

BASIC ACCOUNTING

V SEMESTER

(UG-CCSS-SDE)

OPEN COURSE

(For candidates with Core Course other than B.Com.)

(2011 Admission)



UNIVERSITY OF CALICUT

SCHOOL OF DISTANCE EDUCATION

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BASIC ACCOUNTING

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CHAPTER 1

BASIC ACCOUNTING CONCEPTS

MEANING AND DEFINITION OF ACCOUNTING

Accounting is a system of recording and reporting business transactions in financial terms, to interested parties.

According to American Institute of Certified Public Accountants (AICPA), “accounting is the art of recording, classifying and summarizing in a significant manner in terms of money, transactions and events which are, in part at least, of a financial character and interpreting the results thereof”.

In short, accounting is a system of collecting, classifying, summarizing, analyzing and reporting financial information about a firm.

FEATURES OR CHARACTERISTICS (NATURE) OF ACCOUNTING

Following are the features or characteristics of accounting:

1. Accounting is an art.
2. Accounting is a science.
3. Accounting is the art of recording the transactions in the books.
4. Accounting records only those transactions and events which are of financial character.
5. Accounting classifies the recorded transactions in a systematic manner.
6. Accounting summarizes the classified data.
7. Accounting analyses and interprets the summarized data.
8. Accounting provides information (after analysis and interpretation) to interested parties.

DIFFERENCE BETWEEN BOOK - KEEPING AND ACCOUNTING

Some people use book keeping and accounting synonymously. But really these are different. Book keeping is concerned with the recording of business transactions in books of account. Accounting goes a step further. It includes not only recording of business transactions but also summarizing these transactions and analyzing and interpreting their effects on the working of the business. Thus book keeping is the preliminary study (primary stage) of accounting, while accounting is the advanced study (secondary stage) of book-keeping.

OBJECTIVES OR FUNCTIONS OF ACCOUNTING

The basic objectives or functions of accounting are as follows:

1. To keep a permanent record of business transactions.

2. To ascertain profit or loss of business.
3. To ascertain the financial position of the business.
4. To protect properties of business.
5. To control expenditure of business.
6. To calculate the amount due to and due from others.
7. To ascertain the cost of production and selling price.
8. To provide information for decision making.
9. To satisfy the requirements of law.
10. To know whether the business is profitable or not and analyse the reasons for the same.

USERS OF ACCOUNTING INFORMATION

Accounting is an information system. Accounting information is needed by a variety of people. Some users of the accounting information have a direct interest in the enterprise, while others have an indirect interest. Those who are directly interested in the accounting information are owners, management, creditors, investors, employees, customers and tax authorities. The indirect users are financial analysts, trade unions etc. In other words, there are two categories of users of accounting information. They are internal users and external users. Internal users include owners, management and employees. External users include creditors, investors, government, customers etc.

Users

Internal users

Owners
Management
Employees

External users

Creditors
Investors
Customers
Government

BRANCHES OF ACCOUNTING (KINDS OF ACCOUNTING)

Different branches (forms) of accounting have been developed to satisfy the various users interested in the accounting information. The different branches are: financial accounting, cost accounting, management accounting etc.

1. FINANCIAL ACCOUNTING

Financial accounting is the oldest branch of accounting. The other branches of accounting (cost accounting, management accounting etc.) have been developed from financial accounting. Thus, financial accounting is the basic accounting.

MEANING OF FINANCIAL ACCOUNTING

Financial Accounting is concerned with the provision of information to external parties outside the organization. The outsiders who use accounting information have a variety of interests. Investors and shareholders want to know the company's profit potential. Suppliers, banks and other lenders want to know whether a business is creditworthy. Government agencies regulate and tax businesses and analyze the published financial statements to make decisions.

Financial accounting is mainly concerned with the preparation of financial statements and communication of accounting or business information to the external users including shareholders, employees etc. Its aim is to ascertain the profit or loss and to show the financial position of the business.

NATURE OR CHARACTERISTICS OF FINANCIAL ACCOUNTING

We can understand the nature of financial accounting from its characteristics which are as follows:

1. The primary purpose of financial accounting is to provide information to external users. It is mainly concerned with the preparation of financial statements and communicating the information to investors, creditors and other external users.
2. Financial accounting provides historical data.
3. Transactions of financial character are recorded in the financial accounts.
4. Transactions are recorded on the basis of some concepts and conventions.
5. Financial accounts are subject to accounting standards to ensure uniformity.
6. Financial accounts deal with all commercial transactions.
7. Financial accounts deal with external transactions (i.e., transactions between the organisation and outsiders)
8. Financial accounts are the accounts of whole business.
9. Emphasis in financial accounting is on reporting, not on control.

2. MANAGEMENT ACCOUNTING

It is concerned with accounting information that is useful to management. It takes all financial information from financial accounting.

Difference between financial accounting and management accounting

FINANCIAL ACCOUNTING	MANAGEMENT ACCOUNTING
1. The purpose is to ascertain profit or loss	1. The purpose is to provide information to management for decision making
2. Records historical data	2. Concerned with future plans and operations
3. Compulsory	3. Optional
4. Users are external parties	4. Users are internal parties
5. Lays more emphasis on accuracy	5. Lays more emphasis on quick and prompt reporting

3. COST ACCOUNTING

It is the process of accounting for cost. It is the formal mechanism by which costs of products or services are ascertained and controlled.

ACCOUNTING PRINCIPLES

The need for accounting principles arises because different parties such as investors, creditors etc. are interested to know about the affairs of the business. If every business applies its own way of accounting practices, the final accounts may not be understandable to all such parties. In order to make the final accounts understandable and to maintain uniformity in accounting system, accounting should be based on certain standards. These standards are known as Accounting Principles.

The term “Principle” refers to the fundamental belief or a general truth which once established does not change. As such, accounting principles may be defined as those rules and procedures which are adopted by the accountants universally in recording the accounting transactions.

In the words of A.W. Johnson, “Accounting principles are the assumptions and rules of accounting and the application of these rules, methods and procedures to the actual practice of accounting”.

In short, the general rules or principles adopted in accounting are called accounting principles. If these principles are followed while recording the transactions, it is possible to ensure uniformity, clarity and understanding.

The accounting principles are generally divided into three categories – (a) Accounting postulates, (b) Accounting concepts and (c) Accounting conventions.

ACCOUNTING POSTULATES

Accounting postulates are the basic assumptions relating to the business environment. Ahmed Bakaoui defined accounting postulates as "self evident statements or axioms generally accepted by virtue of their conformity to the objectives of financial statements that portray the economic, political, technological and legal environment in which accounting must operate". The following are the accounting postulates:

- 1. Business entity postulate:** According to this assumption, a business is treated as a separate entity distinct from its owner. Therefore the business transactions must be kept completely separate from the private affairs of the proprietor. This enables the proprietor to ascertain the true picture of business. From the point of view of business, the proprietor is a creditor for the capital.
- 2. Money measurement postulate:** According to this assumption, only those transactions which can be measured in terms of money are to be recorded. For example, the quality of product, working conditions, competition in the market etc. cannot be measured in terms of money. Hence, they cannot be recorded in books of account.
- 3. Going concern postulate:** It is assumed that every business will continue for an indefinite period of time. It is with this assumption that fixed assets are recorded at original cost, less its depreciation.
- 4. Accounting period postulate:** According to this assumption, the life of a business is divided into different periods for preparing financial statements. Generally business concerns adopt 12 months period (say 1st April 2009 to 31st March 2010) for measuring the income of the concern. This time interval is known as accounting period. At the end of each accounting period a Profit and Loss A/c is prepared to find the profit earned by the business.

5. Property rights postulate: This is an essential condition for business. The term 'property right' means the right of accounting entities to possess and alienate property - value. In the context of accounting, this implies that the things of value to an entity can be transferred from one entity to another. Thus this becomes the basis of business transactions.

ACCOUNTING CONCEPTS

Accounting concepts are those assumptions and conditions upon which accounting principles are based. These assumptions are fundamental to accounting practice. The following are the important accounting concepts:

- 1. Cost concept:** According to this concept, all transactions are recorded in the books of account at actual price involved. This price is called cost. If the business purchases a machinery for Rs. 1,00,000, the asset would be recorded in the books at Rs. 1,00,000, even if the market price is increased to Rs. 1,10,000. This cost is the basis for all subsequent accounting for the asset.
- 2. Dual aspect concept:** This is the basic concept of accounting. According to this concept, every transaction has two aspects. These two aspects are (a) receiving of benefit, and (b) giving of that benefit. These two aspects should be recorded. Thus at a given point of time total benefits received should be equal to total benefits given. For example, X starts business with Rs. 2,00,000. In this transaction, there are two aspects. On the one hand, the business has an asset or benefit received (cash). At the same time business (separate from the proprietor) is liable to pay Rs. 2,00,000 to the owner (benefit given). It is because of this concept that the total equity is always equal to total assets of the business. This may be expressed in the form of an equation (accounting equation):

$$\text{Capital} = \text{Total Assets} - \text{Liabilities}$$

$$\text{or Total Assets} = \text{Capital} + \text{Liabilities}$$

$$\text{or Total Assets} = \text{Total Liabilities (from the point of business capital also is a liability)}$$

- 3. Realization concept:** According to this concept, revenue is recognized when a sale is made or a service is rendered to customers, whether it is a cash sale, a credit sale or an instalment sale. This means revenue realization does not necessarily mean that revenue must be realized in cash. If a firm transfers or sells goods in March and receive cash in May, revenue will be considered as earned or realized in March, when the goods were transferred. Realization concept is also known as revenue recognition concept.
- 4. Matching concept:** According to this concept, cost or expenses of a business of a particular period are matched or compared with the revenue of that period in order to ascertain the net profit or net loss. If revenue earned is more than the cost, the result is net profit. If costs are more than the revenue, the difference is net loss.
- 5. Objectivity concept:** This concept requires that accounting data should be verifiable and free from personal bias of the accountant. This means each recorded transaction in the books of account should have an adequate evidence to support it. In historical cost accounting, the accounting data are verifiable because the transactions are recorded on the basis of documents such as vouchers, receipts, invoices etc.

ACCOUNTING CONVENTIONS (DOCTRINE OF ACCOUNTS)

Accounting conventions are the customs and traditions which guide the accountant while preparing accounting statements. Conventions are based on practicability and usage. For instance,

the relationship of 12 units forming a 'dozen' is a convention. The following are the main accounting conventions:

- 1. Convention of consistency:** This convention follows that the basis followed in several accounting periods should be consistent. This means the methods adopted in one accounting year should not be changed in another year. Then only comparison of results is possible. For example, if an asset is depreciated on diminishing balance method in one year, the same method of depreciation should be followed in subsequent years. This does not mean that once a method has been adopted, it can never be changed in future. If the new method is found more useful, the present method can be changed.
- 2. Convention of conservatism:** This is a convention of caution or playing safe which is followed while preparing the financial statements. The idea of this statement is to consider all possible losses (and make provision for such losses) and to ignore all probable profits (unrealized profits). Conservatism is the defensive accounting mechanism against uncertainty and risk. The valuation of stock on cost price or market price, whichever is less is based on the convention of conservatism. Similarly it is on the basis of this convention, provision is made for bad debts and discount on debtors.
- 3. Convention of materiality:** According to this convention, only the material or important facts about the business are to be disclosed through the financial statements. All other unimportant or less important information should either be totally ignored or recorded as foot notes, or merged with important items. If this is not done, accounting statement will be unnecessarily overburdened.

Materiality means 'relative importance'. Whether a matter should be disclosed or not depends on its materiality. Which is material and which is not depends upon the discretion of the accountant.

- 4. Convention of full disclosure:** The objective of accounting is to provide true and accurate information. Hence, accounting records and statements should be honest and informative. They should not be misleading. The convention of disclosure requires that all significant information should be disclosed in the financial statements. Further the accounting records and statements should conform to generally accepted accounting principles. In short, the convention of disclosure requires that accounts and statements should disclose all the information needed for users in a meaningful and clear manner.

