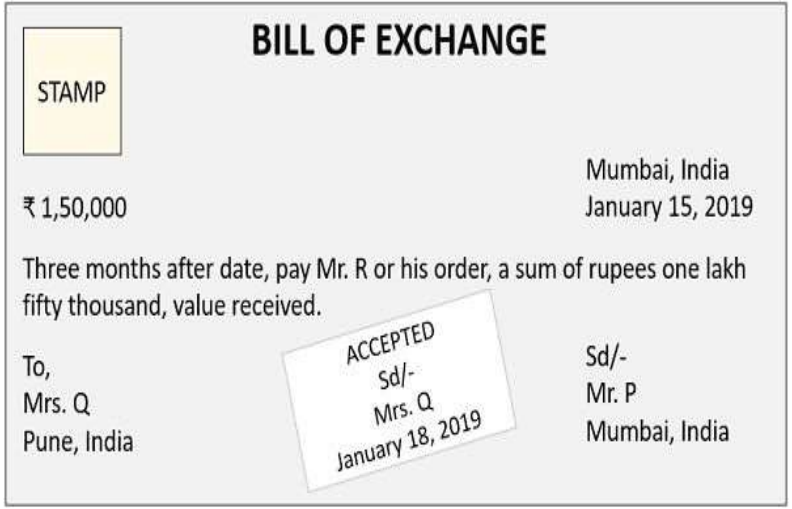
Principles and Practice of Accounting

Chapter 6 : Accounting For Special Transactions

UNIT 1 : BILLS OF EXCHANGE AND PROMISSORY NOTES

A Bill of Exchange has been defined as an "instrument in writing containing an unconditional order signed by the maker directing certain person to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument". A Bill of Exchange has the following characteristics:

- **It must be in writing.**
- **It must be dated.**
- **It must contain an order to pay a certain sum of money.**
- **The promise to pay must be unconditional.**


BILL OF EXCHANGE

STAMP

Mumbai, India
January 15, 2019

₹ 1,50,000

Three months after date, pay Mr. R or his order, a sum of rupees one lakh fifty thousand, value received.

ACCEPTED
Sd/-
Mrs. Q
January 18, 2019

To,
Mrs. Q
Pune, India

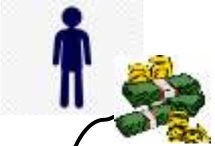
Sd/-
Mr. P
Mumbai, India

- **The money must be payable to a definite person or to his order to the bearer.**
- **The draft must be accepted for payment by the party to whom the order is made.**
- **It should be properly stamped.**
- **Payment must be in legal currency of the country.**

Parties In A Bill Of Exchange

Bill

Acceptance



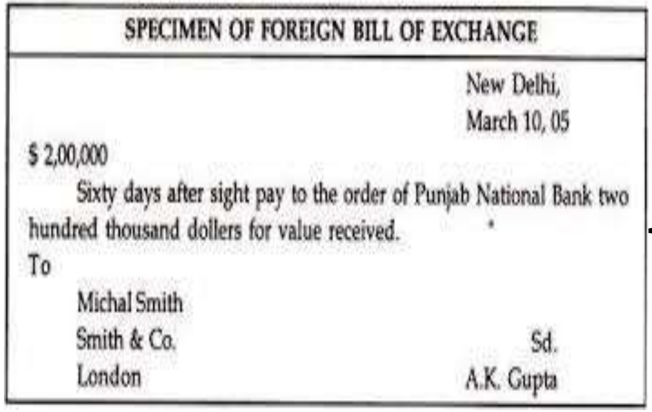
The party which makes the order is known as the drawer.

The party which accepts the order is known as the acceptor

The party to whom the amount has to be paid is known as the payee.

The drawer and the payee can be the same.
A Bill of Exchange can be passed on to another person by **endorsement.** Endorsement on a bill of exchange is made **exactly as it is done in the case of a cheque**. **The primary liability** on a bill of exchange is that of the **acceptor**. **If he does not pay, a holder can recover the amount from any of the previous endorsers or the drawee.**

Foreign Bill of Exchange



SPECIMEN OF FOREIGN BILL OF EXCHANGE

New Delhi,
March 10, 05

$ 2,00,000

Sixty days after sight pay to the order of Punjab National Bank two hundred thousand dollers for value received.

