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ALLAMA IQBAL OPEN UNIVERSITY, ISLAMABAD

Course: Principles of Accounting (438) • Level: ADC

Semester: Autumn 2026

Assignment No. 1 (Units 1–4)

Total Marks: 100 • Pass Marks: 50

SOLVED ASSIGNMENT GUIDE

(For Study & Reference)

Note: This guide is prepared for study and reference purposes. Students are advised to read the relevant units of the course book, understand the concepts, and write the assignment in their own words.

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Question 1: The Term 'Account' and the Classification of Accounts (20 Marks)

Define the term Account and describe the various classifications of Accounts in detail.

Introduction

Accounting is the language of business. Every business, whether it is a small sole-proprietorship shop or a large company, performs hundreds of transactions every month: it buys goods, sells goods, receives cash, pays rent, pays salaries, borrows money and repays loans. If these transactions were merely listed in a diary in the order in which they happened, the owner could never answer simple questions such as: How much cash do we have? How much do our customers owe us? How much have we spent on salaries this year? To answer such questions, accounting collects all the effects of transactions relating to one particular person, asset, expense or income at one single place. That place, or record, is called an account. Understanding what an account is, and how accounts are classified, is therefore the very first step in learning the principles of accounting, because every later stage — journal, ledger, trial balance and final accounts — is built upon accounts and upon their correct classification.

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Meaning and Definition of an Account

An account is a summarised record of all the transactions relating to a particular person, firm, asset, liability, expense or income, kept under one common head in the ledger, so that the net effect of all those transactions can be known at any time. In the words of a simple definition: an account is a record of financial transactions relating to a specific item, maintained in a systematic form in the ledger book. Every account has two sides: the left-hand side is called the debit side (Dr.) and the right-hand side is called the credit side (Cr.). The form of an account resembles the English letter 'T', which is why it is also called a T-account. The difference between the total of the debit side and the total of the credit side is called the balance of the account. If the debit total is greater, the account shows a debit balance; if the credit total is greater, it shows a credit balance; and if the two totals are equal, the account is said to be closed or squared up.

For example, all cash transactions of a business — cash received and cash paid — are recorded in one Cash Account. At the end of any day, the balance of the Cash Account tells the accountant exactly how much cash should be physically present in the cash box. Similarly, the account of a customer, say Mr Naeem, shows everything bought by him, everything returned by him and every payment made by him, and its balance shows the amount he still owes to the business. Without accounts, such ready information would be impossible, and neither profit could be calculated nor the financial position of the business could be judged. An account, therefore, is not merely a record; it is the basic unit of the whole accounting system and the foundation on which the double-entry system of book-keeping stands.

Why Classification of Accounts Is Necessary

A business may have hundreds or even thousands of accounts. These accounts are not all of the same nature. Some belong to persons, some to things or properties, some to expenses and some to incomes. The rules for debiting and crediting an account depend entirely upon the class to which that account belongs. If an accountant treats a machinery account as if it were an expense account, or a customer's account as if it were an income account, the books will become wrong and the trial balance and final accounts will be misleading. Classification therefore serves three purposes. First, it tells the accountant which rule of debit and credit to apply to a transaction. Second, it makes the ledger orderly, so that similar accounts can be found together. Third, it directly helps in preparing the final accounts, because real and personal accounts appear in the balance sheet, while nominal accounts appear in the trading and profit and loss account. Two systems of classification are commonly studied: the traditional or English classification, and the modern or American classification. Both are described in detail below.

Traditional Classification of Accounts

Under the traditional system, all accounts are divided into three main classes: (1) Personal Accounts, (2) Real Accounts, and (3) Nominal Accounts. This classification is based on the nature of the item to which the account relates, and each class has its own golden rule of debit and credit.

(1) Personal Accounts

Personal accounts are the accounts of persons, firms, companies and institutions with whom the business deals. The account of Mr Noman, the account of Miss Hareem, the account of Allied Bank Limited and the Capital Account of the proprietor are all personal accounts. The golden rule for personal accounts is: Debit the receiver, Credit the giver. When a person receives cash, goods or a benefit from the business, his account is debited; when a person gives something to the business, his account is credited. Personal accounts are further divided into three sub-classes. Natural personal accounts relate to human beings, such as the accounts of individual customers, suppliers and the owner. Artificial personal accounts relate to bodies created by law or by agreement, such as companies, banks, firms, clubs and government departments, which are treated as persons for accounting purposes. Representative personal accounts represent a person or a group of persons for a particular purpose; examples are Outstanding Salaries Account (representing the employees to whom salaries are payable), Prepaid Insurance Account (representing the insurance company from which a benefit is still to be received), and the Capital and Drawings accounts of the proprietor, which represent the owner himself.

(2) Real Accounts

Real accounts are the accounts of assets and properties owned by the business, whether they can be touched and seen or not. Cash Account, Building Account, Machinery Account, Furniture Account, Land Account and Stock (Inventory) Account are common examples. The golden rule for real accounts is: Debit what comes in, Credit what goes out. When an asset is purchased or

otherwise received by the business, its account is debited; when the same asset is sold, disposed of or goes out of the business, its account is credited. Real accounts are of two kinds. Tangible real accounts relate to assets which have physical existence and can be touched, seen and measured, such as cash, goods, furniture, machinery and buildings. Intangible real accounts relate to assets which have value but no physical form, such as goodwill, patents, copyrights and trademarks. Real accounts almost always show a debit balance, because a business cannot have 'gone out' more of an asset than it possessed, and their balances are carried forward from one accounting period to the next through the balance sheet.

