# Allama iqbal open university AIOU solved assignment no 2 intermediate autumn 2024

# Code 311 Book keeping and accountancy

## Q.1. Mr. Afaq purchased machinery for Rs.2, 850, 000 and the depreciation rate is 8.50% p. a. You are required to prepare the machinery Account for 5 years using Diminishing Balance Method.

## Ans:

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**Machinery Account Using Diminishing Balance Method**

| Year | Opening Balance (Rs.) | Depreciation (Rs.) | Closing Balance (Rs.) |
|---|---|---|---|
| 1 | 2,850,000 | 242,250 | 2,607,750 |
| 2 | 2,607,750 | 221,659 | 2,386,091 |
| 3 | 2,386,091 | 202,818 | 2,183,273 |
| 4 | 2,183,273 | 185,578 | 1,997,695 |
| 5 | 1,997,695 | 169,804 | 1,827,891 |

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**Q.2. Define cheque and passbook and Explain importance for banking. (20)**

**Ans:**

### Cheque

**Definition:**
A cheque is a written document that instructs a bank to pay a specific amount of money from the account of the person issuing the cheque to a specified individual or entity.

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### Passbook

**Definition:**
A passbook is a booklet issued by a bank to its account holders. It serves as a record of all transactions made in the account, including deposits, withdrawals, and interest credited.

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### Importance of Cheque and Passbook for Banking

| Aspect | Importance of Cheque | Importance of Passbook |
|---|---|---|
| **Convenience** | Provides an easy way to make payments without carrying cash. | Helps in tracking all banking transactions in one place. |
| **Security** | Reduces the risk of theft as payments can be made directly to the payee. | Ensures that account details and transactions are secured. |

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| Aspect | Importance of Cheque | Importance of Passbook |
|---|---|---|
| **Proof of Payment** | Acts as a written proof of payment when signed and cleared by the bank. | Serves as evidence of account activity and balances. |
| **Transparency** | Promotes clear and formal financial dealings. | Offers clear records for reconciliation and dispute resolution. |
| **Recordkeeping** | Assists in maintaining proper financial records for businesses and individuals. | Useful for reviewing past transactions and financial planning. |
| **Legal Backup** | Can be used in court to verify payments. | Provides a valid record of bank transactions in case of disputes. |

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**Importance in Banking:**

1. **Cheque:**
   - **Convenience:** Cheques allow individuals and businesses to make large payments without needing to carry cash. They provide a formal and safe way of paying.
   - **Security:** Cheques reduce the risks associated with carrying cash and can be stopped or replaced if lost or stolen.
   - **Proof of Payment:** Once cleared by the bank, a cheque serves as a reliable proof of payment.
   - **Legal Evidence:** A cheque can be used in legal cases to prove payments or transactions.

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2. **Passbook:**
   - **Recordkeeping:** Passbooks provide a detailed and accurate record of all transactions made in an account, helping with financial management.
   - **Security and Tracking:** It helps individuals and businesses track their balance, withdrawals, deposits, and any interest earned, ensuring transparency in their financial dealings.
   - **Proof of Transactions:** The passbook serves as a valid source of information for reconciling accounts and resolving disputes with the bank.

**Q.3. Following is the trial balance of Zoha & Co. Prepare the trading and Profit and Loss A/C & Balance sheet for the year ending at 31, Dec 2023. (20)**

| Particular | Credit Rs. | Particular | Debit Rs. |
|---|---|---|---|
| Purchases return | 9,900 | Drawing | 60,500 |
| Sales | 7,50,000 | Debtors | 3,30,000 |
| Commission | 27,000 | Machinery | 3,80,500 |
| Capital | 8,23,740 | Building | 4,55,000 |
| Creditors | 1,40,000 | Cash | 6,300 |
| Loan | 4,20,000 | Wages | 54,590 |
| | | Rent | 2,24,000 |
| | | Sales return | 36,250 |

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| | | Purchases | 5,00,000 |
|---|---|---|---|
| | | Stock | 1,33,500 |
| **Total** | **21,70,640** | **Total** | **21,70,640** |

**Adjustments:**

i. Closing stock was valued Rs. 250,000.

ii. Outstanding insurances Rs. 9,000.

iii. Depreciation on building @10% p.a.