To

Michal Smith
Smith & Co.
London

Sd.
A.K. Gupta

A foreign bill of exchange is one which is drawn in one country and is payable in another. It is generally drawn up in **triplicate** wherein each copy is sent by separate post so that at least one copy reaches the intended party. **Payment will be made only on one of the copies** and when such payment is made the other copies become useless.

The following are examples of foreign bills:

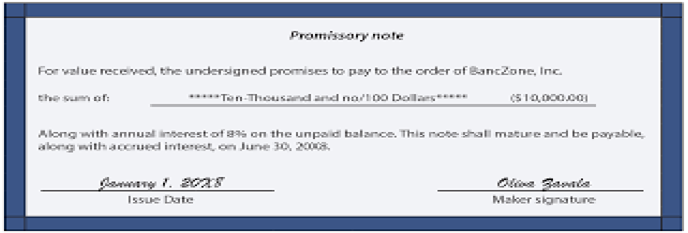
1. A bill drawn in India on a person resident outside India and made payable outside India.
2. A bill drawn outside India on a person resident outside India.
3. A bill drawn outside India and made payable in India.
4. A bill drawn outside India and made payable outside India.

PROMISSORY NOTES

A promissory note is an instrument in writing, not being a bank note or currency note containing an unconditional undertaking signed by the maker to pay a certain sum of money only to or to the order of a certain person.

Features	
1	It must be in writing.
2	It must contain a clear promise to pay. Mere acknowledgement of a debt is not a promissory note.
3	The promise to pay must be unconditional
4	The promiser or maker must sign the promissory note.
5	The maker must be a certain person.
6	The payee must also be certain.

Features	
7	The sum payable must be certain.
8	Payment must be in legal currency of the country.
9	It should not be made payable to the bearer.
10	It should be properly stamped.
11	It does not require any acceptance.



Promissory note

For value received, the undersigned promises to pay to the order of BancZone, Inc.

the sum of: *****Ten-Thousand and no/100 Dollars***** ($10,000.00)

Along with annual interest of 8% on the unpaid balance. This note shall mature and be payable, along with accrued interest, on June 30, 2008.

January 1, 20X8
Issue Date

Olivia Zavala
Maker signature

DIFFERENCES - BILL OF EXCHANGE AND PROMISSORY NOTE

BILL OF EXCHANGE	PROMISSORY NOTE
A bill contains an **unconditional order** to pay	A promissory note contains **only a promise** to pay certain sum of money
There are generally **3 parties** (Drawer, Drawee and Payee) in bill of exchange	There are **2 parties** (Maker and Payee) in promissory note
A bill is **paid by Acceptor**	A promissory note is **paid by maker**
A bill is **drawn by creditor**	A promissory note is **made by debtor**
The drawer and payee may be same person in case of bill of exchange	In promissory note **maker and payee can not be same person**
In a bill of exchange the **liability of drawer is secondary and conditional**	In a promissory note the **liability of a maker is primary and absolute**
A bill of exchange can be **accepted conditionally**	A promissory note **cannot be made conditionally**
In a bill of exchange, **notice of dishonor must be given**	Notice of dishonor is **not required** in case of promissory note
In case of dishonor, a bill of exchange must be **noted and protested**	**Noting and protest is not required** in case of dishonor of a promissory note