(3) Nominal Accounts

Nominal accounts are the accounts of expenses, losses, incomes and gains. Rent Account, Salaries Account, Stationery Account, Utility Bills Account, Purchases Account, Sales Account, Discount Account, Commission Account and Interest Account are all nominal accounts. The golden rule for nominal accounts is: Debit all expenses and losses, Credit all incomes and gains. Nominal accounts are also called fictitious accounts because they do not represent any person or any asset; they exist only in name, to explain how profit has been earned or how a loss has occurred. Unlike personal and real accounts, nominal accounts are not carried forward to the next year. At the end of the accounting period they are closed by transfer to the trading account or the profit and loss account, and in this way they help in calculating the net profit or net loss of the business. Purchases, sales returns, wages and carriage inwards are transferred to the trading account, while office expenses, salaries, rent and similar items, together with incomes such as discount received and commission received, are transferred to the profit and loss account.

Modern (American) Classification of Accounts

Modern writers, especially in America, classify accounts into five classes according to the element of the financial statements to which they belong. This classification is closely connected with the accounting equation, Assets = Liabilities + Capital, and its rules are based on increase and decrease rather than on the older golden rules. The five classes are as follows. Asset accounts include cash, bank, debtors, stock, furniture, machinery and buildings; an increase in an asset is debited and a decrease is credited. Liability accounts include creditors, bills payable, loans and outstanding expenses; an increase in a liability is credited and a decrease is debited. Capital accounts include the owner's capital and drawings; capital increases with a credit and decreases with a debit, while drawings are debited. Revenue (income) accounts include sales, commission received, discount received and interest received; revenues are credited when they increase and debited when they decrease. Expense accounts include purchases, wages, salaries, rent and carriage; expenses are debited when they increase and credited when they decrease. Many teachers consider this classification easier for beginners, because the student only has to decide whether the item is an asset, a liability, capital, revenue or expense, and then apply the rule of increase and decrease shown in the table below.

Table 1: Modern classification of accounts and the rules of debit and credit

Class of Account	Examples	Rule: Increase	Rule: Decrease
Assets	Cash, Stock, Machinery, Debtors	Debit	Credit
Liabilities	Creditors, Loans, Outstanding Expenses	Credit	Debit
Capital	Owner's Capital (Drawings: opposite)	Credit	Debit

Revenue / Income	Sales, Commission Received, Interest Received	Credit	Debit
Expenses	Purchases, Rent, Salaries, Wages	Debit	Credit

The two classifications are not rivals; they describe the same accounts from two different angles. A Cash Account is a real account under the traditional system and an asset account under the modern system. A customer's account is a natural personal account traditionally, and an asset account (accounts receivable) in the modern system, because the customer owes money to the business. A supplier's account is a personal account traditionally and a liability account in modern terms. Rent is a nominal account traditionally and an expense account in the modern system. A student who understands both systems can classify any account correctly in whichever terminology an examination question uses, and can apply the correct debit and credit rule without hesitation.

Conclusion

To conclude, an account is a summarised record of all transactions relating to one person, asset, expense or income, maintained in the ledger with a debit side and a credit side, whose balance shows the net position of that item at any moment. Accounts are classified traditionally into personal accounts (ruled by 'debit the receiver, credit the giver'), real accounts (ruled by 'debit what comes in, credit what goes out') and nominal accounts (ruled by 'debit all expenses and losses, credit all incomes and gains'), and in the modern system into asset, liability, capital, revenue and expense accounts, ruled by the direction of increase and decrease. This classification is not an academic formality: it decides how every transaction is recorded, it keeps

the ledger orderly, and it separates balance-sheet accounts from profit-and-loss accounts at the end of the year. Mastering the classification of accounts is therefore the surest foundation for everything that follows in the study of accounting.

Question 2: Journal, Ledger and Trial Balance — Mr Noman's Business, December 2025 (20 Marks)

Mr Noman started a sole proprietorship business. Suppose you are the accountant of Mr Noman's business, and prepare the journal book for December 2025. You are also required to post journal entries into the ledger and prepare the trial balance. Transactions: Dec. 1 — Mr Noman commenced business with Cash Rs 5,200,000 and Building Rs 3,500,000; Dec. 3 — Purchased goods with cash Rs 400,000; Dec. 6 — Purchased furniture from Miss Hareem Rs 350,000; Dec. 9 — Sold goods to Mr M. Naeem Rs 120,000; Dec. 15 — Goods returned to Miss Hareem Rs 10,000; Dec. 18 — Stationery purchased Rs 10,000; Dec. 22 — Goods returned by Mr M. Naeem Rs 12,000; Dec. 26 — Utility bills paid Rs 70,000; Dec. 31 — Rent paid Rs 50,000.

