O. P. JINDAL SCHOOL, RAIGARH (CG) 496 001, INDIA

Phone: 07762-227042, 227293, (Extn. 227001 - 49801, 02, 04, 06, 09); Fax: 07762-262613; website: www.opjsrgh.in; e-mail: opjsraigarh@jspl.com

CLASS: XI- ACCOUNTANCY

Rectification of Errors

State True or False

(i) Error of principle arises because of an incorrect application of the principles of accounting, and failure to differentiate between capital and revenue expenditure.

(ii) Error of principle affect only one account.

(iii) Omission to record a transaction in the subsidiary book will affect two accounts.

(iv) Wages paid for installation of a machine has been debited to Wages Account. It is a compensating error.

(v) Casting errors are not reflected in the Trial Balance.

(vi) Purchase Day Book was overcast by Rs. 1,000. The rectification of this error will reduce gross profit by Rs. 1,000.

(vii) In taking out a Trial Balance, a book keeper finds that debit total exceeds credit total by Rs. 500. It means that the Suspense Account had a debit balance.

Multiple Choice

(i) A Suspense Account is:

(a) Not part of the double entry system (b) a ledger account
(b) Prepared before the Trial Balance (d) None of these

(ii) Wages paid to workers for extention of office building debited to Wages Account will affect:

(a) Gross profit (b) net profit
(b) A and B both (d) None of these

(iii) Error of principle arise because of:

(a) An incorrect application of accounting principles
(b) Failure to differentiate between capital and revenue items
(c) A and B both
(d) None of these

(iv) Which of the following errors is an error of omission?

(a) Purchase of Rs. 1,000 has been recorded in the sales return book.
(b) Repair to machinery has been debited to machinery account.
(c) The total of purchases day book has not been posted to the purchase account and total creditor account.
(d) Legal charges paid to Mr. Lawyer has been debited to his account.
(e) Rs. 500 received from Mr. X has been debited to his account.

(v) The purchases day book is overcast by Rs. 1,000. This will:

(a) Increase gross profit and decrease net profit
(b) Decrease gross profit and increase net profit
(c) Decrease gross profit as well as net profit
(d) Decrease only gross profit

(vi) In the books of accounts of a trader, the following errors have been detected for the financial year 2013-14:

(i) Depreciation- Rs. 11,000 over stated
(ii) Accrues Expenses- Rs. Rs. 7,000 understated

The impact of this on the reposted net profit for the year ending on 31st March 2014 is:

(a) Rs. 18,000 overstated (b) Rs. 11,000 overstated
(b) Rs. 7,000 understated (d) Rs. 4,000 understated

Q.3 You are presented with a Trial Balance of Saxena as on 30.06.2013, showing the credit is in excess by Rs. 415, which has been carried to Suspense Account. On close scrutiny of the books, the following errors are revealed:
(a) A cheque of Rs. 3,456 received from Shankar, after allowing him a discount of Rs. 46 was endorsed to Sharma in full settlement for Rs. 3,500. The cheque was finally dishonoured but no entries were passed in the books.
(b) Goods valued Rs. 230 returned by Swaminathan were entered in the Purchases Book and posted there from to Swaika's account for Rs. 320.
(c) Bill for Rs. 750 received from Sureka fro repair to machinery was entered in the Inward Invoice Book as Rs. 650.
(d) Goods worth Rs. 1,234 purchased from sharaf on 29.06.2013 had been entered in the Purchased Day Book and credited to him but were not delivered till 5th July 2013, stock being taken 30.06.2013. The title of the goods was, however, passed on 29.06.2013.
(e) Rs. 79 paid for freight on machinery was debited to Freight Account as Rs. 97.
You are required to pass the necessary journal entries for correcting the above errors.

Q.4 The difference in Trial Balance is kept in Suspense Account. Before preparing final accounts, the following errors were detected:
(a) Purchase of Rs. 540 was written in Sales Day Book, but was posted to the correct side of party's account.
(b) Salary Account total Rs. 12,600 on page 32 was carried over to the next page as Rs. 1,260 on the wrong side.
(c) Interest on overdraft Rs. 650 was not posted to the Ledger from the Cash Book.
(d) Rs. 600 collected from a party in respect of the old dues from him which had been written off as bad two years ago, was credited to the party's account.
Prepare Suspense Account also state to what extent the Profit and Loss Account would have been affected if the above errors had been detected and corrected.

Q.5 M/s Modern Chemicals were unable to agree the Trial Balance on 30/06/2013 and have raised a Suspense Account for the difference. Later, the following errors were discovered and rectified and the Suspense Account was closed:
(a) The addition of the 'Sundry Purchases' column in the tabular Purchases Journal was short by Rs 150 and other totals were in order.
(b) A bill of exchange (received from Gupta) for Rs 2,000 had been returned by the bank as dishonoured and had been credited to the bank and debited to Bills Receivable Account.
(c) Goods to the value of Rs 105 returned by a customer, Thomas, had been posted to the debit of Thomas and also to Sales Returns.
(d) Sundry items of furniture sold for Rs 3,000 had been entered in the Sales Day Book, the total of which had been posted to Sales Account.
(e) An amount of Rs 600 due from Z, a customer, had been omitted from the schedule of Sundry Debtors.
(f) Discount amounting to Rs 30 allowed to a customer, had been posted in his account, but not posted to Discount Account.
(g) Insurance premium of Rs 450 paid on June 30, 2012 for the year ended 31th June 2013 had not been brought forward.
You are required to: (i) Pass journal entries to rectify the above errors; and (ii) Draw up Suspense Account after rectifying the above mistakes and explain how the above errors affect the profits for the year ended 30th June 2013.