Drawer's Books

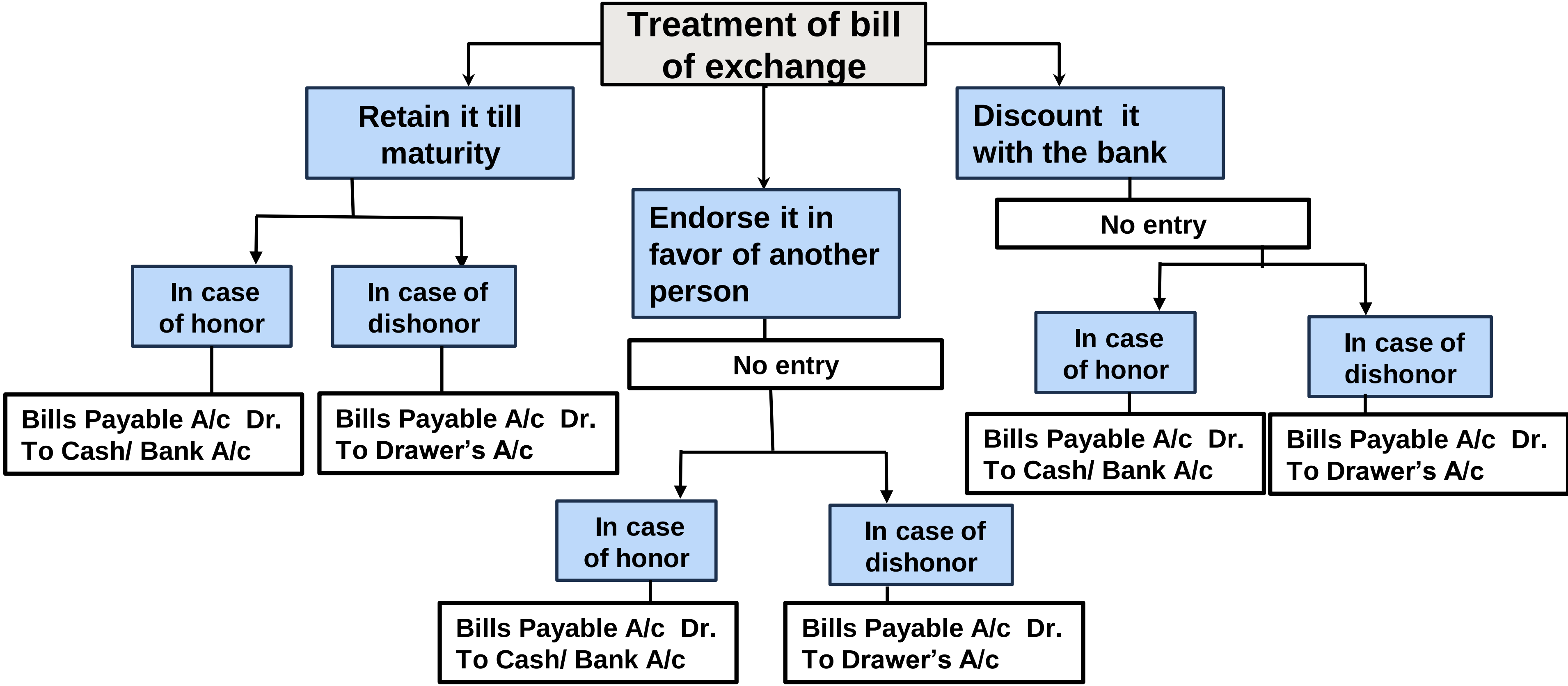
On issue of bill : **Bills Receivable A/c Dr.**
To Drawee's A/c

Treatment of bill of exchange

- **Retain it till maturity**
  - **In case of honor**
    - Cash/Bank A/c Dr.
      To Bills Receivable A/c
  - **In case of dishonor**
    - Drawee's A/c Dr.
      To Bills Receivable A/c
- **Endorse it in favor of another person**
  - Creditor's/ Endorsee's A/c Dr.
    To Bills Receivable A/c
    - **In case of honor**
      - No entry
    - **In case of dishonor**
      - Drawee's A/c Dr.
        To Creditor's/ Endorsee's A/c
- **Discount it with the bank**
  - Bank A/c (amount actually received) Dr.
    Discount A/c (amount of discount) Dr.
    To Bills Receivable A/c
    - **In case of honor**
      - No entry
    - **In case of dishonor**
      - Drawee's A/c Dr.
        To Bank A/c

Drawee's or the Payer's Books

On issue of bill : **Drawer's A/c Dr**
To Bills Payable A/c



Holder/endorsee's Books

On receipt of bill : **Bills Receivable A/c Dr.**
To Drawer's / Debtor's A/c

In case of honor

Cash/ Bank A/c Dr.
To Bills Receivable A/c

In case of dishonor

Drawer's A/c Dr.
To Bills Receivable A/c


Bangalore
1st June, 2018

₹4,00,000

Two months after date, pay to me or my order, the sum of
Rupees Four lakh only, for value received

STAMP

Accepted
(Signed)
Raj Kiran
14, Bangalore

(Signed)
Kunal Singh
Lal Bagh, Bangalore

TERM OF A BILL : The term of bill of exchange may be of any duration. Usually the term does not exceed 90 days from the date of the bill.

When a bill is drawn **after sight**, the term of the bill begins to run from the date of 'sighting', i.e., when the bill is accepted.

When a bill is drawn **after date**, the term of the bill begins to run from the date of drawing the bill.