Introduction

This question takes the student through the first three stages of the accounting cycle in one continuous exercise. The first stage is the journal, the book of original entry, in which every transaction is analysed into its debit and credit aspects and recorded in date order. The second stage is the ledger, in which each entry is posted to its own account so that all the transactions affecting one item are collected together and balanced. The third stage is the trial balance, a statement of the debit and credit balances of all ledger accounts on a given date, prepared to

test the arithmetical accuracy of the double-entry recording. Two working assumptions are applied exactly as the wording of the question indicates: the purchase of furniture on 6 December is a credit purchase from Miss Hareem, because no payment in cash is mentioned and a supplier is named; and the sale on 9 December is a credit sale to Mr M. Naeem for the same reason, so that the returns on 15 and 22 December are respectively a purchase return (goods returned by us to the supplier) and a sales return (goods returned to us by the customer). Stationery purchased on 18 December, for which no supplier is named, is treated as a cash purchase.

Step 1: Journal of Mr Nomani for December 2025

Each journal entry below shows the account to be debited, the account to be credited, the amounts in the debit and credit columns, and a short narration explaining the transaction. The opening entry is a compound entry, because the proprietor introduces two assets, cash and a building, against a single credit to his Capital Account of Rs 8,700,000 (Rs 5,200,000 + Rs 3,500,000). This entry establishes the accounting equation of the new business from its very first day: assets of Rs 8,700,000 are exactly equal to the owner's capital of Rs 8,700,000, there being no liabilities at the start.

Table 1: Journal (Book of Original Entry) — December 2025

Date (2025)	Particulars	Debit (Rs)	Credit (Rs)
Dec. 1	Cash Account Dr.; Building Account Dr. — To Capital Account (Business commenced with cash and building)	5,200,000; 3,500,000	8,700,000
Dec. 3	Purchases Account Dr. — To Cash Account (Goods purchased for	400,000	400,000

	cash)		
Dec. 6	Furniture Account Dr. — To Miss Hareem Account (Furniture purchased on credit from Miss Hareem)	350,000	350,000
Dec. 9	Mr M. Naeem Account Dr. — To Sales Account (Goods sold on credit to Mr M. Naeem)	120,000	120,000
Dec. 15	Miss Hareem Account Dr. — To Purchases Returns Account (Goods returned to Miss Hareem)	10,000	10,000
Dec. 18	Stationery Account Dr. — To Cash Account (Stationery purchased for cash)	10,000	10,000
Dec. 22	Sales Returns Account Dr. — To Mr M. Naeem Account (Goods returned by Mr M. Naeem)	12,000	12,000
Dec. 26	Utility Bills Account Dr. — To Cash Account (Utility bills paid for the month)	70,000	70,000
Dec. 31	Rent Account Dr. — To Cash Account (Rent paid for the month)	50,000	50,000

A study of the journal shows the double-entry principle operating in every transaction. When goods are bought for cash, the Purchases Account gains goods (a nominal account, debited because purchases are treated as an expense of trading) and the Cash Account loses cash (a real account, credited because an asset goes out). When furniture is bought on credit, the Furniture Account is debited because an asset comes in, and Miss Hareem is credited because she is the giver who has supplied the asset without yet receiving payment; she thereby

becomes a creditor of the business. The two returns work in the opposite direction to the original transactions: a purchase return reduces both what we owe the supplier and the net cost of our purchases, while a sales return reduces both what the customer owes us and the net value of our sales. Expenses such as stationery, utility bills and rent are nominal accounts and are therefore debited, with cash credited in each case because the payment is made in cash.

Step 2: Posting to the Ledger and Balancing the Accounts

Posting means transferring every debit and credit in the journal to the debit or credit side of the account named, cross-referenced by the journal folio. After posting, each account is balanced: the two sides are totalled, the smaller total is subtracted from the larger, and the difference is entered on the smaller side as 'Balance c/d' (carried down), so that both sides agree. The balanced ledger accounts for December 2025 are given below. The Cash Account is the most active account: it receives the opening capital of Rs 5,200,000 and pays out Rs 400,000 for purchases, Rs 10,000 for stationery, Rs 70,000 for utility bills and Rs 50,000 for rent — total payments of Rs 530,000 — leaving a debit balance of Rs 4,670,000, which is the cash in hand on 31 December 2025.

Table 2: Ledger accounts after posting and balancing — December 2025

Account	Debit Side (Rs)	Credit Side (Rs)	Balance (Rs)
Cash Account	Dec. 1 To Capital 5,200,000	Dec. 3 By Purchases 400,000; Dec. 18 By Stationery 10,000; Dec. 26 By Utility Bills 70,000; Dec. 31 By Rent 50,000	**Dr. 4,670,000**
Building Account	Dec. 1 To Capital 3,500,000	—	**Dr. 3,500,000**