The convention of materiality should not be confused with the convention of full disclosure. The convention of full disclosure requires that all facts necessary to ensure that the financial statements are not misleading must be disclosed. But the convention of materiality requires that the items or events which have insignificant economic effect or irrelevant to the users' need may not be disclosed.

ACCOUNTING SYSTEMS (BASES OF ACCOUNTING)

There are mainly three systems of recording transactions. They are as follows:

- 1. Cash system:** Under this system, transactions relating to actual cash receipts and actual cash payments are recorded. A transaction is recorded only when cash is received or paid. This means credit transactions are not recorded.

- 2. Mercantile system (Accrual system):** Under this system, all transactions relating to a particular period are recorded. It takes into account the revenue for the whole accounting period whether received or not. Likewise expenses for the whole period whether paid or not, are recorded.
- 3. Hybrid or mixed system:** Under this system of accounting, revenues and assets are recorded on cash basis, while expenses and liabilities are recorded on mercantile system.

SOME IMPORTANT TERMS IN ACCOUNTANCY

Capital: The amount invested by the owner in the business is known as capital. It refers to the money or money's worth invested in a business. In a running business, the excess of assets over liabilities is known as capital. It is the liability of the business to its proprietor.

Liability: Liability is the debts owing by business to others (or outsiders).

Equity: Equity is the total claim against the assets of the business. It is classified into owners' equity and creditors' equity. Owners' equity refers to owners' claim against the assets of the business (generally known as capital). Creditors' equity refers to creditors' claim against the assets of the business (generally known as liabilities).

Assets: Assets are valuable things or properties owned by a business. It also includes the amount due to the business by others. In short, assets are the resources owned by the business. These are the resources on which the business is carried on.

Expense: Expense is the amount spent on any item by the businessman to acquire benefits out of it. It is the cost consumed (used or utilized) in generating revenue. It is an expired cost. It is the cost relating to the operation of an accounting period.

Expenditure: Money value paid or payable for acquiring an asset or service is called expenditure.

Revenue: It is the amount realized or receivable from the sale of goods or assets or both. It also includes the receipts of rent, commission, discount etc.

According to Robert Anthony, "Revenue is a monetary measure of output and expense is monetary measure of input or resources consumed".

Income: It is the excess of revenue over expense.

Goods: Goods are those articles which are purchased for resale or for producing the finished products which are meant for sale. These include articles or things in which the enterprise deals in. For example, a cloth merchant deals in cloth (goods).

Purchase: It refers to purchase of goods in which business deals in for cash or on credit basis.

Sales: It refers to sales of goods in which business deals in for cash or on credit.

Turnover: It refers to sale in relation to any specific period. It is the sales made during an accounting period.

Stock: It is the value of goods lying unsold on a particular date.

Inventories: It includes value of raw materials, semi-finished goods and finished goods meant for resale.

Debtors: Debtors are those persons who owe money to the business. Trade debtors are those persons who owe money on account of goods sold on credit.

Creditors: Creditors are those persons to whom the business owes money . Trade creditors are those who supply goods to the business on credit basis (i.e. goods are purchased from them on credit).

Drawings: It is the amount of cash or goods withdrawn by the proprietor from business for his personal use.

Account: It is a summary of various business transactions relating to a particular person, asset, expense or income for a given period of time.

BUSINESS TRANSACTIONS

Every business activity is not an accounting activity. That is why every activity is not recorded in the books of accounting. We record only business transactions in accounting. Transaction is an event which involves transfer (exchange) of money or money's worth between the business and outsiders including the owner. For example, a business sells goods to a person for cash or on credit is a transaction. This event involves transfer of goods from the business to an outsider. The word 'transaction' is mathematically defined as follows:

$$\text{Transaction} = \text{Action} + \text{Money}$$

FEATURES OF BUSINESS TRANSACTIONS

1. They are financial in nature.
2. They are supported by documentary evidence.
3. They are expressed in numerical and monetary terms.
4. They cause an effect on assets, liabilities, capital, revenue and expenses.

TYPES OF BUSINESS TRANSACTIONS

Business transactions are of the following types:

- (a) **Cash transaction:** Any business transaction which involves immediate payment or receipt of cash is known as cash transaction. For example, sale of goods for cash is a cash transaction.
- (b) **Credit transaction:** In a credit transaction, there is no immediate payment or receipt of cash. The settlement of payment or receipt of cash is done at a later date. For example, goods are purchased on credit is a credit transaction.
- (c) **Non-cash transaction:** This transaction does not involve any payment or receipt of cash either immediately or at a later date. Examples of such transactions are depreciation, return of goods etc.

DOUBLE ENTRY SYSTEM

Double entry system is as old as business itself. It has existed since time immemorial. But it was in 1494, the modern system of bookkeeping took its birth in Venice (in Italy) when Luca Pacioli (Italian Monk and Mathematician) published his book titled 'Summa De Arithmetica Geometrica Proportioni et Proportionalita' (everything about the Arithmetic, Geometry and Proportion). He is considered to be the father of modern accounting. He published his later work 'De Divina Proportione' in 1509. Thereafter, a series of works were published. The most important of them was the one published in 1795 by Edward Jones.

For every transaction, two parties are required. Between these parties there is the exchange of equal values. Accordingly, every transaction has two aspects or elements or effects. One is receiving aspect and the other is giving aspect. The receiving aspect of a transaction is known as debit and the giving aspect of the transaction is known as credit. Thus every transaction has two aspects, namely debit aspect and credit aspect. For example, when A sells goods to B for Rs. 20,000, A exchanges goods for money. A gets money and he gives away goods. In this transaction, cash is the receiving aspect (debit) and goods is the giving aspect (credit). In order to record a transaction completely, it is necessary to record both aspects of the transaction. The method of recording the two fold aspects of every transaction is called double entry system. Thus, “every debit has an equal and corresponding credit”. To conclude, double entry system is the system of recording both aspects of every transaction in order to maintain the equality between debit and credit.

ADVANTAGES OR MERITS OF DOUBLE ENTRY SYSTEM

The main advantages of double entry system are as follows:

1. It provides a complete record of each and every transaction because both aspects of every transaction are recorded.
2. It is scientific system of accounting.
3. In double entry system, a total debit is always equal to total credits. Hence a trial balance can be prepared to check the arithmetical accuracy of accounts.
4. With the help of trial balance, a trader can prepare Trading and Profit and Loss Account to know the profit or loss earned by the business during a particular period.
5. It is possible to find out the exact reasons for the profit earned or loss incurred.
6. Under this system, all business transactions are recorded completely, perfectly and systematically. Therefore, chances of errors and frauds are reduced.
7. It is possible to judge the progress of the business by comparing the results of the previous year with those of the current year.

ACCOUNT

In accounting we keep a separate record of each and individual assets, liabilities, expenses, incomes, equities etc. The place where such a record is maintained is known as an account. It is a place where similar transactions which take place during a period are summarized and accumulated. For example, all cash transactions will be summarized and accumulated in a separate account called cash account. Similarly, all transactions relating to an asset will be recorded in that asset account, all transactions relating to a person will be recorded in that person's account, etc.

CLASSIFICATION OR TYPES OF ACCOUNTS

The accounting equation reminds us that accounts can be classified into the following five categories: 1. Asset accounts. 2. Liability accounts. 3. Capital accounts. 4. Revenue accounts. 5. Expense accounts.

The account can also be classified in a different manner, as given below:

- 1. Real accounts:** These are the accounts of assets or properties of business. Examples of real accounts are cash account, land and building account, furniture account, machinery account etc.

2. Personal accounts: These are the accounts relating to persons with whom business deals. Personal accounts may be of the following three types:

- (a) **Natural person's account:** These are the accounts of human beings. Examples include Midhun's account, Joseph's account, Thufail's account etc.
- (b) **Artificial person's account:** These are the accounts of artificial persons created by law. Examples include firm's account, company's account, educational institution's account, bank account, co-operative society's account etc.
- (c) **Representative person's account:** An account indirectly representing a person or persons is known as representative person's account. Outstanding expense account, prepaid expense account, outstanding incomes account etc. are examples of representative personal account.

3. Nominal accounts: Accounts relating to income, revenue, gain, expenses and losses are called nominal accounts. These are also known as fictitious accounts (accounts in name only). Rent account, salaries account, wages account, discount account, commission account, depreciation account, realization account etc. are some of the examples of nominal accounts.

This classification of accounts is common classification.

MEANING OF DEBIT AND CREDIT

The word debit is derived from the Latin word 'Debitum'. It means due for that. In short, receiving aspect of a transaction is known as debit.

The word 'Credit' is derived from the Latin word 'Creder'. It means 'Due to that'. In short, the giving aspect of a transaction is known as credit.

The abbreviations 'Dr.' for debit and 'Cr.' for credit are generally used.

RULES OF ACCOUNTING (RULES OF DEBIT AND CREDIT)

Every transaction has two aspects – debit and credit. To record a transaction completely, its debit aspect as well as credit aspect should be recorded. There are some rules for ascertaining debit and credit aspects of transactions. There are two approaches for finding debit and credit aspects of transactions. One is English approach and the other is American approach.

English approach: According to this approach the rules of double entry system depends upon the type of account to be recorded. Under this approach, all accounts are classified into three – real account, personal account and nominal account. The classification of accounts into real, personal and nominal is known as *traditional approach*. There are separate rules for each type of account. They are as follows:

Real account: In case of real account, what comes in the business (assets came) is debited and what goes out (assets gone) is credited. In short,

Debit what is coming in

Credit what is going out

Personal account: In case of personal account, who receives the benefit is debited and who gives the benefit is credited. In short,

Debit the receiver

Credit the giver

Nominal account: In case of nominal account all expenses and losses are debited and all incomes and gains are credited. In short,

Debit all expenses and losses

Credit all incomes and gains

The above rules for ascertainment of debit and credit are known as ‘Golden Rule of Accounting’. It is so called because it is unique itself.

American approach: According to American approach accounts are classified into five categories such as assets, liabilities, capital, expenses and incomes. This classification is known as *modern approach*. The following are the debit – credit rule under this approach:

(a) **Assets:** If there is increase in asset, this increase is debited in that asset account. If there is decrease in an asset, this decrease in asset is credited in that asset account. In short,

Increase in asset – Debit

Decrease in asset – Credit

(b) **Liabilities:** When a liability is increased, it is credited and when a liability is decreased, it is debited. In short,

Increase in liability – Credit

Decrease in liability – Debit

(c) **Capital:** When capital is increased, it is credited and when capital is reduced, it is debited. In short,

Increase in capital – Credit

Decrease in capital – Debit

(d) **Expenses/ Losses:** When expense or loss is increased, it is debited and when expense or loss is decreased, it is credited. In short,

Increase in expenses/loss – Debit

Decrease in expenses/ loss – Credit

(e) **Incomes/ Gains:** When income or profit is increased, it is credited and when income or profit is decreased, it is debited. In short,

Increase in incomes/ gain – Credit

Decrease in incomes/ gain – Debit

Of the two approaches, we follow the English approach.

Example

Find out debit and credit in each of the following transactions:

(a) Mani started business with cash Rs. 5,00,000

(b) Deposited cash Rs. 2,00,000 into bank

(c) Bought goods for cash Rs. 40,000 on credit

(d) Bought goods from Madhu on credit for Rs. 20,000

- (e) Sold goods for cash Rs. 30,000
- (f) Sold goods to Nanu for Rs. 10,000
- (g) Bought furniture for Rs. 10,000
- (h) Paid rent Rs. 5,000
- (i) Paid wages Rs. 4,000
- (j) Received commission Rs. 1,000

Solution

(a) This transaction involves two aspects. They are cash and proprietor's capital. Cash is a real account (asset). Proprietor's capital account is a personal account. In the case of real account what is coming into business is debited. Here cash is coming into the business. Hence cash is the debit aspect (increase in asset is debited). In the same time cash is received from the proprietor in the form of capital (personal account). In the case of personal account, giver is the credit. In this case proprietor is the giver of capital. Thus proprietor's capital is credit (increase in capital is credited).

(b) When cash is deposited with the bank, cash is going out of the business. Applying the rule of real account (credit what is going out) cash is the credit aspect.