- The date on which the term of the bill terminates is called as **'Expiry/Due Date of the bill'.**
- Every instrument payable **otherwise than on demand is entitled to three days of grace.**
- The date which comes after adding three days to the expiry/due date of a bill, is called the **date of maturity.**
- Bill **at Sight** means the instruments in which **no time for payment is mentioned**. A cheque is always payable on demand.
- A promissory note or bill of exchange is payable on demand- **(a) when no time for payment is specified, or (b) when it is expressed to be payable on demand, or at sight or on presentment**.
- Bill **after date** means the instrument in which time for payment is mentioned. A promissory note or bill of exchange is a time instrument when it is expressed to be payable-

a) after a specified period.

b) on a specific day

c) after sight

d) on the happening of event which is certain to happen

HOW TO CALCULATE DUE DATE OF A BILL

Case	Due date
When the bill is made payable on a specific date.	That specific date will be the due date
When the bill is made payable at a stated number of months(s) after date.	That date on which the term of the bill shall expire will be the due date. Note:- The term shall expire on that day of the month which corresponds with the day on which the bill is dated. If the month in which the period terminates has no corresponding day, the period shall be deemed to expire on the last day of a month.
When the bill is made payable at a stated number of days after date.	That date which comes after adding stated number of days to the date of bill. Note:- The date of Bill is excluded.
When the due date is a public holiday.	The preceding business day will be the due date.
When the due date is an emergency/ unforeseen holiday	The succeeding business day will be the due date.

Note: The term of a Bill after sight commences from the date of acceptance of the bill whereas the term of a Bill after date commences from the date of drawing of bill.

RENEWAL OF BILL : Sometimes the acceptor is unable to pay the amount and he himself moves that he should be given extension of time and in consideration agrees to bear interest for the extended time period .In such a case a new bill will be drawn and the old bill will be cancelled.

Where the drawee pays nothing	Where the drawee pays the interest amount at the time of renewal	Where the drawee makes part payment of the original bill or interest amount or both
original bill as well as the interest for the extended time period.	Amount of the Original bill.	That part of total of amount of original bill as well as the interest for the extended time period on unpaid amount.

Accommodation Bill

Basis for Distinction	Trade bill	Accommodation bill
Object	These bills are drawn against trade transactions of sale and purchase.	These bills are drawn for financial assistance.
Consideration	These bills are drawn against proper consideration.	These bills are drawn without consideration
Proof of Debt	These bills are proof of debt. The drawee is a debtor.	These bills are not a proof of debts because the drawee id not a debtor.

- An **accommodation bill** is a bill that is drawn and accepted **without any consideration**. These bills are drawn to assist one or both parties financially in a **bill of exchange**.
- Accommodation bills are **not legally enforceable** because they are drawn and accepted without any consideration.
- **Accounting** for accommodation bills is the same process as is applied in the case of ordinary bills.

SALE OF GOODS ON APPROVAL OR RETURN BASIS

- Accounting treatment when the business sends goods.
  - Casually
    - Transaction is treated as Ordinary Sale
  - Frequently
    - Sales or Return Journal is prepared with four Main columns
      - Goods sent on Approval
      - Goods Returned
      - Goods Approved
      - Balance
  - Numerously
    - Sales or Return Day Book
    - Sales or Return Ledger
      - Treated as Memorandum Books

SALE OF GOODS ON APPROVAL OR RETURN BASIS

Sale on Approval is **a business arrangement wherein an individual or company who is interested in purchasing a specific item is allowed to use the item for a given length of time**. At the end of that time, if the individual is satisfied with the item, they agree to purchase it.

Features of sale of goods on approval or return basis:

1

There is a change in the possession of goods from one person to another.

2

It does not involve transfer of ownership of goods. The ownership is passed only when the buyer gives his approval or if the goods are not returned within that specified period.

3

The customer does not incur any liability when the goods are merely sent to him. In case of online transactions , sometimes customers are given choice to pay on receipt of goods and in some cases they are required to pay in advance and then seller ships the goods to buyer. Even in case the buyer has paid in advance, it retains the right of refund if the goods are returned as per the terms and conditions agreed between seller and buyer.

Entries in case of sale on approval basis :

When goods are sent on sale or return basis:

Trade receivables / Customers Account Dr. [Invoice price]
To Sales Account

When goods are rejected or returned within the specified time:

Sales/Return Inwards Account Dr. [Invoice price]
To Customers/Trade receivables Account

When goods are accepted at invoice price:

(No entry)

When goods are accepted at a higher price than invoice price:

Trade receivables / Customers Account Dr.
To Sales Account [Difference in price]

When goods are accepted at a lower price than the invoice price

Sales Account Dr.
To Trade receivables / Customers Account [Difference in price]

At the year-end, when goods are lying with customers and the specified time limit is yet to expire

Sales Account Dr. [Invoice price]
To Trade receivables / Customers Account

These goods should be considered as Inventories with customers and in addition to the above, the following adjustment entry is to be passed

Inventories with Customers on Sale or Return Account Dr.