Ans:

**Trading and Profit & Loss Account for the Year Ended 31st December 2023**

**Step 1: Trading Account**

| **Particulars** | **Rs.** | **Particulars** | **Rs.** |
|---|---|---|---|
| **Opening Stock** | 1,33,500 | **Sales** | 7,50,000 |
| **Purchases** | 5,00,000 | Less: **Sales Return** | 36,250 |
| Less: **Purchase Return** | 9,900 | **Net Sales** | 7,13,750 |
| **Wages** | 54,590 | | |
| **Closing Stock** | 2,50,000 | | |
| **Gross Profit c/d** | 2,86,240 | | |
| **Total** | 7,13,750 | **Total** | 7,13,750 |

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**Step 2: Profit and Loss Account**

| Particulars | Rs. | Particulars | Rs. |
|---|---|---|---|
| **Gross Profit b/d** | 2,86,240 | **Rent** | 2,24,000 |
| **Depreciation on Building** | 45,500 | **Commission** | 27,000 |
| **Outstanding Insurance** | 9,000 | **Net Profit** | 1,15,740 |
| **Net Profit transferred to Capital** | 1,15,740 | | |
| **Total** | 2,86,240 | **Total** | 2,86,240 |

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**Step 3: Balance Sheet as at 31st December 2023**

| Liabilities | Rs. | Assets | Rs. |
|---|---|---|---|
| **Capital** | 8,23,740 | **Fixed Assets** | |
| Add: **Net Profit** | 1,15,740 | Machinery | 3,80,500 |
| **Adjusted Capital** | 9,39,480 | Building | 4,55,000 |
| **Loan** | 4,20,000 | **Current Assets** | |
| **Creditors** | 1,40,000 | Debtors | 3,30,000 |
| **Outstanding Insurance** | 9,000 | Stock | 2,50,000 |
| | | Cash | 6,300 |
| **Total** | 14,08,480 | **Total** | 14,08,480 |

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**Explanation:**

1. **Trading Account:**

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- The **gross profit** is calculated by subtracting the cost of goods sold from net sales.
- Closing stock is valued at Rs. 2,50,000 (adjustment).

2. **Profit and Loss Account:**
   - **Depreciation** on the building is calculated at 10% of Rs. 4,55,000 = Rs. 45,500.
   - **Outstanding insurance** of Rs. 9,000 is added as an expense.
   - **Net profit** is transferred to the capital account.
3. **Balance Sheet:**
   - Assets include machinery, building, debtors, stock, and cash.
   - Liabilities include the adjusted capital, loan, creditors, and outstanding insurance.

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This format should provide the full set of financial statements required for the year ending 31st December 2023.

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**Q.4. Explain the following terms: (20)**

**(i) Errors of Omission (ii) Errors of Principle**

**(iii) Errors of Original Record (iv) Compensating Errors**

**(v) Posting Errors**

**Ans:**

### (i) Errors of Omission

**Definition:**
Errors of omission occur when a transaction is completely omitted from the books of accounts. This means that the transaction is either not recorded at all or partially recorded, leading to incorrect financial records.

**Example:**
If a purchase of goods worth Rs. 10,000 is not recorded in the purchase journal, this would be an error of omission.

**Importance in Banking and Accounting:**

- **Impact:** The balance sheet and profit & loss statement will be incomplete, leading to incorrect financial reporting.
- **Correction:** The error can be corrected by recording the transaction in the appropriate account.

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### (ii) Errors of Principle

**Definition:**
Errors of principle occur when a transaction is recorded in the wrong account, contrary to accounting principles. This means that the nature of the transaction is misunderstood or improperly classified.

**Example:**
Recording a payment for office furniture as an expense instead of treating it as a capital expenditure is an error of principle.