When cash is deposited, the bank (personal account) receives cash. Applying the rule of personal account (debit the receiver), bank is debit. Thus cash and bank are the two aspects of the transaction.

(c) When goods are purchased, goods (real account) are coming into business. According to the rule of real account (debit what comes in) goods is the debit aspect because goods are coming in.

When goods are purchased for cash, cash (real account) goes out of the business. According to rule of real account (credit what goes out) cash is the credit aspect because cash goes out of the business.

(d) When goods are bought on credit, goods is the debit aspect because goods come into the business. This is a credit transaction (name of the party is given). Cash is not immediately paid. Madhu (personal account) is the giver of goods. When we apply the rule of personal account (credit the giver), Madhu is the credit aspect.

(e) When goods are sold, goods (real account) go out of the business. Applying the rule of real account (credit what goes out), goods is the credit aspect.

When goods are sold for cash, cash is received. In case of real account, what comes in is debit. Thus cash is the debit aspect.

(f) When goods are sold, goods are going out of the business. Hence goods are the credit aspect.

Here goods are sold on credit; the receiver of goods (Nanu) is the debit according to the rule of personal account.

(g) In this transaction, the two aspects involved are furniture and cash. Both are assets. Hence both come under real accounts. Applying the rule of real account, furniture is debit (furniture comes into business) and cash is the credit (cash goes out of business).

- (h) Rent is an expense. It comes under nominal account. Applying the rule of nominal account (debit expenses), rent is the debit aspect. Rent is paid in cash (real account). Since cash is going out, cash is credit.
- (i) Wage is an expense. It is a nominal account. When we apply the rule of nominal account (debit all expenses) wage is the debit aspect. Wages are paid in cash (real account). Since cash is going out, cash is the credit aspect.
- (j) Commission received is an income. It is a nominal account. According to the rule of nominal account (credit all incomes), commission is credit aspect. It is received in cash (real account). Since cash is coming in, cash is debit aspect.

MEANING OF JOURNAL

The word 'Journal' is derived from the French word 'Jour'. It means a 'Day'. Therefore, journal means daily record. It is the daily record of business transactions in a chronological order. It is a chronological record in the sense that transactions are recorded in the journal in the order in which they occur i.e. in the order of dates. It is a book of original entry because transactions are first recorded in the journal. In short, journal is a primary record of business transactions.

Today business enterprises are using computers in keeping accounting records. In this case data shall be stored on CDs rather than in Journal and Ledger. However, the study of manual recording system is relevant for a proper understanding of basic accounting concepts.

The specimen (format) of a journal is given as follows:

Journal

Date	Particulars	L.F	Debit (Rs)	Credit(Rs)
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Name of account to be debited

To Name of the account to be credited

(Narration)

The five columns of journal are explained as follows:

- 1. Date:** In the first column, date of the transaction is recorded. The year is recorded at the top. Below it month and day are recorded.
- 2. Particulars:** In the second column, the names of the account will be debited and credited (debit aspect and credit aspect) are to be recorded. First the name of the account to be debited (debit aspect or debit entry) is entered in the extreme left of the particulars column. The symbol 'Dr' (Debtor) is written at the right end of the particulars column on the same line of the debit entry. This indicates that the account is debited. In the next line the name of the account to be credited (Credit aspect or Credit entry) should be written after leaving some space to the left. The credit entry begins with 'To'. This indicates that the account is credited. Then a brief explanation should be given as to why one account is debited and the other is credited. This is known as 'Narration'. It is given in brackets.
- 3. Ledger Folio (L.F):** This column is not filled at the time of recording in the journal. It is used for recording page number of the ledger to which the journal entry is posted or transferred.

4. Debit Amount: The fourth column is used to record the debit amount. It is written on the same line of debit entry.

5. Credit Amount: The fifth column is used to record the credit amount. It is written on the same line of credit entry.

Note: The recent trend is to omit the word 'Dr' and 'To' from journal entries.

IMPORTANT TERMS

1. Journalising: The process of recording transactions in the journal is known as journalizing.

2. Journal Entry: The record of each transaction in a journal is known as journal entry. Every transaction has two aspects. Therefore there are two entries. One is debit entry and the other is credit entry. Thus a journal entry consists of debit entry and credit entry for a transaction.

3. Narration: A brief explanation of a transaction given in brackets below the journal entry in the particulars column is called narration.

STEPS IN JOURNALISING

The following are the different steps to be followed in journalizing transactions:

1. First read the transaction carefully and find out the two accounts (aspects) involved in the transaction.
2. Then find out which category these accounts belong, i.e. real, or personal, or nominal.
3. Apply the rules of debit and credit and find out which account is to be debited and which is to be credited.
4. Enter the date of the transaction in the date column.
5. In the particulars column write the debit entry and in the next line write the credit entry.
6. Give narration below the journal entry in the particulars column.
7. Enter the amount in the 'Debit' and 'Credit' columns.
8. After every journal entry, a thin line should be drawn in particulars column, so that each entry is separated.

POINTS TO BE NOTED WHILE PASSING JOURNAL ENTRIES

1. While passing journal entries, the proprietor should be considered as a separate person with whom business deals. All transactions are recorded in the books of the business and not in the books of the proprietor.
2. It is not necessary to use the word A/c or 'Account' after the personal accounts. The modern trend is to omit the word 'A/c' or Account after all accounts (real, nominal and personal accounts.)
3. When it is not clearly stated in the problem whether a transaction is on a cash basis or on a credit basis, (the name of the party is not given). It may be treated as on cash. For example, sold goods Rs.5,000, it should be considered as on cash basis.

4. When the name of the party is given and there is no mention of cash paid/received, it should be considered as a credit transaction. For example, 'purchased goods from Lal', should be treated as on credit.
5. When the word 'received' or 'paid' appears in the transaction, it means cash is received or paid. For example, received dividend means cash is received by way of dividend.
6. The articles or products in which a firm deals are called goods. For example, a clothes merchant deals in clothes (goods), a furniture company deals in furniture (goods)
7. When goods are purchased, the term 'Purchase Account' should be used (Purchase A/c is debited). When assets are purchased, Assets Accounts are debited (not Purchase A/c).
8. When goods are sold, the term "Sale Account' should be used (Sales A/c is credited). When assets are sold, Assets Accounts are credited (not Sales A/c)
9. In case of nominal accounts, if the name of the receiver or giver is given in the transaction, the receiver or giver should be ignored. For example, salary paid to Shyam should be debited in salary account and not in Shyam's account. Similarly, commission received from Raju is credited in commission account and not in Raju's account.
10. Whenever the proprietor of a business brings cash or any other assets into the business an account called Capital Account should be opened in the name of the proprietor. Suppose the proprietor introduces cash into his business. Here the two accounts involved are Cash A/c and Capital A/c (A/c is the short form of Account). When business is started with assets along with cash, the assets are to be debited and the total amount brought in is credited to capital account.

OBJECTS OF JOURNAL

1. To simplify ledger
2. To provide an adequate explanation of each entry (through narration) from journal itself.
3. To ensure observance of double entry system
4. To help in solving misunderstanding and disputes in the business.

ADVANTAGES/USES/IMPORTANCE OF JOURNAL

1. It provides date wise record of all the transactions. This facilitates quick and easy reference of any transaction.
2. It provides complete record of all the transactions at one place.
3. By providing narration to each entry, journal helps to understand the purpose and nature of the entry.
4. Since the amounts to be debited and credited are written side by side, the two amounts can be compared to see that they are equal. This reduces the possibility of errors.
5. Journal is a book of prime entry or original entry. Hence in legal matters, journal is treated as main evidence in a court of law.

Example 1

Journalize the following transactions in the book of Mr. Ashok:

2009 Sept. 1 Commenced business with cash Rs.80,000

4. Purchased goods for cash Rs. 5,000
8. Purchased furniture for Rs.6,000
9. Sold goods for Rs 4,000
15. Bought goods from Madhavan for Rs. 10,000
17. Sold goods to Shyam for cash Rs. 2,000
20. Sold goods to Anil for Rs. 3,000
22. Paid Madhavan cash Rs. 5,000
23. Paid for stationery Rs.200
25. Received cash from Anil Rs. 3,000
29. Received commission Rs. 30
30. Paid salaries to Accountant Rs. 2000
30. Paid rent to landlord Rs. 1500

Journal

Date	Particulars	L.F	Debit Rs	Credit Rs.
2009 Sept 1	Cash A/c' To Ashok's Capital A/c (Started business with cash)	Dr.	80,000	80,000
4	Purchase A/c To Cash A/c (Cash Purchase)	Dr	5,000	5,000
8	Furniture A/c To Cash A/c (Purchased Furniture)	Dr.	6,000	6,000
9	Cash A/c To Sales A/c (Cash Sales)	Dr	4,000	4,000
15	Purchase A/c To Madhavan (Bought goods from Madhavan on Credit)	Dr	10,000	10,000
17	Cash A/c To Sales A/c (Cash Sales)	Dr	2,000	2,000
20	Anil To Sales A/c (Sold goods to Anil on credit)	Dr	3,000	3,000

22	Madhavan To Cash A/c (Paid cash to Madhavan)	Dr	5,000	5,000
23	Stationery A/c To Cash A/c (Paid stationery)	Dr	200	200
25	Cash A/c To Anil (Received cash from Anil)	Dr	3,000	3,000
29	Cash A/c To Commission A/c (Received commission)	Dr	30	30
30	Salary A/c To Cash A/c (Paid salaries)	Dr	2000	2,000
30	Rent A/c To Cash A/c (Paid rent)	Dr	1,500	1,500

MEANING OF LEDGER

The word 'Ledger' is derived from the Dutch word 'Ledger'. It means to 'Lie'. Therefore, ledger means a book in which various accounts are kept. It is a summary of similar transactions at one place. It is the ultimate destination of all transactions. A complete list of account titles is known as *chart of accounts*. In the ledger all transactions are classified and recorded under suitable heads of accounts in a summarized form. Thus it contains accounts of assets, expenses, incomes or persons which have taken place during a specified period. In short, ledger is a collection of accounts. It is the book of secondary entries.

In the words of Fieldhouse Arther, "ledger is the permanent storehouse of all the transactions".

POSTING

Separate accounts are opened for each person and each item on separate pages in the ledger. Then all transactions related to that person or item as recorded in the journal are transferred to the concerned account. For example, all transactions relating to a particular debtor, say Kamal, are transferred to Kamal's Account. Similarly all cash payments and cash receipts are transferred to Cash Account. This process is known as *posting*. Thus posting refers to the process of recording the transaction from journal to ledger. It is the process of transferring the debit and credit items from the journal to the respective accounts in the ledger.

ADVANTAGE OR IMPORTANCE OF LEDGER

Ledger is the second stage in the accounting cycle. It is considered to be the principal book of accounts. The need and importance of ledger may be stated as below:

1. It provides a permanent record of all the transactions
2. It gives complete information of all accounts in one book
3. It helps to know the final balance or position of each account on any date
4. It helps to prepare trial balance.
5. It helps to prepare final accounts.

In short, ledger helps a trader to achieve the objects of book keeping

DIFFERENCE BETWEEN JOURNAL AND LEDGER

<i>Journal</i>	<i>Ledger</i>
1. Book of first or prime entry	1. Book of final or secondary entry
2. Chronological record	2. Analytical record
3. The process of recording is known as journalising	3. The process of recording is known as as posting
4. It is a subsidiary book	4. It is a principal or main book
5. Final accounts cannot be prepared	5. Final accounts can be prepared
6. Unit of classification is transaction	6. Unit of classification is account
7. Narration is written after every entry	7. No narrations is given

FORM OF LEDGER

Each ledger account is divided into two equal parts. The left hand side is known as debit side and the right hand side is known as credit side. The debit side is meant for recording the debit aspect of a transaction and the credit side is meant for recording the credit aspect of a transaction. Each side is divided into four columns. They are date, particulars, J.F and amount. It may be kept in bound ledger or loose leaf form. A proforma of a ledger account is given below:

LEDGER

Dr	Name of Account				Cr				
Date	Particulars	J.F	Amount	Rs.	Date	Particulars	J.F	Amount	Rs.