To Trading Account [Cost price or market price whichever is less]

No entry is to be passed for goods returned by the customers on a subsequent date.

MEANING OF CONSIGNMENT ACCOUNT

- The term "**consignment account**" relates to accounts dealing with a situation where **one person (or firm) sends goods to another person (or firm) on the basis that the goods will be sold on behalf of and at the risk of the former.** The following should be noted carefully:

i. The party which sends the goods (consignor) is called **principal.**

ii. The party to whom goods are sent (consignee) is called **agent.**

iii. The ownership of the goods, i.e., the property in the goods, **remains with the** consignor or the **principal** – the agent or the consignee does not become their owner even though goods are in his possession.

iv. On sale, of course, **the buyer will become the owner.**

v. The **consignor** does not send an invoice to the consignee. He **sends** only **a proforma invoice**, a statement that looks like an invoice but is really not one. The object of the proforma invoice is **only to convey information to the consignee regarding particulars of the goods sent.**

vi. Usually, **the consignee recovers from the consignor all expenses incurred by him on the consignment ,** This however can be changed by agreement between the two parties.

PROFORMA INVOICE
ROBERTS TEA AND COFFEE LLC (CONSIGNOR)

ST/GST No: 27AASCS1234F2Z5 Date: 01/01/2020
Phone No: +1-541-754-3010
Website: www.robertconsignors.com
Vehicle No: PZ65BYV
Consigned to: David & co (Consignee)

Quantity	Details	Rate	Amount
750 bags	Argo tea	$10	7,500
500 bags	Mighty leaf tea	$12	6,000
250 cart	Ethica coffee	$25	6,250
600 bags	Exotica coffee	$20	12,000

Sales Manager: David Write
David Wright

E & O.E.

MEANING OF CONSIGNMENT ACCOUNT

vi. It is also usual for the **consignee to give an advance to the consignor in the form of cash or a bill of exchange.** It is adjusted against the sale proceeds of the goods.

vii. For his work, the **consignee receives a commission** calculated on the basis of gross sale. For ordinary commission the consignee is not responsible for any bad debt that may arise. If the agent is to be made responsible for bad debts, he is to be paid a commission called **del-credere commission**. It is calculated on total sales, not merely on credit sales until and unless agreed.

viii. Periodically, the consignees ends to the consignor a statement called **Account Sales**. **It sets out the sales made by the consignee, the expenses incurred on behalf of the consignor, the commission earned by the consignee and the balance due to the consignor.**

ix. Firms usually like to ascertain the profit or loss on each consignment or consignments to each consignee.

Dr Consignment to Rangoon Account Cr

		₹	₹			₹
?	To Goods Sent on Consignment Account		1,50,000	?	By T. Nu (Sales)	1,76,000
	To Cash Account:				By Abnormal Loss A/c/ Profit & Loss A/c (loss by fire) (1)	16,150
	Freight	10,000			By Stock on Consignment Account (2)	17,750
	Insurance	1,500	11,500			
	To T. Nu: Customs Duty		14,400			
	Sundry Expenses		2,000			
	Commission		8,800			
	Bad Debt (5 × ₹ 220)		1,100			
	To Profit & Loss A/c (profit)		22,100			
			2,09,900			2,09,900

CONSIGNMENT V/S SALE

Consignment	Sale
Ownership of the goods rests with the consignor till the time they are sold by the consignee, no matter the goods are transferred to the consignee.	**The ownership of the goods transfers with the transfer of goods from the seller to the buyer.**
The consignee **can return the unsold goods** to the consignor.	Goods sold are the property of the buyer and **can be returned only if the seller agrees**.
Consignor bears the loss of goods held with the consignee.	It is **the buyer who will bear the loss** if any, after the transfer of goods.
The relationship between the consignor and the consignee is that of a **principal and agent.**	The relationship between the seller and the buyer is that of a **creditor and a debtor.**
Expenses done by the consignee to receive the goods and to keep it safely **are borne by the consignor** unless there is any other agreement.	**Expenses incurred by the buyer are to be borne by the buyer itself** after the transfer of goods.