Capital Account	—	Dec. 1 By Cash 5,200,000; By Building 3,500,000	**Cr. 8,700,000**
Purchases Account	Dec. 3 To Cash 400,000	—	**Dr. 400,000**
Furniture Account	Dec. 6 To Miss Hareem 350,000	—	**Dr. 350,000**
Miss Hareem Account	Dec. 15 To Purchases Returns 10,000	Dec. 6 By Furniture 350,000	**Cr. 340,000**
Mr M. Naeem Account	Dec. 9 To Sales 120,000	Dec. 22 By Sales Returns 12,000	**Dr. 108,000**
Sales Account	—	Dec. 9 By M. Naeem 120,000	**Cr. 120,000**
Purchases Returns Account	—	Dec. 15 By Miss Hareem 10,000	**Cr. 10,000**
Stationery Account	Dec. 18 To Cash 10,000	—	**Dr. 10,000**
Sales Returns Account	Dec. 22 To M. Naeem 12,000	—	**Dr. 12,000**
Utility Bills Account	Dec. 20 To Cash 70,000	—	**Dr. 70,000**
Rent Account	Dec. 31 To Cash 50,000	—	**Dr. 50,000**

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The balances of the personal accounts carry a clear commercial meaning which the student should always check for reasonableness. Miss Hareem supplied furniture worth Rs 350,000, but goods worth Rs 10,000 were returned to her, so the business owes her Rs 340,000 at the month-end — a credit balance, because she is a creditor. Mr M. Naeem bought goods worth Rs 120,000 and returned goods worth Rs 12,000, so he owes the business Rs 108,000 — a debit balance, because he is a debtor. The asset accounts (cash, building and furniture) show debit balances representing property owned by the business; the nominal accounts (purchases, stationery, sales returns, utility bills and rent on the debit side; sales and purchases returns on the credit side) are left open in the trial balance at this stage and will be closed to the trading

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and profit and loss account only when the final accounts are prepared at the end of the accounting period.

Step 3: Trial Balance as on 31 December 2025

The trial balance is prepared by listing every ledger balance once, debit balances in the debit column and credit balances in the credit column. If the journalising and posting have been done correctly, the two columns must agree, because every transaction has been recorded with equal debits and credits. The trial balance of Mr Noman's business is as follows, and it does agree at Rs 9,170,000 on both sides.

Table 3: Trial Balance as on 31 December 2025

Title of Account	Debit (Rs)	Credit (Rs)
Cash Account	4,670,000	
Building Account	3,500,000	
Purchases Account	400,000	
Furniture Account	350,000	
Mr M. Naeem Account (Debtor)	108,000	
Stationery Account	10,000	
Sales Returns Account	12,000	
Utility Bills Account	70,000	
Rent Account	50,000	
Capital Account		8,700,000
Miss Hareem Account (Creditor)		340,000
Sales Account		120,000
Purchases Returns Account		10,000
Total	**9,170,000**	**9,170,000**

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The agreement of the trial balance proves the arithmetical accuracy of the recording, though the student must remember that it does not prove the complete absence of errors: a transaction omitted altogether, an entry posted to the wrong personal account, or two compensating errors would still leave the trial balance in agreement. The trial balance also acts as a summary of the whole month's work and as the starting point for the final accounts: from it, the net purchases (Rs 400,000 − Rs 10,000 = Rs 390,000) and net sales (Rs 120,000 − Rs 12,000 = Rs 108,000) can be read at once, and the financial position can be summarised as assets of Rs 9,170,000 (cash Rs 4,670,000, building Rs 3,500,000, furniture Rs 350,000 and debtor Rs 108,000, together with the expense balances awaiting transfer) against the creditor of Rs 340,000 and the owner's capital of Rs 8,700,000.

Conclusion

To conclude, the nine transactions of December 2025 have been journalised with equal debits and credits, posted to thirteen ledger accounts, and summarised in a trial balance which agrees at Rs 9,170,000. The exercise demonstrates the complete first cycle of book-keeping: the journal preserves a chronological, explained record; the ledger classifies the same information under account heads and yields balances; and the trial balance tests the accuracy of both and prepares the ground for the trading account, profit and loss account and balance sheet. A student who performs these three steps carefully, and who checks the personal balances of Miss Hareem (Rs 340,000 payable) and Mr M. Naeem (Rs 108,000 receivable) against the underlying transactions, has mastered the practical core of double-entry book-keeping.

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Question 3: The Journal and Non-Trading Concerns (10 + 10 Marks)

(i) Define a journal and also explain in detail the objective and importance of a journal in the daily life of business. (ii) What is meant by non-trading concerns? Differentiate between the receipts and payments account and the income and expenditure account.

Part (i): The Journal — Definition, Objectives and Importance

The word 'journal' comes from the French word 'jour', meaning a day. A journal is the book of original (or prime) entry in which all business transactions are first recorded in chronological order, that is, in the order of the dates on which they occur, as soon as they take place. Every entry in the journal shows the date of the transaction, the account to be debited, the account to be credited, the amount, and a brief explanation called the narration. Because transactions are recorded in it day by day from source documents such as cash memos, invoices, receipts and cheque counterfoils, the journal is also called the day book. From the journal, entries are later posted to the ledger. Where a business has many transactions, the journal is sub-divided into special journals or subsidiary books — purchases journal, sales journal, cash book, purchases returns journal, sales returns journal and the journal proper for the remaining entries — but the general journal described here is the parent book from which all of them have developed.