These columns may be explained as follows.

1. **Date:** In the date column the date of the transactions is recorded
2. **Particulars:** These columns are used for recording the details of the transactions (i.e., debit and credit entries)
3. **J. F (Journal Folio):** These are used for recording the page numbers of the journal from where the entries are posted.
4. **Amount:** These are meant for writing the amounts of the transactions.

PROCEDURE OF POSTING TO LEDGER ACCOUNTS

Ledger is a book wherein all accounts are opened. The following steps are to be taken while posting the entries to the ledger:

1. Open separate ledger accounts for each account found in the journal. For example, consider the transaction, cash sales. This transaction involves two accounts namely, cash account and sales account. First cash account is opened and then sales account is opened. Subsequent transactions are considered (refer the journal and see the accounts involved) and accounts should be opened. It should be noted that all the transactions relating to a particular account should be recorded in the account already opened. No new account for the same should be opened in the ledger. Name of the account should be written at the top and in the centre of each account.
2. Write the word 'Dr' on the top left corner of the account, indicating the debit side. Similarly write the word 'Cr' on the right hand top corner of the account, indicating the credit side.
3. The journal entry should be posted in the order of their dates.
4. In the account opened in the ledger in the name of the debit account, write the date of the transaction in the date column, then write the other account (i.e. the account to be credited) in the particulars column. Then record the page number of the journal from where the entry is taken, in the JF column. After this, record the amount of the debit entry in the amount column. Now all these are recorded in the four columns on the left hand side (debit side). In this way the debit aspect is posted.

Then post the credit aspect of the transaction. For this, open the account to be credited. We now turn our attention to the right hand side because the account is to be credited. Write the date of the transaction in the date column, then record the other account (i.e. the account which has been debited earlier) in the particulars column. After this, fill the JF column and then write the amount of the credit entry in the amount column. Now all these are recorded in the four columns on the right hand side (credit side). In this way the credit aspect is posted and the posting of a journal entry is over. In short, the debit account in the journal is posted on the debit side of that account in the ledger by the name of credit account and the credit account in the journal is posted on the credit side of that account in the ledger by the name of debit account. Continue this procedure till all entries are posted from journal. It may be noted that every entry on the debit side of the account begins with the word 'To' in the 'Particulars' column. Similarly every entry on the credit side of an account begins with the word 'By' in the 'Particulars' column. Now-a-days the words 'To' and 'By' are not compulsory.

Thus, to debit an account means to enter an amount on the debit (left) side and to credit an amount means to enter an amount on the credit (right) side.

The following example will make the procedure of posting very clear:

On 10th November 2009, goods sold for cash Rs.10000

Journal (Page 22)

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2009				
Nov.10	Cash A/c	4	10,000	
	To Sales A/c	9		10,000
	(Cash sales)			

Ledger
Cash Account (Page 4)

Dr				Cr			
Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Nov.10	To Sales A/c	22	10,000				

Sales Account (Page 9)

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2009 Nov.10	By Cash A/c	22	10,000

Note: The debit amount in cash account by referring to the ‘Sales Account’ implies that the debit or increase in the cash has been brought about by the sales transaction.

POSTING OF COMPOUND JOURNAL ENTRIES

In compound entries there may be only one debit and many corresponding credits of equal value or there may be several debits and one credit of equal value or several debits and several credits of equal value. While posting the compound entries, the principle to be kept in mind is that for every debit there is a corresponding and equal credit. This may be explained with the help of the following transactions

On 15th October 2009 Ram paid Rs. 4800 and was allowed discount of Rs.200

Journal

Date	Particulars	L.F	Debit Rs	Credit Rs.
15.10.09	Cash A/c	Dr.	4,800	
	Discount Allowed A/c	Dr.	200	
	To Ram			5,000

(Cash recd from Ram & dis. allowed.)

Ledger

Cash A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Oct.15	To Ram		4,800				

Discount Allowed A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Oct.15	To Ram	200					

Ram's A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2009 Oct.15	By Cash A/c " Dis. Allow.		4,800 200

Note: It can be seen that both in journal and ledger total debit is equal to total credit.

BALANCING OF ACCOUNTS (CLOSING OF ACCOUNTS)

After all transactions have been posted to the various accounts in the ledger, the next step is to balance the ledger accounts. The difference between the two sides of an account is known as balance. In the words of Kohler "Balance is the difference between the total debits and total credits of an account or total of an account containing only debits or credits". If debit side of an account is more than the credit side, the balance is called debit balance. If credit side is more than the debit side, the balance is called 'credit balance'. The following steps should be taken in balancing an account:

1. Take totals of both the sides roughly.
2. Find out the difference between total debit and total credit.
3. If the total debit is more, put the difference (i.e. closing debit balance) on the credit side amount column by writing the words 'By Balance c/d (c/d indicates 'carried down') in particulars column. If the total credit is more, put the difference (i.e. closing credit balance) on the debit side amount column by writing the words 'To Balance c/d' in particulars column
4. After putting the difference in the appropriate side of an account, add both the sides of the account (alternatively, put the larger total on both sides). Draw a line above and below the total.
5. Bring down the debit balance on the debit side by writing the words "To Balance b/d (b/d indicates 'brought down') in the particulars column. Similarly bring down the credit balance on the credit side by writing the words 'By Balance b/d' in the particulars column

Thus 'c/d' indicates closing balance and 'b/d' indicates opening balance. Closing debit balance is first written on the credit side (i.e. on closing date). On the next or opening date it becomes an opening balance and it appears on the debit side i.e. opening debit balance is shown on the debit side. Similarly closing credit balance is first written on the debit side (i.e. on closing date). On the next or opening date it becomes an opening credit balance and it appears on the credit side i.e. opening credit balance is shown on the credit side.

Posting the Opening Entry: - Separate accounts should be opened for each opening asset, opening liability and capital. All opening assets show debit balances while, opening liabilities and capital (unless there is deficiency) show credit balances. In each account of opening assets opening debit balance should be written with the words "To Balance b/d". Similarly in each account of opening liabilities and also in capital account, opening credit balance should be written with the words 'By Balance b/d'. If capital a/c shows a debit balance (overdrawn), such opening balance will appear on the debit side with the words 'To Balance b/d'.

BALANCING OF DIFFERENT TYPES OF ACCOUNTS

Balancing and closing of personal accounts: Some personal accounts are closed (i.e. nil balance). Others may show either a debit balance or a credit balance. If a personal account shows a debit balance, it indicates the amount owing from him (i.e. he is a debtor). On the contrary, if a personal account shows a credit balance, it indicates the amount owing to him (i.e. he is a creditor)

Capital is a personal account. It generally shows a credit balance. If there is a deficiency in capital it will show a debit balance. Similarly drawings account is a personal account. It always shows a debit balance. Bank account may show either a debit balance (i.e. deposit) or a credit balance (i.e. overdraft)

Balancing and Closing of Real Accounts: Real accounts are the accounts of assets. Asset accounts will not be closed if they are existing in the business. These show debit balances.

Balancing of Nominal Accounts :- Nominal accounts are not balanced. At the end of every accounting period they are closed by transferring to Trading A/c or Profit and Loss A/c. Accounts of all direct expenses are closed by transferring the total to Trading A/c by writing the words 'By Trading A/c' on the credit side of the accounts of direct expenses. Sales account is closed by transferring the total to Trading A/c by writing the words 'To Trading A/c' on the debit side of sales account. All accounts of indirect expenses are closed by transferring the total to Profit and Loss A/c by writing the words 'By Profit and Loss A/c' on the credit side of indirect expense accounts. All accounts of incomes are closed by transferring the total to Profit and Loss A/c by writing the words 'To Profit and Loss A/c' on the debit side of income accounts.

Example 2

The following balances existed in the books of Gayathri Traders on 1st April 2009.

Cash Rs. 16,000, Bank (Dr) Rs. 15,000, Muthu (Debtor) Rs.8,000, Furniture Rs. 10,000, Stock Rs. 24,000, Rajan (Creditor) Rs. 9,000

The following transactions took place during the month of April

April 5 Received from Muthu Rs.3, 000

8 Sold goods for cash 5,000

12 Paid to Rajan Rs. 4,000

15 Purchased goods for cash Rs. 6,000

17 Sold good to Jeevan Rs.5,000

19 Jeevan returned goods worth Rs.500

20 Received goods form Menon Rs.10,000

Paid carriage on the goods purchased Rs.500

- 22. Bought furniture from Rao for Rs 12000
- 23. Returned goods worth Rs.800 to Menon
- 25 Withdrew cash Rs.4000 and goods worth Rs. 200 for private purpose
- 26 Received cash from Jeevan Rs. 4250 in full settlement of his account
- 29 Issued cheque for Rs.9000 to Menon in full settlement
- 30 Paid salaries Rs.3000

Pass journal entries and post them in ledger accounts

Solution

Journal

Date	Particulars	L.F	Debit Rs	Credit Rs.
2009 April 1	Cash A/c Bank A/c Muthu A/c Furniture A/c Stock A/c To Rajan To Capital A/c (Assets and liabilities at the beginning, the balance represents capital)	Dr Dr Dr Dr Dr	16,000 15,000 8,000 10,000 24,000	9,000 64,000
5	Cash A/c To Muthu (Cash received from Muthu)	Dr	3,000	3,000
8	Cash A/c To Sales A/c (Cash sales)	Dr	5,000	5,000
12	Rajan To Cash A/c (Cash paid to Rajan)	Dr	4,000	4,000
15	Purchase A/c To Cash (Cash purchases)	Dr	6,000	6,000
17	Jeevan To Sales A/c (Sold goods to Jeevan)	Dr	5,000	5,000

SCHOOL OF DISTANCE EDUCATION

19	Sales Returns A/c To Jeevan (Jeevan returned goods)	Dr	500	500
20	Purchase A/c To Menon (Credit purchase from Menon)	Dr	10,000	10,000
20	Carriage A/c To Cash A/c (Paid carriage)	Dr	500	500
22	Furniture A/c To Rao (Bought furniture from Rao)	Dr.	12,000	12,000
23	Menon To Purchase Return (Returned goods to Menon)	Dr	800	800
25.	Drawings A/c To Cash A/c To Purchase A/c (Withdrew cash & goods for personal use)	Dr	6,000	4,000 2,000
26	Cash A/c Discount Allowed A/c (5,000-500 – 4,250) To Jeevan (Cash received from Jeevan and discount allowed to him)	Dr Dr	4250 250	4,500
29	Menon To Bank A/c To Discount Received (10000-800-9000) (Paid to Menon by cheque and dis. recd.)	Dr	9,200	9,000 200
30	Salaries A/c To Cash A/c (Paid salaries)	Dr	3,000	3,000

Ledger

Dr.