Discounts

Defination :

The term discount refers to any reduction or rebate allowed

Cash discount

An allowance given for the settlement of a debt before it is due

Trade discount

An allowance given to the whole sellers or bulk buyers on the list price or retail price, known as trade discount. **A trade discount is not shown in the books of account separately and it is shown by way of deduction from cost of purchases.**

Commissions

- Commission may be defined as remuneration of an employee or agent relating to services performed in connection with sales, purchases, collections or other types of business transactions and is usually based on a percentage of the amounts involved.
- Commission earned is accounted for as an income in the books of accounts, and commission allowed or paid is accounted for as an expense in the books of the party availing such facility or service.

Ordinary Commission

- The term **commission simply denotes ordinary commission**. It is based on **fixed percentage of the gross sales** proceeds made by the consignee.
- It is given by the consignor **regardless** of whether the consignee is making **credit sales or not.**
- This type of commission **does not give any protection** to the consignor from **bad debts** and is provided on total sales.

Del-credere Commission

To **increase the sale and to encourage the consignee to make credit sales**, the consignor provides an additional commission generally known as **del-credere** commission. This **additional commission** when provided to the consignee gives a protection to the consignor against bad debts.

Over-riding Commission

- It is an **extra commission** allowed by the consignor to the consignee **to promote sales at higher price** than specified or to encourage the consignee to **put hard work in introducing new product in the market.**
- Depending on the agreement it is **calculated on total sales or on the difference between actual sales and sales at invoice price** or any specified price.

In the books of consignor

When goods are consigned or dispatched	Consignment Account …… Dr. To Goods Sent on Consignment Account
Expenses incurred by consignor	Consignment Account …….. Dr. To Supplier Account/Bank/Cash
When advance is received from the consignee	Bank/Cash Account …….. Dr. To Consignee's Personal Account
On receipt of account sales from the consignee	**For sales proceeds** Consignee's Personal Account …… Dr. To Consignment Account **For expenses incurred by consignee** Consignment Account ….. Dr. To Consignee's Personal Account
Cash or cheque or bank draft or bill of exchange/promissory note received from the consignee as settlement	Cash/Bank/Bills Receivable Account …… Dr. To Consignee's Personal Account
For bad debts	**1. When del-credere commission is not paid to the consignee** Consignment Account ……. Dr. To Consignee's Personal Account **2. When del-credere commission is paid to the consignee** No entry

In the books of consignor

For the goods taken over by the consignee	Consignee's Personal Account ……. Dr. To Consignment Account
For unsold consignment stock	Consignment Stock Account ……. Dr. To Consignment Account
For commission payable to consignee	Consignment Account ……. Dr. To Consignee's Personal Account

In the Books of Deepak (Consignor)
Consignment Account (At Cost Price)

Particulars		Amount (₹)	Particulars		Amount (₹)
To Stock with Consignee (Opening Stock)		5,000	By Stock Reserve $\left(5{,}000 \times \frac{25}{125}\right)$		1,000
To Goods sent on Consignment at Invoice Price		25,000	By Vivek (Sales Proceeds)		
To Cash (Expenses)		1,000	Cash Sales	12,500	
			Credit Sales	10,800	23,300
To Vivek (Expenses)			By Goods sent on Consignment (Loading Profit) $\left(25{,}000 \times \frac{25}{125}\right)$		5,000
Advertisement	1,200				
Brokerage	500	1,700			
To Vivek Commission			By Abnormal Loss		3,150
General Commission	1,631		By Stock with Agent		3,150
Delcredere Commission	699				
+(7+3)% Commission on	1,100				
	110	2,440			
To Profit & Loss A/c		460			
		35,600			35,600

Vivek Account

	₹		₹
To Consignment A/c (Sales)	23,300	By Consignment (Exp.)	1,700
		By Consignment (Commission)	2,440
		By Cash (Advance)	10,000
		By Bad Debts	1,500
		By Bank (Final Payment)	7,660
	23,300		23,300