The objectives of maintaining a journal flow directly from its position as the first record of every transaction. Its first objective is to provide a permanent and chronological record: nothing that happens in the business is allowed to pass unrecorded, and the sequence of events can be reconstructed on any later date. Its second objective is analysis: before an entry is written, the

accountant must decide which account is to be debited and which is to be credited, so the journal is where the double-entry analysis of each transaction is actually performed. Its third objective is explanation: the narration written below each entry records why the entry was passed, so that a reader years later can understand the transaction without hunting for outside evidence. Its fourth objective is to serve as the basis of posting: the ledger is written up from the journal, and the journal folio (J.F.) and ledger folio (L.F.) references create a two-way trail between the two books. Its fifth objective is the prevention and detection of errors and fraud: because entries follow one another in strict date order, an omitted or fabricated entry disturbs the sequence and is easier to trace than it would be in a classified record alone.

The importance of the journal in the daily life of a business is correspondingly great. First, it provides legal evidence: the journal, supported by vouchers, is accepted as evidence of transactions in disputes with customers, suppliers, tax authorities and courts, because it is written at the time the transaction occurs. Second, it prevents omission: a trader who relied on memory until the end of the month would certainly forget small cash expenses and minor receipts, whereas the daily journal habit captures them all. Third, it facilitates the division of work and internal check in a growing business: one clerk can maintain the journal while another posts the ledger, and the work of each checks the work of the other. Fourth, it makes information available in one place: before posting is complete, a manager can still consult the journal to find out what was sold, bought or paid on any particular day. Fifth, special entries which fit nowhere else — opening entries, closing entries, adjusting entries, rectification of errors and the purchase or sale of assets on credit — are all passed through the journal proper, so the book remains indispensable even in a computerised system, where the same logic

survives as the 'journal voucher' screen of accounting software. In short, the journal is the gate through which every transaction must pass before it enters the permanent classified record of the business, and the discipline of journalising is the discipline of accounting itself.

Part (ii): Non-Trading Concerns

Non-trading concerns are organisations which are established not for earning profit but for rendering service to their members or to society. Clubs, societies, schools, colleges, hospitals, charitable trusts, libraries, religious and welfare organisations and professional bodies are common examples. Their income comes mainly from subscriptions, donations, entrance fees, grants and life-membership fees rather than from the sale of goods, and any excess of income over expenditure is not called profit but surplus, just as an excess of expenditure over income is called a deficit. Such organisations are generally not legally bound to keep books on the full double-entry trading pattern, but they must still account honestly to their members and donors for the money entrusted to them. For this purpose they prepare two statements at the end of the year: a receipts and payments account, which is simply a summarised cash book, and an income and expenditure account, which is the non-trading equivalent of a profit and loss account and shows the surplus or deficit of the year. Together with a balance sheet, these statements present the financial position of the concern. The distinction between the two accounts is fundamental and is frequently examined, because confusing them leads to wrong results: the receipts and payments account can never show a surplus or deficit, and the income and expenditure account can never show a cash balance.

Table 1: Difference between the Receipts and Payments Account and the Income and Expenditure Account

Basis of Difference	Receipts and Payments Account	Income and Expenditure Account
Nature	A summarised cash (and bank) account; a real account in character	The equivalent of a profit and loss account; a nominal account in character
Purpose	To show total cash received and paid under each head during the period	To show the surplus or deficit earned/suffered during the period
Period covered	Includes receipts and payments of the past, current and future years, whenever cash actually moves	Includes only incomes and expenses belonging to the current year, whether received/paid or not
Capital and revenue items	Includes both capital and revenue receipts and payments (e.g. furniture purchased, life-membership fee)	Includes only revenue incomes and expenses; capital items are excluded and go to the balance sheet
Non-cash items	Excludes non-cash items such as depreciation and outstanding expenses	Includes non-cash items such as depreciation, outstanding and prepaid amounts, and arrears of income
Opening and closing balance	Opens with cash/bank balance b/d and closes with cash/bank balance c/d	Has no opening or closing cash balance; it ends with surplus or deficit transferred to the capital (accumulated) fund
Accrual basis	Prepared on cash basis only	Prepared on accrual basis, after all adjustments
Balance sheet link	Its closing balance appears in the balance sheet as the cash asset; the account itself needs no balance sheet	Must be accompanied by a balance sheet; its surplus/deficit is added to (or deducted from) the accumulated fund in the balance sheet

The practical method of converting the first account into the second should also be understood. Starting from the receipts and payments account, the accountant (a) removes all capital receipts and payments, such as life-membership fees, legacies, sale or purchase of fixed assets, and sends them to the balance sheet; (b) removes receipts and payments belonging to other years and adjusts for amounts outstanding and prepaid at both ends of the year, so that each income and expense is stated for the current year only (for example, subscription received is

increased by subscription in arrears and decreased by subscription received in advance); and (c) adds the non-cash charges of the year, principally depreciation on assets and provisions. What remains is the income and expenditure account, whose credit excess is the surplus and whose debit excess is the deficit for the year.