**Importance in Banking and Accounting:**

- **Impact:** The error distorts the financial statements, affecting profit calculations and asset reporting.

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- **Correction:** The transaction should be correctly reclassified according to accounting principles (e.g., moving the payment from an expense to an asset account).

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### (iii) Errors of Original Record

**Definition:**
Errors of original record happen when an entry is recorded incorrectly in the first place, such as an error in the journal or ledger. These errors can include incorrect amounts or wrong accounts.

**Example:**
A sale of goods worth Rs. 5,000 is recorded as Rs. 50,000 in the books.

**Importance in Banking and Accounting:**

- **Impact:** The initial error leads to incorrect financial statements, especially in the trial balance.
- **Correction:** The error can be corrected by adjusting the original entry in the journal or ledger.

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### (iv) Compensating Errors

**Definition:**
Compensating errors occur when two or more errors cancel each other out, leading to no apparent effect on the final financial statement, even though individual errors exist.

**Example:**

- An error of overstatement of sales by Rs. 5,000 and an overstatement of expenses by Rs. 5,000 results in the net profit remaining unchanged.

**Importance in Banking and Accounting:**

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- **Impact:** Although the net effect on financial statements might seem correct, individual errors still exist, which could lead to misunderstandings.
- **Correction:** Each error should still be identified and corrected for accurate financial reporting.

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### (v) Posting Errors

**Definition:**
Posting errors occur when the amounts or entries are incorrectly transferred from the journal to the ledger. This can happen due to wrong amounts, wrong accounts, or both.

**Example:**
A payment of Rs. 2,000 made for rent is posted in the ledger under "office supplies" instead of "rent."

**Importance in Banking and Accounting:**

- **Impact:** Posting errors can cause discrepancies in the trial balance, and financial statements may not accurately reflect the true position of the business.
- **Correction:** The correct amounts should be posted to the right accounts in the ledger to fix the error.

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### Summary:

| Error Type | Definition | Example | Impact |
| --- | --- | --- | --- |
| **Errors of Omission** | Transactions omitted from records. | Failure to record a purchase. | Incomplete financial statements, |

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| Error Type | Definition | Example | Impact |
| --- | --- | --- | --- |
| | | | incorrect balances. |
| **Errors of Principle** | Transactions recorded in the wrong account due to misapplication of accounting principles. | Treating a capital expenditure as an expense. | Distorts financial statements, incorrect profit and asset reporting. |
| **Errors of Original Record** | Errors made during the initial recording of a transaction, such as incorrect amounts or wrong accounts. | Recording a sale of Rs. 5,000 as Rs. 50,000. | Incorrect journal or ledger entry, leading to incorrect trial balance and financial statements. |
| **Compensating Errors** | Two or more errors cancel each other out, resulting in no effect on final statements. | Overstating sales and expenses by the same amount. | Net effect on financial statements may be correct, but individual errors remain. |
| **Posting Errors** | Incorrect posting of amounts or entries from journal to ledger. | Posting a rent payment to the wrong account. | Causes discrepancies in the trial balance and incorrect financial reporting. |

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These errors can lead to inaccurate financial reporting, affecting decision-making, legal compliance, and overall business management. It's crucial to detect and correct these errors in a timely manner to ensure the accuracy and reliability of financial statements.

**Q.5. Define the following terms: (20)**

**(i) Bill Of Exchange (ii) Drawer**

**(iii) Drawee (iv) Payee**

**(v) Kinds of Bill of Exchange**

**Ans:**

**(i) Bill of Exchange**

**Definition:**
A Bill of Exchange is a written, unconditional order signed by the drawer, directing the drawee to pay a specified sum of money to the payee either on demand or at a predetermined future date. It is primarily used in international trade and credit transactions.

**Example:**
If a supplier (drawer) sells goods to a buyer (drawee), the supplier may issue a bill of exchange to the buyer, instructing them to pay a certain amount at a future date.

**Importance:**

- Serves as a legally binding document for payment.
- Used to secure payment in business transactions.