Distinctions between normal and abnormal loss

Normal loss	Abnormal loss
Normal loss occurs due to inherent nature of the goods being shipped e.g. leakage, evaporation, loss of perishable goods etc.	**Abnormal loss occurs mainly because of unforeseen events e.g. accident or natural calamity etc..**
Normal loss is **not accounted for immediately and is loaded on the remaining goods**. It gets accounted for as cost of remaining goods as and when they are sold.	Abnormal loss is **accounted for immediately in profit and loss account.**
As normal loss is **added to cost of remaining goods, it impacts gross profit.**	Abnormal loss **does not impact gross profit.**
Insurance companies generally do not cover normal loss as it is expected to be incurred on each consignment or storage of goods.	**Insurance is generally available** for abnormal losses.
Normal loss is almost certain however it may vary from time to time.	**Abnormal loss is because of unforeseen events and is not certain.**

Entries for abnormal loss

- Following entry is recorded for abnormal loss

Abnormal Loss Account … Dr.
To Consignment Account

- If abnormal loss is recoverable from the insurance company

Insurance Company's Account … Dr.
To Abnormal Loss Account

- If abnormal loss is recoverable from the consignee

Consignee's Personal Account … Dr.
To Abnormal Loss Account

- **If abnormal loss is not recoverable, Abnormal Loss Account is transferred to Profit & Loss Account.**

IN THE BOOKS OF THE CONSIGNEE

On making sales	Cash/Bank Account/Debtors …… Dr. To Consignor's Personal Account
For expenses incurred and his commission	Consignor's Personal Account …… Dr. To Bank Account
For advance paid to consignor	Consignor's Personal Account ….. Dr. To Bank Account
For recording bad debts	Bad Debts Account ……. Dr. To Customer's Account
For writing off bad debts	**(a) When del-credere commission is not allowed** Consignor's Personal Account ……. Dr. To Bad Debts Account **(b) When del-credere commission is allowed** Commission Account …… Dr. To Bad Debts Account

Average due date: It is the mean or equated date on which a single total payment may be made in lieu of different payments on different dates without any loss to either party.
Where payment is not made on the average due date, the party receiving the amount charges interest for as many days as the payment is delayed from the average due date.

$$\textbf{Average due date} = \textbf{Base date} \pm \frac{\textbf{Total of the products}}{\textbf{Total of the amounts}}$$

1. **Selection of base date/ zero date:** Such a date may be the due date of the first transaction or the due date of the last transaction or any other due date between the first and the last but preferably earlier due date may be taken.
2. While ascertaining the number of intervening days (plus or minus) between the base date and the due date of each transaction **ignore the first date and include the last day.**
3. **If due date is in fraction, round it off .**
4. **If amount is paid before due date, rebate is given.**
5. **If amount is paid after due date, then interest is charged.**
6. Whenever there is a sale of goods by two persons to each other on different dates, the formula for calculating average due date becomes:
   $$\textbf{Base date} \pm \frac{\textbf{Difference in products}}{\textbf{Difference in amounts}}$$

USES OF AVERAGE DUE DATE

- For calculating interest on drawings of partners
- Where amount is lent in various instalments
- Where amount is lent in one instalment

CONCEPT OF DUE DATE (DATE OF MATURITY)

The due date of a bill of exchange/invoice is the date when the amount of a bill/invoice is payable by the drawee/ creditor to drawer/ debtor.

Calculation of Due Date after Taking into Consideration Days of Grace

Every promissory note or bill of exchange falls due on the third day after on which it is expressed to be payable.

Calculating Due Date of Bill or Note Payable Few Months after Date or Sight

A Bill due on 29th January, 2015 is made payable at one month after date. The due date of instrument is 3rd day after 28th February, i.e., 3rd March

If Maturity Day is holiday (after including days of grace).

Public Holiday (including Sundays & other days declared by Central Government by notification in the official gazette)

Due date = Preceding Business day ;
If Preceding day is also Public Holiday ;
Due date = Day Preceding the previous day

Emergency or unforeseen holiday

Due date = Next following day

1. Calculation of average due date where one party is involved

- Take the earliest due date as starting day or base date or "O" day for convenience. Any date whatsoever , may also be taken as "O" day.
- Consider the number of days from base date up to each due date. Calculations may also be made in month.
- Multiply the number of days by the corresponding amounts.
- Add up the amount and products.
- Divide the "Product total" by "Amount total" and get result approximately upto a whole number.
- This number is added in the base date to find the average due date.
- Thus the formula for the average due date can be under.

$$\textbf{Average due date} = \textbf{Base date} \pm \frac{\textbf{Total of products}}{\textbf{Total amounts}}$$

2. Calculation of average due date where inter transactions between 2 parties are involved

When more than one party is involved where one party purchase and also sells to other party like JK Tyres and Maruti where Maruti sells car to JK Tyres for their employees and purchases Tyres from them. In such a case instead of paying gross amount they may go for new amount i.e. **Purchase amount and sales amount will be set off** and thus here we take difference of amount and produce **as Net Amount**. **In such cases, earliest date of both parties is taken as the base date.**

3. Calculation of average due date where amount is repaid in instalments

Calculation of average due date in a case where the amount is lent in one instalment and repayment is done in various instalments (opposite to what we have done in the first case). The procedure for calculating average due date can be summarized as under:

Step 1: Calculate number of days/monthly/years from the date of lending money to the date of each repayment.