Conclusion

To conclude the two parts of this question: the journal is the book of original entry in which every transaction is analysed, explained and recorded in date order, serving the objectives of permanent record, correct debit–credit analysis, legal evidence and error control, and it remains the gateway of the whole accounting system in the daily life of every business. Non-trading concerns, which exist for service rather than profit, report their stewardship through a receipts and payments account — a cash summary covering all periods and both capital and revenue items — and an income and expenditure account — an accrual-based, current-year, revenue-only statement that measures surplus or deficit. Knowing exactly how these two statements differ is essential for solving the practical problems of clubs and societies, one of which is worked in full in Assignment No. 2 of this course.

Question 4: Machinery Account — Change of Depreciation Method (20 Marks)

Mr Abdullah purchased a second-hand machine on 1st January 2022 for Rs 1,427,000 and immediately spent Rs 122,000 on its repairs and Rs 11,000 on its erection. On 1st July 2023, he purchased another machine for Rs 510,000. Depreciation was provided for machinery @ 10%

p.a. on the original cost annually on 31st December. In 2023, the company changed the method of providing depreciation and adopted the written down value method, with a rate of depreciation being 5% p.a. Give the machinery account for four years commencing from the acquisition of the first machine. Compute to the nearest paisa. Note: change of method during the year from the straight line (original cost) method to the diminishing balance method.

Introduction

Depreciation is the systematic allocation of the cost of a fixed asset over its useful life. It represents the fall in the value of an asset caused by wear and tear, the passage of time, obsolescence and accidental damage, and it must be charged against the revenue of each year so that the profit of the year bears the cost of the asset's use and the balance sheet shows the asset at a realistic value. This problem combines four ideas that must each be handled correctly. First, the cost of a second-hand machine includes not only its purchase price but also the repairs necessary to bring it into working condition and the erection charges incurred to install it, because all expenditure incurred before the asset is put to use is capital expenditure. Second, depreciation for the first year is charged under the straight line (original cost) method at 10 per cent. Third, from the year 2023 the method is changed to the written down value (diminishing balance) method at 5 per cent, so the charge for 2023 and afterwards is calculated on the opening written down value of each machine, not on its original cost. Fourth, the second machine, bought on 1 July 2023, earns depreciation for only six months in 2023, because it was used for only half of that year.

Working Notes

Working Note 1 — Cost of the first machine: purchase price Rs 1,427,000 + repairs before use Rs 122,000 + erection charges Rs 11,000 = Rs 1,560,000. This is the capitalised cost on 1 January 2022. (Had the repairs been incurred later, during ordinary use, they would have been revenue expenditure; incurred immediately on a second-hand machine to make it workable, they are part of its cost.) Working Note 2 — Year 2022 (straight line method): depreciation = 10% of Rs 1,560,000 = Rs 156,000; written down value on 31 December 2022 = Rs 1,560,000 − Rs 156,000 = Rs 1,404,000. Working Note 3 — Year 2023 (written down value method at 5%): on the first machine, 5% of Rs 1,404,000 = Rs 70,200, leaving Rs 1,333,800; on the second machine, 5% of Rs 510,000 for six months = Rs 12,750, leaving Rs 497,250; total depreciation for 2023 = Rs 70,200 + Rs 12,750 = Rs 82,950, and the total written down value on 31 December 2023 = Rs 1,831,050. Working Note 4 — Year 2024: first machine 5% of Rs 1,333,800 = Rs 66,690 (balance Rs 1,267,110); second machine 5% of Rs 497,250 = Rs 24,862.50 (balance Rs 472,387.50); total depreciation Rs 91,552.50; total balance Rs 1,739,497.50. Working Note 5 — Year 2025: first machine 5% of Rs 1,267,110 = Rs 63,355.50 (balance Rs 1,203,754.50); second machine 5% of Rs 472,387.50 = Rs 23,619.38 (to the nearest paisa; exactly Rs 23,619.375) (balance Rs 448,768.12); total depreciation Rs 86,974.88; total closing balance on 31 December 2025 = Rs 1,652,522.62.

Table 1: Year-by-year depreciation working

Year	Method and Rate	Depreciation — Machine I (Rs)	Depreciation — Machine II (Rs)	Total Depreciation (Rs)	Closing W.D.V. (Rs)
2022	Straight line, 10% on cost Rs 1,560,000	156,000.00	—	156,000.00	1,404,000.00

2023	Written down value, 5% (Machine II: 6 months)	70,200.00	12,750.00	82,950.00	1,831,050.00
2024	Written down value, 5%	66,690.00	24,862.50	91,552.50	1,739,497.50
2025	Written down value, 5%	63,355.50	23,619.38	86,974.88	1,652,522.62

Machinery Account for the Four Years 2022–2025

The machinery account below presents both machines in one combined account, as required by the question. Each year the account is debited with the balance brought down (and, in 2023, with the cost of the second machine purchased on 1 July) and credited with the depreciation charged for the year and the balance carried down. The account balances in every year, which is the internal check on the arithmetic: for example, in 2023 the debit side totals Rs 1,404,000 + Rs 510,000 = Rs 1,914,000, and the credit side totals Rs 82,950 + Rs 1,831,050 = Rs 1,914,000.