Cash A/c

Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.1	To Balance b/d		16,000	Apr.12	By Rajan		4,000
Apr.5	To Muthu		3,000	Apr.15	" Purchase A/c		6,000
Apr.8	To Sales A/c		5,000	Apr.20	By Carriage A/c		500
Apr.26	To Jeevan		4,250	Apr.25	By Drawing A/c		4,000
				Apr.30	By Salaries A/c		3,000
					By Balance c/d		10,750
			28,250				28,250
May.1	To Balance b/d		10,750				

Muthu A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.1	To Balance b/d		8,000	2009 Apr.5	By Cash A/c		3,000
				Apr.30	By Balance c/d		5,000
			8,000				8,000
May1	To Balance b/d		5000				

Furniture A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.1	To Bal. b/d		10,000	2009 April30	By Balance c/d		22,000
Apr.22	To Rao		12,000				
			22,000				22,000
May 1	To Balance b/d		22,000				

Stock A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.1	To Bal. b/d		24,000	2009 Apr.30	By Trading A/c		24,000
			24,000				24,000

Rajan A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.12	To Cash		4,000	2009 Apr.1	By Balance b/d		9,000
2009 Apr.30	To Balance c/d		5,000				9,000
			9,000	2009 May.1	By Balance b/d		5,000

Sales A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.30	To Trading A/c		10,000	2009 Apr.8	By Cash A/c		5,000
				2009 Apr.17	By Jeevan.		5,000
			10,000				10,000

Purchase A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.15	To Cash A/c		6,000	2009 Apr.25	By Drawings A/c		2,000
2009 Apr.20	To Menon		10,000	2009 Apr.30	" Trading A/c(bal.)		14,000
			16,000				16,000

Jeevan A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.17	To Sales A/c		5,000	2009 Apr.19 Apr.26	By Sales Return A/c By Cash By Dis. Allowed		500
			4,250				
			250				
			5,000				5,000

Sales Return A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
Apr.17	To Jeevan		500	2009 Apr.30	By Trading A/c .		500
			500				500

Menon A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.23 Apr.29	To Purchase Ret. A/c To Bank To Dis. received		800	2009 Apr.24	By Purchase A/c		10,000
			9,000				
			00				
			10,000				10,000

Carriage A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.20	To Cash A/c		500	2009 Apr.30	By Trading A/c		500
			500				500

Rao A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
Apr.30	To Balance c/d		12,000	2009 Apr.22	By Furniture A/c		12,000
			12,000	May1			12,000
							By Balance b/d

Purchase Return A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.30	To Trading A/c		800	2009 Apr.23	By Menon		800
			800				800

Drawings A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.25	To Cash To Purchase A/c		4,000	2009 Apr.30	By Balance c/d		6,000
			2,000				
May.1	To Balance b/d		6,000				6,000
			6,000				

Discount Allowed A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.26	To Jeevan		250	2009 Apr.30	By P/L A/c		250
			250				250

Bank A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.29	To Balance b/d		15,000	2009 Apr.29	By Menon A/c.		9,000
				Apr.30	By Balance c/d		6,000
			15,000				15,000
May1	To Balance c/d		6,000				

Salaries A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.30	To Cash A/c		3,000	2009 Apr.30	By P/L A/c		3,000
			3,000				3,000

Capital A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.30	To Balance c/d		64,000	2009 Apr.1	By Balance b/d		64,000
			64,000				64,000
				May1	By Balance b/d		64,000

Discount Received A/c

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2009 Apr.30	To P/L A/c		200	2009 Apr.29	By Menon		200
			200				200

CHAPTER-2

SUBSIDIARY BOOKS

In small concerns there is only limited number of transactions. Hence all transactions are recorded in a single journal. But in big organizations there is large number of transactions. If all the transactions are recorded in one journal, the journal would become overburdened or bulky. This necessitates the subdivision of journal. Thus in large enterprises it would be better and convenient to divide the journal into various parts. These subdivisions of journal are called subsidiary books. These are also known as *Special Journals*.

MEANING OF SUBSIDIARY BOOKS

The subdivisions of journal for recording transactions of similar nature are known as subsidiary books. These books are books of original entry. This is so because transactions are first recorded in these books and later on transferred or posted to respective ledger accounts. This is the practical system of accounting. This is also known as *English System*.

ADVANTAGES OF SUBSIDIARY BOOKS

The advantages of maintaining special journals may be summarized and follows:

1. It facilitates division of work and specialization because different persons handle different journals.
2. Due to division of work, it is possible to perform accounting processes simultaneously. Thus lesser time is required to complete accounting work. In the meantime efficiency is increased.
3. It reduces the possibility of errors and frauds. It also helps in location of errors, if any.
4. A lot of useful data like credit sale, credit purchase, cash payment, cash receipt etc are available at one place.
5. Each employee is entrusted to maintain a particular book. Hence he can be held responsible for the errors committed in that book.
6. Recording is simplified, because transactions are not journalised.
7. Posting is also simplified because only the totals are considered and not all the details.

TYPES OF SUBSIDIARY BOOKS

The following are the main subsidiary books generally maintained by business enterprises:

<i>Subsidiary Books</i>	<i>Nature of Transactions Recorded</i>
1. Cash Book	Cash and bank transactions
2. Purchase Book	Credit purchase of goods
3. Sales Book	Credit sale of goods
4. Sales Returns Book	Goods returned by customers
5. Purchase Returns Book	Goods returned to suppliers

- | | |
|--------------------------|---------------------------------------|
| 6. Bills Receivable Book | Bills drawn on customers |
| 7. Bills Payable Book | Bills accepted in favour of suppliers |
| 8. Journal Proper | All remaining transactions |

These books are discussed here under:

CASH BOOK

In every business concern generally there is large number of cash transactions. For the purpose of recording all such transactions a separate book is maintained. This is called cash book. Thus cash book is a subsidiary book meant for recording all cash transactions. In this book all cash receipts and cash payments are recorded in a chronological order.

Cash Book is a subsidiary book as well as a principal book. It is a subsidiary book (or book of original or prime entry) because transactions are directly recorded in this book. It is a principal book (or book of final entry) because one aspect of the transactions relating to cash is completed in the Cash Book itself and only the second aspect has to be posted into the ledger. Another reason is that it is ruled like a ledger and only one type of transaction is recorded in it. When Cash Book is prepared there is no need to prepare cash account in the ledger. Thus Cash Book plays the double role of Journal as well as Ledger. In short, Cash Book is both a Journal and a Ledger. In fact, it is a Journalized Ledger

A Cash Book has two sides- debit side and credit side. All receipts are recorded on the debit side and all payments are recorded on the credit side

ADVANTAGES OR IMPORTANCE OF CASH BOOK

Cash Book is a very important and popular book for every business whether big or small. The following are the main advantages of Cash Book:

1. It is useful for recording all cash receipts and cash payments during a given period.
2. It enables to know cash in hand and cash at bank at any time.
3. There is no need to prepare separate cash account. Hence it saves time and labour.
4. It helps to avoid fraud and misappropriation of cash.

TYPES OF CASH BOOK

There are four types of Cash Book. They are:

1. Simple or single column cash book
2. Double (two) column cash book
3. Three column cash book
4. Petty cash book

SIMPLE OR SINGLE COLUMN CASH BOOK

This is the simplest form of cash book. It has only one column (cash column) for amount on each side. On the debit side all receipts are recorded. On the credit side all payments are recorded. The format of a simple Cash Book is given below:

Simple Cash Book

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs
------	-------------	-----	------------	------	-------------	-----	-----------

POINTS TO REMEMBER WHILE PREPARING SIMPLE CASH BOOK

1. If opening balance of Cash Book is given, it should be written first on the debit side as 'To Balance b/d'.
2. Every entry made on the debit side should begin with the word 'To' and every entry made on the credit side should begin with the word 'By' in the particulars column.
3. All receipts should be recorded on the debit side and all payments on the credit side
4. Only one amount column (cash column) should be provided on either side
5. It is balanced like other accounts. Cash columns are balanced. The receipt column (cash column on the debit side) will always be bigger than the payment column. Hence the debit side is totaled first and written there. Then this total is written on the credit side also. The difference between total debit (receipts) and total credit (payments) is the closing balance of cash. This is written on the credit side as 'By Balance c/d'. On the next opening date, it becomes 'To Balance b/d'.

Cash book will always show a debit balance. This is so because no one can pay more than what he has got.

POSTING OF SIMPLE CASH BOOK

The opening and closing balance of Cash Book is not to be posted to any account. The entries on the debit side of the Cash Book are posted to the credit of the respective accounts in the Ledger as 'By Cash A/c'. The entries on the credit side of the Cash Book are posted to the debit side of the respective accounts in the ledger as 'To Cash A/c'.

Example 1

Prepare a single column cash book

2009

- | | |
|-------|--|
| May 1 | Received cash from Nirmal Rs. 4,000 |
| 7 | Paid Rajagopal Rs. 300 |
| 9 | Paid to Joseph Rs. 200 |
| 10 | Received interest from Achuthanpillai on the loan given to him Rs. 500 |
| 12 | Cash sales Rs, 5,000 |
| 15 | Office furniture purchased Rs. 5,000 |
| 20 | Paid salaries Rs.1,000 |
| 31 | Rent paid Rs. 200 |

Solution

Dr.	Cash book				Cr.		
Date	Receipts	LF	Amount	Date	Payments	LF	Amount
			Rs.				Rs.
2009				2009			
May1	To Nirmal		4000	May7	By Rajagopal		300
10	To Interest		500	9	By Joseph		200
12	To Sales		5000	15	By Office		
					furniture		5000
				20	By Salaries		1000
				31	By Rent		200
					By Bal. c/d		2800
			9500				9500
June1	To Bal. b/d		2800				

TWO COLUMN CASH BOOK (CASH BOOK WITH DISCOUNT COLUMN)

In the two column Cash Book one additional column for 'Discount' is provided on either side to record cash discount. Thus two column cash book has two columns on each side- cash column and discount column. In the additional column added on the debit side discount allowed is recorded. In the extra column added on the credit side, discount received is recorded. Hence two column cash book is also known as cash book with cash and discount column.

The format of double column cash book is given below:

Two Column Cash Book

Date	Receipts	L.F	Dis.	Cash	Date	Payments	L.F.	Dis.	Cash
			All.	Rs.				Rece	Rs.

POINTS TO REMEMBER WHILE PREPARING TWO COLUMN CASH BOOK

- 1 Two columns should be provided on each side—cash column and discount column.
- 2 Opening balance of cash is recorded on the debit side (in the cash column) as 'To Balance b/d'.
- 3 When cash is received it is recorded in the cash column on the debit side. The discount allowed is recorded in the discount allowed column on the debit side.
- 4 All other receipts are recorded in the cash column on the debit side.
- 5 When cash is paid it is recorded in the cash column on the credit side. The discount received is shown in the discount received column on the credit side.
- 6 All other payments are written in the cash column on the credit side.
- 7 Cash columns are balanced. This has already been discussed.
- 8 Discount columns are not balanced. They are merely totaled. The total of the discount column on the debit side shows the total discount allowed to customers. The total of the discount column on the credit side shows the total discount received from the suppliers.

POSTING OF TWO COLUMN CASH BOOK

The discount columns of Cash Book are only memorandum columns. They are not part of double entry system. Hence the procedures for posting these items are slightly different. Discount received total is credited to Discount Received A/c in the ledger. Similarly Discount Allowed (total) is debited to Discount Allowed A/c in the ledger. The individual items of discount allowed are posted to the credit of their respective personal accounts. Each item of discount received is posted to the debit of the respective personal accounts. The cash columns are posted in the same way as in the simple cash book.

Example 2

Enter the following transactions in double column cash book.

2009	Rs.
Jan.1 Cash in hand	5000
5 Purchased goods for cash	5000
8 Wages paid	500
10 Cash withdrawn from bank	2500
12 Cash sales	2000
15 Capital introduced	25000
20 Cash paid to Ramanan	4950
Discount allowed by him	50
23 Cash received from Abraham	3950
Discount allowed to him	50

Solution

Double Column Cash Book

Date	Receipts	LF	Dis.	Amt.	Date	Payments	LF	Dis.	Amt.
			Rs.	Rs.				Rs.	Rs.
2009					2009				
Jan.1	To Bal b/d			5000	Jan.5	By Purchase			5000
10	To Bank			2500	8	By Wages			500
12	To Sales			2000	15	By Ramanan		50	4950
15	To Capital			25000	31	By Bal. c/d			28000
23	To Abraham		50	3950					
			50	38450				50	38450
Feb.1	To Bal b/d			28000					

THREE COLUMN CASH BOOK

When cheques are received from debtors, they are paid into bank. The bank collects the cheques and credits the amount in the bank account. Similarly businessman makes some payments through cheques. In this case businessman will maintain triple column cash book. This type of cash book contains three columns on both sides. These three columns are cash, bank and discount. Thus the cash book which contains bank column in addition to cash and discount columns is called three column cash book.

The businessman will always keep only a small cash balance and deposit the rest in the bank account.

The specimen of the three column cash book is given below:

Three Column Cash Book

Date	Receipts	LF	Dis	Cash	Bank	Date	Payments	LF	Dis	Cash	Bank	
	All.			Rs.	Rs.					Rec.	Rs.	Rs.