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**(ii) Drawer**

**Definition:**
The drawer is the person or entity who creates and signs the Bill of Exchange, ordering the drawee to make the payment. The drawer is the creditor in the transaction, and they have the right to receive payment.

**Example:**
In the example of a bill of exchange, if a supplier sells goods to a buyer, the supplier (who issues the bill) is the drawer.

**Importance:**

- The drawer has the right to claim the payment from the drawee upon maturity of the bill.
- Acts as the initiator of the payment request.

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**(iii) Drawee**

**Definition:**
The drawee is the person or entity who is directed to pay the specified amount in the Bill of Exchange. The drawee is typically the buyer or the party owing the money. Upon accepting the bill, the drawee agrees to pay the amount on the due date.

**Example:**
In the same transaction where a supplier issues a bill to a buyer, the buyer (the one who owes the money) is the drawee.

**Importance:**

- The drawee's acceptance of the bill signifies the acknowledgment of the debt.
- If the drawee refuses to pay, the bill can be dishonored.

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**(iv) Payee**

**Definition:**
The payee is the person or entity who is entitled to receive the payment specified in the Bill of Exchange. This person can be the drawer themselves or a third party designated by the drawer.

**Example:**
In the bill of exchange scenario, if the supplier specifies that the bill should be paid to a third party, that third party is the payee.

**Importance:**

- The payee receives the payment on behalf of the drawer.
- The payee must endorse the bill to transfer the right to payment if needed.

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**(v) Kinds of Bill of Exchange**

1. **Sight Bill of Exchange:**
   A sight bill is payable immediately upon presentation to the drawee. No credit period is involved.
   - **Example:** A supplier asks for immediate payment on the goods delivered.
2. **Time Bill of Exchange:**
   A time bill is payable at a specified future date or after a certain period, such as 30, 60, or 90 days from the date of acceptance.
   - **Example:** A buyer agrees to pay after 30 days for goods purchased.
3. **Accommodation Bill of Exchange:**
   This type of bill is drawn not for the purpose of making a trade transaction but as a form of financial assistance. It involves a

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party (usually the drawer) who agrees to accept a bill to help another party in need of credit.

- **Example:** A businessman asks a bank to draw a bill on his behalf to secure credit from another entity.

4. **Draft or Documentary Bill of Exchange:**
A documentary bill is used in international trade and is accompanied by shipping or title documents such as a bill of lading. The payment is made only when the documents are presented.
    - **Example:** A seller ships goods overseas and sends the bill of exchange along with the shipping documents to the buyer's bank.
5. **Clean Bill of Exchange:**
This is a bill of exchange that does not involve any shipping documents or goods as security. It is a simple promise to pay the stated amount at a future date without any collateral.
    - **Example:** A business owes money to another without any attached goods or shipping documents.

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**Summary Table**

| Term | Definition | Example | Importance |
|---|---|---|---|
| **Bill of Exchange** | A written order directing payment from one party to another, typically involving a buyer and seller. | Supplier to buyer, "pay Rs. 50,000 in 30 days." | Secures payment in business transactions, often used in international trade. |

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| Term | Definition | Example | Importance |
|---|---|---|---|
| **Drawer** | The person who creates and signs the Bill of Exchange, ordering the payment. | Supplier in the sale of goods. | Initiates the payment request and retains the right to claim payment. |
| **Drawee** | The person who is directed to pay the amount specified in the Bill of Exchange. | Buyer who owes the payment. | Must accept and pay the amount when due. |
| **Payee** | The person or entity who is entitled to receive the payment from the Bill of Exchange. | Supplier or a third party named by the drawer. | Receives the payment, which can be transferred if endorsed. |
| **Kinds of Bill of Exchange** | Various types of bills, such as sight bills, time bills, accommodation bills, documentary, and clean bills, each with specific terms of payment. | Sight Bill, Time Bill, Documentary Bill, Clean Bill, etc. | Provides flexibility for different payment terms and trade scenarios. |

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