Table 2: Machinery Account (Dr. / Cr.) — 1 January 2022 to 31 December 2025

Date	Particulars (Debit)	Amount (Rs)	Date	Particulars (Credit)	Amount (Rs)
1 Jan 2022	To Bank — Machine I purchased	1,427,000.00	31 Dec 2022	By Depreciation Account	156,000.00
1 Jan 2022	To Bank — Repairs (capitalised)	122,000.00	31 Dec 2022	By Balance c/d	1,404,000.00
1 Jan 2022	To Bank — Erection charges	11,000.00		**Total**	**1,560,000.00**
1 Jan 2023	To Balance b/d	1,404,000.00	31 Dec 2023	By Depreciation Account	82,950.00
1 Jul 2023	To Bank — Machine II	510,000.00	31 Dec 2023	By Balance c/d	1,831,050.00

	purchased				
	Total	**1,914,000.00**		**Total**	**1,914,000.00**
1 Jan 2024	To Balance b/d	1,831,050.00	31 Dec 2024	By Depreciation Account	91,552.50
			31 Dec 2024	By Balance c/d	1,739,497.50
	Total	**1,831,050.00**		**Total**	**1,831,050.00**
1 Jan 2025	To Balance b/d	1,739,497.50	31 Dec 2025	By Depreciation Account	86,974.88
			31 Dec 2025	By Balance c/d	1,652,522.62
	Total	**1,739,497.50**		**Total**	**1,739,497.50**
1 Jan 2026	To Balance b/d	1,652,522.62			

Three features of this account deserve comment. First, the change of method in 2023 is applied prospectively: the depreciation already charged for 2022 under the straight line method is left untouched, and the new written down value method is applied from 2023 onwards to the book value standing in the account. This is the treatment indicated by the note printed with the question — 'change method during the year from straight line to diminishing balance method' — and it is consistent with the accounting principle that a change in the method of depreciation is applied to the written down value from the year of change, with the fact of the change disclosed. Second, the depreciation charge falls every year under the diminishing balance method (Rs 82,950 in 2023 on the combined machines, Rs 91,552.50 in 2024 when the second machine bears a full year's charge, then Rs 86,974.88 in 2025), because the charge is always a fixed percentage of a shrinking balance; this is the essential contrast with the straight line method, under which the charge on the first machine would have remained a constant Rs 156,000 every year. Third, the repairs figure illustrates the capital–revenue distinction: Rs

122,000 spent immediately to make a second-hand machine serviceable is capitalised, whereas the same amount spent on routine repairs in, say, 2024 would be charged to the profit and loss account as revenue expenditure.

Conclusion

To conclude, the first machine's capitalised cost is Rs 1,560,000 (price Rs 1,427,000 + repairs Rs 122,000 + erection Rs 11,000). Depreciation of Rs 156,000 is charged for 2022 under the straight line method at 10 per cent on cost; from 2023 the written down value method at 5 per cent is applied, giving charges of Rs 82,950 (2023, including six months on the second machine), Rs 91,552.50 (2024) and Rs 86,974.88 (2025), all computed to the nearest paisa. The machinery account accordingly closes on 31 December 2025 with a written down value of Rs 1,652,522.62 — Rs 1,203,754.50 for the first machine and Rs 448,768.12 for the second — which is carried down as the opening balance of 2026. The account balances in each of the four years, confirming the arithmetic.

Question 5: Three-Column Cash Book — Mr Zubair, August 2025 (20 Marks)

Mr Zubair is running a sole proprietorship business. During August 2025, the following transactions were recorded. You are required to enter the transactions in the three-column cash book. August 2025: 2 — Cash in hand Rs 5,300,000; 2 — Cash at bank Rs 722,500; 3 — Paid salaries Rs 5,000; 5 — Purchased machinery Rs 135,000; 8 — Cash sales Rs 67,500; 12 — Received a cheque from Mr Farooq for Rs 154,000 in full settlement of his account of Rs

155,000, and deposited it into the bank; 15 — Payment to Mr Furqan, cash Rs 75,000 and a cheque for Rs 73,500; 17 — Cash purchases Rs 25,500; 20 — Electricity bill paid by bank Rs 15,000; 23 — Paid to Mr Kaleem by a cheque Rs 70,000; 30 — Cash drawn from the bank for office use Rs 10,000; 31 — Cash drawn from the bank for personal use Rs 7,500.

Introduction

The cash book is both a book of original entry and a part of the ledger: cash and bank transactions are recorded in it directly, and its balances serve as the Cash Account and Bank Account without any separate ledger accounts being needed. A three-column cash book is used when a business keeps both cash and a bank current account and also frequently allows and receives cash discount. Its three money columns on each side are: discount, cash and bank. The discount columns are not accounts in themselves; they are memorandum columns whose totals are posted at the end of the month — total discount allowed to the debit of the Discount Allowed Account, and total discount received to the credit of the Discount Received Account — while the individual items are also posted to the personal accounts concerned, so that each debtor or creditor is credited or debited with the full amount of his settled account. Entries which merely move value between the cash column and the bank column of the same book — depositing cash into the bank, or withdrawing cash from the bank for office use — are called contra entries; they are marked 'C' in the folio column and require no posting, because both aspects of the transaction are completed within the cash book itself.