Some firms maintain Two Column Cash Book and a separate bank account in the ledger.

POINTS TO REMEMBER WHILE PREPARING THREE COLUMN CASH BOOK

- In the case of a newly started business, the amount of capital is shown in the cash column on the debit side with the description 'To Capital A/c' in the particulars column. In the case of an existing business the opening balance of cash is shown in the cash column on the debit side with the description 'To Balance b/d'. The opening balance of bank may be debit (if deposit) or credit (If overdraft). If it is debit balance, it is recorded in the bank column on the debit side as 'To Balance b/d. If it is credit balance, it is recorded in the bank column on the credit side as 'By Balance b/d'.
- There are certain transactions which affect both cash account and bank account. Hence they are shown on both sides of the cash book (i.e. on the debit side as well as on the credit side). These are called *contra entries*. Thus contra entries are those journal entries which appear on both sides of a Cash Book. Examples of contra entries are as follows:

(a) *Cash paid into bank (Cash deposited with bank)*: This transaction involves both cash and bank accounts. Therefore it is entered on both sides of the cash book (remember the journal entry). The effect of the transaction is that the cash goes out (decreases) and bank balance increases (Bank is the receiver). Therefore bank account is to be debited and cash account is to be credited. It is recorded in the bank column on the debit side (bank balance increases) by writing 'To Cash A/c'. The same is shown in the cash column on the credit side (cash balance decreases) by writing 'By Bank A/c

(b) *Cash withdrawn from bank (for office use)*: This transaction also involves cash and bank accounts. The effect of the transaction is that cash comes in (increases) and bank balance decreases (bank is the giver). Therefore, cash account is to be debited and bank account is to be credited. This is recorded in the cash column on the debit side (cash increases) by writing 'To Bank A/c'. The same is shown in the bank column on the credit side (bank balance decreases) by writing 'By Cash A/c'.

(c) *Cheque received but paid it into bank at a later date:* If cheque received is sent to bank for collection at a later date, the cheque received is shown in cash column on the debit side (cheque received may be treated as cash received) with the words 'To Personal A/c (from whom cheque is received)'. When the cheque is deposited in the bank for collection on a subsequent date, a contra entry is recorded. In this case the amount is shown in the bank column on the debit side (bank balance increases) with the words 'To Cash A/c'. The same is shown in the cash column on the credit side (cheque goes away) with the words 'By Bank A/c'

When the cheque received is paid into bank on the same day, it is entered in the bank column on the debit side (without entering in cash column) with the words 'To Customer's A/c (this is not a contra entry).

Contra entries are indicated by the letter 'C' on both sides. The term contra is a Latin phrase. It means 'opposite side'. It indicates that the other aspect of the transaction can be found on the opposite side.

3. If the cheque sent to bank for collection is dishonored, it is recorded in the bank column on the credit side (customer or debtor account is to be debited and bank account is credited).
4. All receipts whether in cash or in cheques are written on the debit side and all payments are written on the credit side. Payment made in cash is recorded in the cash column (credit side). Payment made in cheque is shown in the bank column (credit side).
5. Sometimes bank makes payment on behalf of its customer (insurance premium, rent, interest on loan etc.). These are recorded in the bank column on the credit side (bank balance decreases). Similarly, when bank collects incomes on behalf of its customer (interest, dividend etc.) these will be recorded in the bank column on the debit side (bank balance increases).
6. Bank charges and commission should be entered in the bank column on the credit side (bank balance reduces).
7. If any customer remits directly into bank it should be entered in the bank column on the debit side.
8. Bank and Cash columns are separately balanced. Cash column always shows a debit balance. In bank column it can be either debit balance (deposit) or credit balance (overdraft). Therefore totals of bank columns are taken on rough sheet and balance is found. If the debit total is more than the credit total, it will be debit balance. It is shown in the bank column on the credit side with the words 'By Balance c/d'. If the credit total is bigger than the debit total, it will be credit balance (overdraft). It is shown in the bank column on the debit side with the words 'To Balance c/d'.

POSTING OF THREE COLUMN CASH BOOK

Opening balances of cash and bank columns are not posted. Closing balances are carried forward to the next period. Contra entries are also not posted. Rest of the items on the debit side and credit sides of cash and bank columns are posted in the credit and debit sides of the concerned accounts respectively.

Example 3

Enter the following transactions in triple column cash book and ledger accounts.

2009

- June. 1 Cash in hand Rs. 4000, cash at bank Rs. 10000
- 5 Goods sold for cash Rs. 2500
- 10 Received a cheque from Thilak Rs. 2000 on account of sales done. Discount allowed to him Rs. 50
- 11 The above cheque sent for collection
- 15 Cash paid to Sunder Rs. 5000
Discount received Rs. 100
- 20 Cash paid into bank Rs. 2000
- 21 Draw a cheque for Rs. 1000 for personal use
- 23 Paid salaries by cheque Rs. 1000
- 24 Cash withdrawn for office use Rs. 1200
- 26 Sold goods on credit Rs. 2500 to Sankar
- 27 Cheque received from Sankar Rs. 2500 and sent for collection
- 30 Sankar's cheque dishonoured

Solution

Dr.		Cash Book						Cr.			
Date	Particulars	LF	Dis	Cash	Bank	Date	Particulars	LF	Dis	Cash	Bank
			All	Rs.	Rs.				Rec	Rs.	Rs.
2009						2009					
Jun1	To Bal. b/d			4000	10000						
5	To Sales			2500		Jun11	By Bank	c			2000
10	To Thilak	50		2000		15	By Sunder		100	5000	
11	To Cash	c			2000	20	By Bank	c		2000	
20	To Cash	c			2000	21	By Drawings				1000
24	To Bank	c		1200		23	By Salaries				1000
27	To Sankar				2500	24	By Cash	c			1200
						30	By Shankar				2500
							By Bal. c/d			700	10800
			50	9700	16500				100	9700	16500
Jul1	To Bal. b/d			700	10800						

Ledger

Sales A/c

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
2009				2009			
				Jun5	By Cash		2,500
				26	By Sankar		2,500
							5,000

Thilak

2009	Particulars	Rs.	2009	Particulars	Rs.
June.1	To Balance b/d	??	Jun10	By Cash	2,000
				By Discount	50

Sunder

2009	Particulars	Rs.	2009	Particulars	Rs.
Jun15	To Cash	5,000			
	To Discount	100	Jun30	By Bal. b/d	??

Drawings A/c

2009	Particulars	Rs.	2009	Particulars	Rs.
Jun21	To Bank	1,000			

Salaries A/c

2009	Particulars	Rs.	2009	Particulars	Rs.
Jun23	To Bank	1,000			

Sankar's A/c

2009	Particulars	Rs.	2009	Particulars	Rs.
Jun26	To Sales	2,500	Jun27	By Bank	2,500
30	To Bank	2,500	30	By Bal. c/d	2,500
					5,000
Jul.1	To Bal. b/d	2,500			

Note: Credit sale to Shankar should not be entered in cash book as it is a credit transaction.

PETTY CASH BOOK

Every business concern has to make a large number of small expenses quite frequently. These expenses include stationery, cartage, postage and telegrams, travelling expenses, small donations etc. These are called petty expenses. The term 'petty' is derived from the French word 'petit'. It means small. The petty expenses are required to be paid in cash and not by cheques. If such small payments are recorded in the cash book, it will become very bulky. Besides, the main cashier will be overburdened. To avoid inconvenience to main cashier and to save time, a separate

book is maintained to record small expenses. This book is known as Petty Cash Book. Thus petty cash book is a subsidiary book maintained for recording minor expenses to be paid in cash. It is maintained by a petty cashier. He is given a certain amount of money by the chief cashier. The petty cashier makes small or petty payments out of this money.

ADVANTAGES OR MERITS OF PETTY CASH BOOK

1. It helps to reduce the number of entries in the main cash book.
2. It saves time and labour of main cashier.
3. Specialised knowledge of accounting is not required.
4. The total of all petty expenses are posted in the main cash book. It is, therefore, easy and convenient to make ledger posting from petty cash book.
5. Every petty expense is to be supported by vouchers. This minimizes chances of frauds.
6. It helps to exercise effective control over small payments.

IMPREST SYSTEM

Generally petty cash book is maintained on imprest system. Under this system a fixed amount is given to the petty cashier in advance in the beginning of a period (a week or month) by the main cashier. The petty cashier makes all the petty payments out of this amount. He records these in the petty cash book. At the end of the period he submits the account to the chief cashier. The chief cashier examines the account and gives the petty cashier a fresh advance equal to the amount spent by him during the period. Thus at the beginning of each period (week or month) the petty cashier has the same fixed balance. This fixed amount in the hands of the petty cashier at the beginning of each period is known as ‘imprest’. This is also known as *float*. For example, Rs.500 are given to the petty cashier on 1st January 2009 He spends Rs.475 during the month. At the end of the month the petty cashier will be given the exact amount spent by him i.e. Rs.475. Thus at the beginning of the next month, again he will have the same amount as he had in the beginning i.e. Rs.500 (amount reimbursed plus the unspent balance). Thus the system of giving the exact amount of money spent by the petty cashier is called imprest system of petty cash.

TYPES OF PETTY CASH BOOK

There are two types of petty cash book. They are:

1. Simple petty cash book.
2. Analytical or columnar petty cash book

Simple petty cash book: Under this type of petty cash book, only one amount column is given for all types of petty payments. It resembles to simple cash book. The format of a simple petty cash book is given as follows:

Simple Petty Cash Book

Date	Receipt	Amt.	Date	Payments Voucher	Amt.
		Rs.		No.	Rs.

Analytical Petty Cash Book: Generally the petty cash book is maintained in a columnar or analytical form. In this type of petty cash book all petty expenses are classified into five or six heads. Separate columns are provided on the payment side for each class of petty expenses in addition to a total column. Every transaction is entered twice, once in total column and secondly in the appropriate analytical column.

A specimen of an analytical petty cash book is given below:

Analytical Petty Cash Book

Cash Received	Date	Particulars	L F	Total	Postage	Stationary	Wages	Travelling expenses	Telegram
---------------	------	-------------	--------	-------	---------	------------	-------	---------------------	----------

The amount received from the main cashier is recorded in the amount received column with the words 'To Cash A/c' in the particulars column. At the time of making payments, write 'By Expenses' in the particulars column and write the amount in total as well as in particular expense column. At the end of the period (week or month) all columns are totaled. The total of total column is compared with the total receipt column (amount received) and balance is obtained. The closing balance is shown as 'By Balance c/d'. It is carried forward to the next week or month. In the beginning of the next week or month it becomes the opening balance. It is shown as 'To Balance b/d'.

Example 4

Prepare a columnar petty cash book on imprest system and post them into ledger for the month of April, 2009

2009

- April 1 Cash received from the chief cashier Rs. 300
- 2 Paid postage Rs. 40
- 5 Paid stationery Rs. 25
- 8 Paid wages Rs. 100
- 15 Paid travelling expenses Rs. 20
- 25 Paid Telegram Rs. 10

Solution

Petty Cash Book

Cash Received	Date	Particulars	L F	Total	Postage Payments	Stationery	Wages	Travelling exp.	Telegram
	2009								
300	Apr.1	To Cash							
	2	By Postage		40	40				
	5	By Stationery		25		25			

SCHOOL OF DISTANCE EDUCATION

8	By Wages	100			100				
15	By Travelling Exp.		20			20			
25	By Telegram	10				10			
		195	40	25	100	20	10		
30	By Balance c/d	105							
300		300							
105	May1 To Balance b/d								
195	May1 To Cash received								

Ledger Accounts

Postage A/c

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount
2009							
Apr.2	To Petty Cash		40				

Stationery Account

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount
2009							
Apr.5	To Petty Cash		25				

Wages A/c

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount
2009							
Apr.8	To Petty Cash		100				

Travelling Expense A/c

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount
2009							
Apr.15	To Petty Cash		20				

Telegram A/c

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount
2009							
Apr.25	To Petty Cash		10				

Petty Cash A/c

Date	Particulars	JF Amount	Date	Particulars	JF Amount
2009			2009		
Apr.1	To Cash	300	Apr.2	By postage	40
			5	By Stationery	25
			8	By Wages	100
			15	By Travelling Expenses	20
			25	By Telegram	10
			31	By Bal. c/d	105
		300			300
May1	To Balance b/d	105			
	To Cash	195			

PURCHASE BOOK

Purchase book is a subsidiary book used for recording credit purchase of goods. It is also known as Purchase Day Book or Purchase Journal or Invoice Book. Proforma of purchase book is given below:

Purchase Book

Date	Name of suppliers	Invoice No.	L.F	Details	Amount
------	-------------------	-------------	-----	---------	--------

POINTS TO REMEMBER WHILE PREPARING PURCHASE BOOK

1. Only credit purchase of goods should be taken. Cash purchases will be recorded in the cash book.
2. Credit purchase of assets should not be taken. These are taken in general journal.
3. Only net amount should be written in the amount column. (i.e. after deducting trade discount)
4. Credit purchases are recorded in the chronological order. The names of the suppliers from whom goods are purchased are recorded in the second column. Other details of goods purchases are shown in the details column.
5. After recording all entries in the purchase book, the amount column is totaled.