Step 2: Find the total of such days/months/years.

Step 3: Quotient will be the number of days/months/years by which average due date falls away from date of commencement of loan.

If instalment are same, we can use Simple mean concept i.e. Divide days by number of items and no need for product.

Thus, the formula for the average due date can be written as under:

$$\textbf{Average due date} = \textbf{Date of Loan} + \frac{\textbf{Sum of days / months / Years from the date of Lending to the date of repayment of each instalment}}{\textbf{No. of installments}}$$

4. Calculation of average due date for determining interest on drawings

In the case of drawings also, **amount is drawn by the owners of business on various dates** but it may settled on one day. It should be noted that, when different amounts are due on different dates, **but they are ultimately settled on one day the interest may be calculated by means of Average Due Date**. When interest is chargeable on drawings, and drawings are on different dates, interest may be calculated on the basis of Average Due Date of drawings determined on the basis given above.

Account Current : Introduction

An Account Current is a running statement of transactions between parties for a given period of time and includes interest allowed or charged on various items. It takes the form of an ledger account.

Some of the situations when account current is prepared are:

It is prepared when two or more persons are in joint venture and each co-venture is entitled to interest on their investment. Also, no separate set of book is maintained for it.	**It is prepared when frequent transactions regularly take place between two parties.**	**A consignee of goods can also prepare an Account Current, if the latter is to settle the account at the end of the consignment & interest is chargeable on outstanding balance.**	**An Account Current also is frequently prepared to set out the transactions taking place between a banker and his customer.**

An Account Current has two parties - **one who renders the account and the other to whom the account is rendered.** This is indicated in the heading of an Account Current, which is like the following: “A in Account Current with B”. It implies that A is the customer, and the account is being rendered to him by B.

Method of Computing the numbers of Days

<u>Forward Method-</u> Under this method the number of days are calculated from the due date of the transaction to the date of closing the account.

<u>Backward (or Epoque Method)-</u> Under this method, the number of the days are calculated from the opening date of statement to the due date of transaction.

PREPARATION OF ACCOUNT CURRENT

With help of interest table

By means of products

By means of products of balances

According to this method, all the transactions are arranged in the form of an account. There are two additional columns on both the sides of such an account.

(a) One column is meant to indicate the number of days counted from the due date of each transaction to the date of rendering the account. If no specific date is mentioned as the date on which payment is due,
the date of the transactions is presumed to be the due date.

(b) The other column is meant for writing interest.

With the help of ready made tables, interest due on different amounts at given rates for different periods of time is found out and this is entered against each item separately.

PREPARATION OF ACCOUNT CURRENT

- **With help of interest table**
- **By means of products**
- **By means of products of balances**

In this method, interest columns are replaced by “product” columns. Product in this case is the amount multiplied by the number of days for which it has been outstanding. Interest on a certain sum of money for a certain number of days is the same thing as interest on the product for one day.

The remaining steps are as follows:

(a) Find out the balance of the products on the two sides.

(b) Calculate interest at the given rate on the balance of the products for a single day.

(c) Enter interest on the appropriate side in the amount column. This entry is made on the side other than

that on which the balance of products appears.

PREPARATION OF ACCOUNT CURRENT

With help of interest table

By means of products

By means of products of balances

This method, also known as **periodic balance method**, is usually adopted in the case of banks **where the balance of account is taken out after every transaction**. In this case, the number of days written against each transaction are the days counted from its date or due date to the date of the following transaction. In the case of the last transaction, the number of days is counted to the close of the period. **Each amount is multiplied with the number of days.** If the amount represents a debit balance, the product is entered in the **Dr. Product column**; and if it represents a credit balance, the product is written in the **Cr. Product column**. The Dr. Product and Cr. Product columns are then totaled up. Interest is calculated on each total at the given rate of interest; and the net interest is ascertained.