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Working Notes and Treatment of Each Transaction

Before the book is written up, each transaction must be assigned to its correct column. The opening balances on 2 August are entered on the debit side as 'Balance b/d': cash Rs 5,300,000 and bank Rs 722,500. Salaries paid on 3 August (Rs 5,000) and the machinery purchased on 5 August (Rs 135,000) are cash payments, no bank payment being mentioned, and are entered in the cash column of the credit side. Cash sales of Rs 67,500 on 8 August increase cash and are entered in the cash column of the debit side. The cheque of Rs 154,000 received from Mr Farooq on 12 August is deposited into the bank the same day, so it is entered in the bank column of the debit side; but Farooq's account was Rs 155,000 and he has settled it in full for Rs 154,000, so the difference of Rs 1,000 is discount allowed to him and is recorded in the discount column of the debit side. The payment to Mr Furqan on 15 August is a mixed payment — Rs 75,000 in cash and Rs 73,500 by cheque — so both money columns of the credit side are used on the same line; no discount is recorded because the question gives no amount of Furqan's account against which a discount could be computed. Cash purchases of Rs 25,500 (17 August) go to the cash credit column, and the electricity bill paid by bank, Rs 15,000 (20 August), and the payment to Mr Kaleem by cheque, Rs 70,000 (23 August), go to the bank credit column. The withdrawal of Rs 10,000 on 30 August for office use is a contra entry: cash column debited, bank column credited. The withdrawal of Rs 7,500 on 31 August for the proprietor's personal use is not a contra entry, because the money leaves the business; it is drawings, credited in the bank column and posted to the debit of the Drawings Account. Students should note this deliberate contrast between the two withdrawals, which is the most commonly tested point in cash book questions.

Three-Column Cash Book for August 2025

Table 1: Three-Column Cash Book (Dr. / Cr.) — August 2025

Date	Particulars (Debit)	Disc. (Rs)	Cash (Rs)	Bank (Rs)	Date	Particulars (Credit)	Disc. (Rs)	Cash (Rs)	Bank (Rs)
Aug 2	Balance b/d	—	5,300,000	722,500	Aug 3	Salaries	—	5,000	—
Aug 8	Sales	—	67,500	—	Aug 5	Machinery	—	135,000	—
Aug 12	Mr Farooq	1,000	—	154,000	Aug 15	Mr Furqan	—	75,000	73,500
Aug 30	Bank (C)	—	10,000	—	Aug 17	Purchases	—	25,500	—
					Aug 20	Electricity Bill	—	—	15,000
					Aug 23	Mr Kaleem	—	—	70,000
					Aug 30	Cash (C)	—	—	10,000
					Aug 31	Drawings	—	—	7,500
					Aug 31	Balance c/d	—	5,137,000	700,500
	Total	**1,000**	**5,377,500**	**876,500**		**Total**	**—**	**5,377,500**	**876,500**
Sep 1	Balance b/d	—	5,137,000	700,500					

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The balancing of the book can be verified column by column. Cash receipts total Rs 5,300,000 + Rs 67,500 + Rs 10,000 = Rs 5,377,500; cash payments total Rs 5,000 + Rs 135,000 + Rs 75,000 + Rs 25,500 = Rs 240,500; hence the cash balance carried down is Rs 5,377,500 − Rs 240,500 = Rs 5,137,000. Bank receipts total Rs 722,500 + Rs 154,000 = Rs 876,500; bank payments total Rs 73,500 + Rs 15,000 + Rs 70,000 + Rs 10,000 + Rs 7,500 = Rs 176,000; hence the bank balance carried down is Rs 876,500 − Rs 176,000 = Rs 700,500. The discount columns are simply totalled, not balanced: discount allowed for the month is Rs 1,000 and discount received is nil. Both balances are brought down on 1 September as the opening cash in hand and cash at bank. Two practical checks follow from the balanced book: the cash balance of Rs 5,137,000 must

agree with the physical cash actually counted in the cash box, and the bank balance of Rs 700,500 must agree with the bank statement (pass book) after allowing for any unpresented cheques or deposits in transit; any disagreement is investigated through a bank reconciliation statement. The postings still to be made from this cash book are: Farooq's personal account is credited with Rs 155,000 in total (Rs 154,000 bank plus Rs 1,000 discount), Furqan's account is debited with Rs 148,500, Kaleem's account is debited with Rs 70,000, and the total discount allowed of Rs 1,000 is debited to the Discount Allowed Account.

Conclusion

To conclude, the three-column cash book for August 2025 closes with a cash balance of Rs 5,137,000 and a bank balance of Rs 700,500, both brought down to 1 September, and with total discount allowed of Rs 1,000 arising from Farooq's full settlement of his Rs 155,000 account for Rs 154,000. The exercise shows why the three-column form is preferred by businesses that bank most of their receipts: cash, bank and discount are controlled in a single book, contra entries between cash and bank need no ledger posting, settlements at a discount are fully recorded against the personal accounts, and the distinction between an office withdrawal (a contra entry, still business money) and a personal withdrawal (drawings, money leaving the business) is preserved exactly.

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