Procedure of posting from the purchase book: Purchase book is totaled periodically (usually on monthly basis). At the end of every month the total value of credit purchase (total of the amount column) is posted to the debit side of the Purchase Account in the ledger with the words 'To Total for the month'. Then individual suppliers' accounts are credited with the respective amounts with the words 'By Purchase A/c' in the particulars column of the ledger account. The total credit of all suppliers' accounts will be equal to the total purchase debited in the purchase account.

Example 5

Enter the following transactions in the purchase book and post them into ledger.

2009

- April 6 Bought from Vishnu & Co., Calicut,
 500 yds. of coating @ Rs. 40 per. Yd.
 20 Piece of 480 yds. Shirting @ 20 per. Yd.
 Less 10% trade discount on these goods.
- 10 Purchased from Madhavan & Sons., Kasargod.
 200 piece of coating @ Rs. 400 per piece.
 100 piece of coating @ 250 per piece.
- 25 Bought from Ganesh & Co., Mangalore.
 1000 yds. of terrycot @ Rs. 100 per yard.
 500 Janatha Saree @ Rs. 200 per Saree
 Less 5% trade discount on these goods.
- 28 Purchased goods from Manohar, for cash Rs. 10,000.
- 30 Bought a machine on credit from Surya Traders for Rs. 20,000.

Solution

Purchase Book

Date	Name of Suppliers	Inv. LF No.	Details Rs.	Amount Rs.
2009				
Apr. 6	Vishnu & Co., Calicut			
	500yds. of coating @ Rs. 40 per. Yd.			20,000
	20 Piece of 480 yds. Shirting @ 20 per. Yd.			1,92,000
				2,12,000
	Less: Trade discount 10%			21,200
				1,90,800
10	Madhavan & Sons., Kasargod.			
	200 piece of coating @ Rs. 400 per piece.			80,000
	100 piece of coating @ 250 per piece.			25,000
				1,05,000
25	Ganesh & Co., Manglore.			
	1000 yds. of terrycot @ Rs. 100 per yard.			1,00,000
	500 Janadha Saree @ Rs. 200 per Saree			1,00,000
				2,00,000

Less: Trade discount 5%	10,000	1,90,000
Total		4,85,800

Note: Purchase of goods for cash and purchase of machinery on credit should not be taken in purchase book.

Ledger

Vishnu & Co.

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount
2009							
				Apr. 6	By Purchase A/c		1,90,800

Madhavan & Sons

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount
2009							
				Apr. 10	By Purchase A/c		1,05,000

Ganesh & Co.

2009							
				Apr. 25	By Purchase A/c		1,90,000

Purchase A/c

2009							
	Apr. 30	To Sundries as					
		per Purch. Book	4,85,800				

SALES BOOK

Sales book is a subsidiary book meant for recording credit sales of goods. It is also known as Sales Day Book or Sales Journal. Specimen of Sales Book is given as follows:

Sales Book

Date	Name of Customers	Invoice No.	L.F	Details	Amount
				Rs.	

POINTS TO REMEMBER WHILE PREPARING SALES BOOK

1. Only credit sale of goods should be entered in the Sales Book. Cash sales will be recorded in the cash book.
2. Credit sale of assets should not be taken.
3. Only net amount should be entered in the amount column (i.e. after deducting trade discount)
4. Credit sales are recorded in the chronological order. Names of customers to whom goods are sold on credit are entered in the second column. Other details of goods sold are entered in the details column.
5. After recording all entries, the amount column is totaled.

Procedure of posting from Sales Book: Sales book is closed periodically, usually at the end of each month. The total of the Sales Book is posted to the credit side of Sales A/c as 'By Total for the month'. Individual Customers' Accounts are debited with the respective amounts by writing 'To Sales A/c' in the particulars column of the ledger account. The total debit of all customers' accounts will be equal to the total sales credited in the sales account.

Example 6

Record the following transactions in sales book and post them in the ledger.

2009

- April. 8 Sold to Nagji & Co., Calicut
1000 metres shirting @ Rs. 35 per metre.
2500 metres long cloth @ Rs. 20 per metre.
750 metres flannel @ Rs. 80 per metre.
Less: Trade discount 10%.
- April 15 Sold to Ram brothers, Ernakulam
1000 metres shirting @ Rs. 60 per mtr.
200 metres plain silk @ 75 per metre.
- April 22 Sold to Anil Prasad, Kollam
500 Sarees @ Rs. 120 each
1000 Silk Sarees @ Rs. 400 each
Less: Trade discount 10%.
- April 26 Sold to Manmohan for Cash, 200 sarees @ Rs. 50 each.
- April 29 Sold furniture for Rs. 1,000

Solution

Sales Book

Date	Name of Customers	Inv. No.	LF	Details	Amount
				Rs.	Rs.
2009					
Apr8	Nagji & Co., Calicut				
	1000 metres shirting @ Rs. 35 per metre.				35,000
	2500 metres long cloth @ Rs.20 per metre.				50,000
	750 metres flannel @ Rs.80 per metre.				60,000
				1,45,000	
	Less: Trade discount 10%.			14,500	1,30,500
Apr15	Ram brothers, Ernakulam				
	1000 metres shirting @ Rs. 60 per mtr.				60,000
	200 metres plain silk @ 75 per metre.			15,000	75,000
Apr22	Anil Prasad, Kollam				
	500 Sarees @ Rs. 120 each			60,000	
	1000 silk Sarees @ Rs. 400 each			4,00,000	
				4,60,000	
	Less: Trade discount 10%.			46,000	4,14,000
	Total				6,19,500

Note: Sale of goods for cash and sale of asset should not be entered in sales book.

Ledger A/c

Nagji & Co.

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount
2009							
Apr.6	To Sales A/c		1,30,500				

Ram Brothers

2009			
Apr.15	To Sales A/c		75,000

Anil Prasad

2009			
Apr.22	To Sales A/c		4,14,000

Sales A/c

2009

Apr.30 By Sundries as

per Sales Book 6,19,500

PURCHASE RETURNS BOOK

The goods which are purchased on credit may be returned by the buyer if they are defective or they are not according to the terms and conditions. Such returns are recorded in purchase returns book. Thus purchase returns book is a subsidiary book used for recording purchase returns. It is also known as 'returns outward book'.

When goods are to be returned to supplier, a debit note is prepared and is sent to supplier along with the goods to be returned. *Debit Note* informs the supplier that his account has been debited with the value of goods returned. It contains the full description and the net value of goods returned along with the reasons for returning the goods. If trade discount was allowed by the supplier, the same rate of discount may be deducted from the prices of the goods returned.

The specimen of the purchase returns book is given below:

Purchase Returns Book

Date	Name of suppliers	Debit Note L.F	Details	Amount
		No.	Rs.	Rs.

Posting from the Purchase Returns Book: The purchase returns book is totaled periodically and the entries therein are posted. Total of the purchase returns book is posted to the credit of the Purchase Returns Account with the word 'By Total as per purchase returns book'. 'Individual Suppliers' accounts are debited with the respective amounts by writing 'To Purchase Returns A/c'.

SALES RETURNS BOOK

After the goods have been sold, they may be returned by the buyer due to some reasons. Such returns of goods are recorded in a book which is called Sales Returns Book. It is a subsidiary book in which sales returns are recorded. Sales Returns Book is also known as Returns Inward Book.

When goods are received back along with the debit note, the seller acknowledges the same by sending the Credit Note to the customers. The *Credit Note* informs that customers' account has been credited with the amount stated in the Credit Note.

The format of a sales returns book is given below:

Sales Returns Book

Date	Name of Customers	Credit Note L.F	Details	Amount
		No.	Rs.	Rs.

Posting from the Sales Returns Book: The amount column of sales returns book is totaled and this total is posted to the debit of Sales Returns A/c with the words 'To Total as per Sales Returns Book'. Individual customers' accounts are credited with the respective amounts by writing 'By Sales Returns A/c'.

JOURNAL PROPER (GENERAL JOURNAL)

All those transactions for which special journals are not maintained are recorded by passing journal entries. Book maintained to record these entries is known as Journal Proper. It is also known as *General Journal*. The following types of entries are generally recorded in the Journal Proper:

1. Opening entries (Entries for opening accounts in the beginning of an accounting year)
2. Closing entries (Entries to close revenue expenditure and revenue receipts by transferring to Trading and Profit and Loss Account)
3. Adjusting entries (Entries for making various adjustments at the time of preparing final accounts)
4. Transfer entries (entries for making transfers from one account to another)
5. Rectification entries (Entries to rectify or correct the errors in journalizing, posting, carry forward etc)
6. Other entries
 - (a) Credit purchase of assets
 - (b) Credit sales of assets
 - (c) Loss of property or goods by fire, theft etc.
 - (d) Goods withdrawn by proprietor for personal use
 - (e) Goods distributed as samples
 - (f) Cancellation of discount allowed or received in case of dishonour of bill of exchange
 - (g) Endorsement and dishonour of bill of exchange
 - (h) Transactions in respect of consignment, joint venture etc.

Thus all transactions which cannot be entered in any of the special journals are recorded in Journal Proper. These transactions are not of frequent nature.

CHAPTER 3

TRIAL BALANCE

When transactions take place, first they are recorded in the journal. Then the journal entries are posted to ledger. Then each ledger account is balanced. After this a list of these ledger balances is prepared to make sure that posting has been done correctly. This list is called Trial Balance.

MEANING AND DEFINITION OF TRIAL BALANCE

When all entries in the journal (or subsidiary books) have been posted into the ledger, it is necessary to test whether the accounting work is done accurately and correctly. For this purpose a statement is prepared by taking all balances (debit and credit) from ledger accounts. This statement is known as Trial Balance. Thus a trial balance is a statement of debit and credit balances extracted from all accounts in the ledger for testing the arithmetical accuracy. It is a device for verifying the equality of debits and credits. Pacioli is said to have advised that a person should not go to sleep at night until debits equalled the credits. The debit balances are shown in one column and the credit balances are shown in another column, the amounts of the two columns are totaled. If the debit total is equal to credit total, we can say 'there is an arithmetical accuracy in books of account'. It is drawn at any time, or at periodic intervals, or at the end of an accounting period.

OBJECTIVES OR FUNCTIONS OF TRIAL BALANCE

1. To ensure arithmetical accuracy of books of accounts.
2. To provide a base for preparing final accounts
3. To help in detecting certain errors
4. To serve as an aid to management in decision making

METHODS OF PREPARING TRIAL BALANCE

Following are the three methods of preparing the trial balance:

- 1. Total method:** Under total method, debit totals and credit totals of each account are entered in the trial balance in the debit and credit columns respectively. Both the sides of the trial balance should be equal. If they are not equal, we can understand that there are certain errors.
- 2. Balance method:** This method is based on the assumption, "If equals are subtracted from equals, the remainders are equal." Under this method, trial balance is prepared with the balances extracted from the ledgers and not total. Debit balances should be entered in debit column and credit balances shall be taken in credit column. Generally trial balance is prepared under balance method.
- 3. Total and balance method:** This method is a combination of the first and second methods. In this method trial balance is prepared by taking totals as well as balances from each ledger account.

