenses of similar nature are incurred again and again because of which lot of entries are made in the cash book. Such large number of entries make the task of posting a very difficult one. So, to avoid this an Analytical Petty Cash Book is maintained in place of the simple cash book. In this book, separate columns are made on the credit side of the book for expenses which are incurred again and again. Expenses vary from business to business according to their nature. For example, in an export house expenses on postage and telegram and stationery are incurred again and again. So, in petty cash books of export houses there will be separate columns for

4 . Cash book and its Type .

According to *Carter*, "Cash Book is that book of original entries in which receipts and payments in cash are recorded." So, cash book is a book of original entries which also functions as a ledger.

FEATURES OF CASH BOOK

Following are the main features of Cash Book :

(i) Only cash transactions are recorded in this book.

(ii) Cash receipts are recorded on the debit side of this book while cash payments are recorded on the credit side.

(iii) Cash book is also a ledger alongwith being a Journal.

(iv) Transactions with the Bank are also recorded in this book alongwith the cash transactions.

(v) Transactions are recorded datewise in this book.

IMPORTANCE OF CASH BOOK

Cash book is of equal importance to all sorts of organisations whether big or small. Every organisation wants to know about the position of cash like how much cash was at the beginning (usually of the accounting period), how much cash came into the business and how much went out of it during the period and what is the balance at the end. Cash being the most liquid asset needs to be kept under strict control and vigil as it could be embezzeled easily.

OBJECTIVES OF CASH BOOK

The main objective of cash book is to find out about the total cash receipts and payments for the given periods. The cash and bank balances are also verified through this. Apart from being a subsidiary book a cash book also functions as a ledger.

DIFFERENCE BETWEEN CASH BOOK AND CASH ACCOUNT

Cash transactions are recorded in both Cash Book as well as Cash Account and both provide information about cash balance, but still there are the following differences :

Cash Book	*Cash Account*
1. This is a subsidiary book.	This is a ledger account.
2. This ia a book of original entry in which cash transactions on recorded.	Posting is done from Journal.
3. After entering transactions in cash book, preparation of cash account is not necessary.	Preparation of Cash Account is necessary after journalising.
4. This is a subsidiary book as well as a main book.	This is only a main book.

are shown in the miscellaneous expenses column. As all the major expenses of daily nature are shown in separate columns, it becomes easy to analyse them.

SPECIMEN OF ANALYTICAL PETTY CASH BOOK

Dr. **Analytical Petty Cash Book** Cr.

Amt.	*L. B. F.*	*Date*	*Particulars*	*V. N.*	*L. F.*	*Amt.*	*Postage & Telegram*	*Printing & Stationery*	*Travelling*	*Wages & Cartage*	*Sundry Exp.*

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4.	This is a subsidiary book as well as a main book.	This is only a main book.

Cash Book is a Journal as well as a Ledger : Cash book is a Journal because all cash transactions are recorded in it with the help of vouchers at first. It is a ledger because after entering transactions into cash there is no need to open a separate Cash Account. Thus, it also serves the purpose of Cash Account. This is the reason why cash book is a Journal as well as a Ledger

TYPES OF CASH BOOK

u Any one of the following types of cash book is used according to the nature, size and requirement of the business :

(i) Single Column Cash book or Simple Cash Book

(ii) Double Column Cash Book