DEPRECIATION

Meaning: It is the process of allocating the cost of a fixed asset (less any residual value) over its estimated useful life in a rational and systematic manner.

It is the measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes.

Depreciable Assets are assets which

(i) are expected to be used during more than one accounting period; and

(ii) have a limited useful life; and

(iii) are held by an enterprise for use in the production or supply of goods and services, for rental to others, or for administrative purpose and not for the purpose of sale in the ordinary course of business.

Useful life is either (i) the period over which a depreciable asset is expected to be used by the enterprise; or (ii) the number of production or similar units expected to be obtained from the use of the asset by the enterprise.

Objects of providing for depreciation:

1. To find out the net profit or loss for an accounting period, we add the revenues of that period and deduct all the expenses incurred in that period in earning those revenues. One such expense is the portion of the cost of the fixed assets that has expired during the period (i.e. depreciation).
2. To present a true and fair view of the state of affairs of the business, the assets must be valued correctly on the Balance Sheet. Unless depreciation is charged, the assets may be overstated in the Balance Sheet. Hence, the value at which the fixed assets will be shown in the Balance Sheet is its original value less the amount charged as depreciation. This value is called written down value.
3. A continuous decline in the value of asset over several years may lead to a decision to replace the asset. If depreciation is not charged and profit available for distribution is not reduced, it is quite likely that the whole of the profits may be withdrawn during the life of the assets. In such a case, the business unit may not have sufficient funds left for depreciation.

Methods of calculating Depreciation:

There are several methods of allocating depreciation over the useful life of the assets. Those most commonly employed in industrial and commercial enterprises are the straight line method and reducing balance method. The management of the business select the most appropriate methods based on various important factors; types of assets, the nature of the use of such asset and circumstances prevailing in the business.

1. **Straight Line/Equal Installment/ Original Cost Method**: This is the most popular method because of its simplicity and consistency. It requires allocation of an equal amount to each period. A fixed amount of the original cost is charged as depreciation every year.

   Under this method depreciation is calculated as per the following formula:

   Annual Depreciation= Cost of Asset – Estimated Residual Value/ Estimated Economic life

   The rate of depreciation is the reciprocal of the estimated useful life.

   Rate of Depreciation= Annual Depreciation/ Cost of Asset- Estimated economic life.

   Advantages:

   1. It is simple to calculate and easy to understand
   2. It can reduce the book value of the asset to Zero
   3. The valuation of the asset each year in the Balance Sheet is reasonable fair.

   Disadvantages:

   1. This method ignores the fact that the service yielding ability of the assets fall while the repairs and maintenance costs increase with the passage of time. Though each year’s charge for depreciation is the same, the charge for repairs and renewals goes on increasing as the asset becomes older. Therefore, the charge to the Profit and Loss Account increases over the years.
   2. If an additional asset is acquired, the amount to be charged as depreciation needs to be recalculated.

   Diminishing Balance Method:

Where the straight line method assumes that the net cost of an asset should be allocated to successive periods in uniform amounts, the diminishing balance method assumes that the rate of allocation should be constant through time. Under this method, instead of a fixed amount, a fixed rate on the reduced balance of the asset is charged as depreciation every year. Though the percentage at which depreciation is charged remains fixed, the amount of depreciation goes on diminishing year after year. This method assumes that an asset should be depreciated more in the earlier years of use than later years because the maximum loss of an asset occurs in the early years of use.

The fixed percentage rate can be obtained by the following formula:

r= 1- $\sqrt[n]{\ s/c}$ (This formula cannot be applied if the asset has no or insignificant scrap value)

Where:

n= the expected useful life in years;

s= the scrap value;

c= the acquisition cost;

r=the rate of depreciation to be applied

Advantages:

1. As the decreasing charge for depreciation cancels out the increasing charges for repairs over the years, it gives a fair charge for depreciation.
2. No recalculation is necessary when additional assets are purchased.
3. This method is applicable for income tax purpose.
4. The impact of obsolescence can be reduced if a significant part of the cost is written off in early years.

Disadvantages:

1. This method lacks simplicity- the ascertainment of the percentage to be applied.
2. This method cannot be applied for assets with a very short life.
3. The asset is never depreciated.

Fill in the blanks:

1. The Furniture Account shows a closing balance of Rs 60,000. The fact that one-third of this value was bought and used only in the last quarter, the casual wear and tear calculated @ 15% p.a. and termed …………………. will be Rs ……………. for the given accounting year.
2. Given the Same rate percent assets depreciate faster by the …………………. compared to the ……………………
3. Two computers, each costing Rs 1,00,000 and each estimated to have a scrap value of Rs 10,000 and a life span of 10 years, will be depreciated in one accounting year by a total depreciation loss of Rs…………
4. Depreciation of assets is accounted to provide…………………… and ………………….
5. Depreciation for the second year @ 10% on Rs 15,000 purchase price will be…………… on the fixed instalment method where as it will be ………………… on the diminishing balance method.

State True or False

1. When writing back excess depreciation written off for one machine, it is incorrect to debit depreciation account and credit machinery account.
2. When Provision for Depreciation Account is maintained for providing depreciation, provision for Depreciation Account is debited and Depreciation Account is credited.
3. Depreciation arises because fall in the value of money.
4. The main objective of providing depreciation is to calculate true profit.
5. Providing depreciation ensures sufficient cash for replacement of asset.
6. Depreciation cannot be provided in case of loss, in a financial year.