POINTS TO REMEMBER WHILE PREPARING TRIAL BALANCE

1. All assets accounts have debit balances. Cash A/c, Cash at Bank A/c, B/R A/c, Debtors A/c, Stock A/c, Building A/c, Plant and Machinery A/c, Furniture A/c, Goodwill A/c etc. have debit balances. These should be written on the debit side.
2. All liabilities accounts have credit balances. Creditors A/c, Outstanding expense A/c, Income received in advance A/c, bank overdraft A/c, B/P A/c etc have credit balances.
3. Capital A/c shows a credit balance (if there is deficiency in Capital A/c, it will show a debit balance).
4. Reserves on assets and reserves created out of profits show credit balances.
5. Drawings A/c shows a debit balance.
6. Loan taken is a liability. Hence it is a credit balance. Loan given is an asset. Hence it is debit balance. If only Loan A/c is given it should be taken as liability.
7. Purchase A/c shows a debit balance and Purchase Returns (Returns outward) shows a credit balance.
8. Sales A/c shows a credit balance and Sales Returns A/c (Returns inward) shows a debit balance.
9. Losses and expenses are debit balances, while incomes and gains are credit balances.
10. There are certain items which are not specified as paid or received. Such items should be taken as paid (i.e. expenses or debit balances). For example, commission paid is an expense and commission received is an income, but if only commission is given, it may be taken as commission paid. Other examples include rent, interest, discount etc.

Example 1

The following trial balance has been prepared wrongly. You are asked to prepare the trial balance correctly:

	Debit Rs.	Credit Rs.
Cash in hand		2,000
Purchase returns	4,000	
Wages	8,000	
Establishment expenses	12,000	
Sales returns		8,000
Capital	22,000	
Carriage outward		2,000
Discount received	1,200	
Commission earned	800	
Machinery		20,000
Stock		10,000
Debtors	8,000	

Creditors	12,000	
Sales		44,000
Purchases	28,000	
Bank overdraft	14,000	
Manufacturing expenses		14,000
Loan from Ravi	14,000	
Carriage inward	1,000	
Interest on investment		1,000
	1,13,000	1,13,000

Solution

Correct Trial Balance

	Debit Rs.	Credit Rs.
Cash in hand	2,000	
Purchase returns		4,000
Wages	8,000	
Establishment expenses	12,000	
Sales returns	8,000	
Capital		22,000
Carriage outward	2,000	
Discount received		1,200
Commission earned		800
Machinery	20,000	
Stock	10,000	
Debtors	8,000	
Creditors		12,000
Sales		44,000
Purchases	28,000	
Bank overdraft		14,000
Manufacturing expenses	14,000	
Loan from Ravi		14,000
Carriage inward	1,000	
Interest on investment		1,000
	1,13,000	1,13,000

Illustration 2

Enter the following transactions in various subsidiary books, post them into ledger and prepare trial balance:

2009

- Aug 1 Cash in hand Rs. 5,000;
Cash at bank Rs. 2,000;
Capital account Rs. 10,000.
- 2 Cash purchases Rs. 2,000
- 5 Bought goods from Shreenath, for Rs. 3,000; Less 10% trade discount.
- 8 Withdraw cash from bank for office use Rs. 1,500
- 9 Sold goods to Bhaskar for Rs. 5,000; Less 5% trade discount.
- 10 Withdraw cash for personal use Rs. 1,000
- 15 Paid to Shreenath Rs. 2,600 by cheque in full settlement of his account.
- 19 Returned goods by Bhaskar Rs. 100
- 20 Received cash from Baskar Rs. 4,500 in full settlement of his account.
- 21 Purchased furniture from Ravi Rs. 5,000
- 22 Cash sales Rs. 3,000
- 23 Purchased goods from Sreejesh Rs. 2,000; Less 10% trade discount.
- 24 Goods returned to Sreejesh Rs. 50
- 27 Cash paid to Sreejesh Rs. 1,700 in full settlement of his account.
- 28 Paid into bank Rs. 2,000

Solution

Journal

Date	Particulars	LF	Details	Credit
2009			Rs.	Rs.
Aug.21	Furniture A/c	Dr.	5,000	
	To Ravi			5,000
	(Furniture purchased from Ravi)			

Sales Book

Date	Name of Customers	LF	Details	Amount
2009			Rs.	Rs.
Aug.9	Bhaskar		5,000	
	Less: 5% trade discount		250	4,750

Purchase Book

Date	Name of Suppliers	LF	Details	Amount
2009			Rs.	Rs.
Aug.5	Sreenath		3,000	
	Less: 10% trade discount		300	2,700
23	Sreejesh		2,000	
	Less: 10% trade discount		200	1,800
	Total			4,500

Sales Returns Book

Date	Name of Customers	LF	Details	Amount
2009			Rs.	Rs.
Aug.19	Bhaskar			100

Purchase Returns Book

Date	Name of Suppliers	LF	Details	Amount
2009				Rs. Rs.
Aug.24	Sreejesh			50

Ledger

Capital A/c

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2009			Rs.	2009			Rs.
Aug.31	To Balance c/d		10,000	Aug.1	By Bal. b/d		10,000
				Sep.1	By Bal. b/d		10,000

Furniture A/c

2009		Rs.	2009		Rs.
Aug.21	To Ravi		5,000	Aug.31	By Bal. c/d
Sep.1	To Balance b/d	5,000			5,000

Ravi's A/s

2009		Rs.	2009		Rs.
Aug.31	To Bal. c/d		5,000	Aug.21	By Furniture
				Sep.1	By Bal. b/d
					5,000

Sreenath A/c

		Rs.			Rs.
2009			2009		
Aug.15	To Bank	2,600	Aug.5	By purchase	2,700
	T o Discount	100			
		2,700			2,700

Sreejesh A/c

		Rs.			Rs.
2009			2009		
Aug.27	To Cash	1,700	Aug.23	By Purchase	1,800
	" Discount	50			
	" Purchase Ret	50			
		1,800			1,800

Purchase A/c

		Rs.			Rs.
2009			2009		
Aug.2	To Cash	2,000			
31	To Amount as per Purchase Book	4,500			
		6,500			

Bhaskar A/c

		Rs.			Rs.
2009			2009		
Aug.9	To Sales	4,750	Aug.19	By Sales Returns	100
				By Cash	4,500
				By Discount	150
		4,750			4,750

Sales A/c

		Rs.			Rs.
2009			2009		
			Aug.22	By Cash	3,000
			31	By Amount as per Sales Book	4,750
					7,750

Purchase Return A/c

2009	Rs.	2009	Rs.
		Aug.31 By Amt. as per	
		PR Book	50
			50

Sales Return A/c

2009	Rs.	2009	Rs.
Aug.31		To Amt. as per	
		SR Book	100
			100

Drawings A/c

2009	Rs.	2009	Rs.
Aug.10		To Cash	
			1,000
			1,000
Step. 1		To Balance b/d	
			1,000

Discount A/c

2009	Rs.	2009	Rs.
Aug.19		To Bhaskar	
			150
		Aug.15 By Sreenath	100
		27 By Sreejesh	50
			150

Trial Balance as at 31st August 2009

	LF	Debit	Credit
		Rs.	Rs.
Cash A/c		7,300	
Bank A/c		2,900	
Capital A/c			10,000
Furniture A/c		5,000	
Ravi's A/c			5,000
Purchase		6,500	
Sales			7,750
Purchase returns			50
Sales returns		100	
Drawings		1,000	
		22,800	22,800

ERRORS

If the debit and credit balances of trial balance do not agree, it is sure that there have been some errors. Trial Balance serves to prove only the arithmetical accuracy of the books. There are several types of which may exist and may remain undisclosed in spite of the agreement of Trial Balance.

TYPES OF ERRORS

1. Errors of Principles

When a transaction is recorded in contravention of accounting principles it is an error of principle.

2. Errors of Omission

When a transaction is omitted to be recorded in the books of original entry or omitted to be posted from the books of original entry to the ledger, it is an error of omission. In case of complete omission it will not effect Trial Balance. But trial balance will show disagreement if the omission is partial.

3. Errors of Commission

If while making an entry, the wrong amount is written either in the subsidiary book or in the ledger or the entry is made on the wrong side of the account , the error will be an error of commission. Wrong totaling and balancing are also called errors of commission.

4. Compensating errors

If the effect of an error in one account is cancelled by the effect of one or more errors in some other accounts, it is called a compensating error.

RECTIFICATION OF ERRORS

Errors should not be corrected by overwriting. It should be corrected by making a fresh entry. The errors may be such as affecting only one account called one sided errors or they may affect both the accounts involved called two sided errors.

One-sided errors:

It will cause for the disagreement of the trial balance because this error is committed only on one aspect of a transaction. It may be noted that one sided errors do not require any journal entry for rectification. They require physical correction of wrong figures or an opposite entry in the same account.

Example:

The purchase book is under cast by Rs. 500

The effect of the error is that purchase account has been debited short by rs.500. So purchase account is to be corrected. This will be done by making an entry for rs.500 on the debit side,"to under casting of purchase book rs.500

Two sided errors:

Complete omission, error of principle, wrong account posting etc. are common type of two sided errors.

CHAPTER 4

FINANCIAL STATEMENTS

After the preparation of the trial balance the next step is to prepare final accounts or final statements. The preparation of final account is the last step in the accounting cycle. It helps to achieve the first and foremost objective of accounting. The objective of accounting is to determine profit or loss made by business during any accounting period and to ascertain the financial position on a given date.

MEANING OF FINAL ACCOUNTS

Final accounts are the accounts prepared at the final stage to judge the financial position of the business. The final accounts consist of Trading and Profit and Loss Account and Balance Sheet. These statements provide necessary information to various interested groups-shareholders, investors, creditors etc. Final accounts are also known as financial statements.

The final accounts are prepared from trial balance. All revenue (nominal) accounts are transferred to Trading and Profit and Loss A/c and all non revenue (real and personal) accounts are transferred to the Balance Sheet.

The Trading and Profit and Loss A/c is usually split into two parts. The first part is known as Trading A/c and the second part is called the Profit and Loss A/c.

TRADING ACCOUNT

Trading means buying and selling of goods. Trading account is prepared to show the result of buying and selling of goods during an accounting period. The result of trading may be gross profit or gross loss. If the sale proceeds exceed the cost of goods sold, the difference is gross profit. On the other hand, if the cost of the goods sold exceeds sale proceeds the difference is gross loss. The profit or loss is called gross profit or gross loss because it is the profit or loss before deducting indirect expenses. In short, Trading Account is an account which shows gross profit or gross loss.

The following are the equations relating to Gross Profit:

Gross Profit (or Gross Loss) = Net Sales- Cost of Goods Sold

Cost of goods sold = Opening Stock + Net purchases + Direct expenses
– Closing Stock

Net Sales = Gross sales – Sales returns

Net Purchases = Gross purchases – Purchase returns

Trading account is prepared for a particular accounting period and not at a particular point of time. Hence it is a flow statement and not a static statement.

OBJECTIVES OF PREPARING A TRADING ACCOUNT

1. To ascertain gross profit or gross loss
2. To provide information about the direct expenses

3. To compare closing stock with the stock of previous year
4. To provide safety against the possible losses

Trading Account helps to determine the sales policy, price policy and gross profit margin to sales. A comparative study over the years will pinpoint the defects or effectiveness of trading policy. It also helps to determine the optimum level of stock.

TRADING ACCOUNT ITEMS

Opening stock, purchases, (less returns), and all direct expenses such as wages, freight and carriage, cartage, octroi, excise duty, import duty etc. are debited to Trading A/c. Sales (less returns), closing stock etc. are credited to Trading A/c.

The balance of trading account represents gross profit or gross loss. If the total credit is more than the total debit, the difference is gross profit. On the other hand, if the total debit is greater than total credit, the difference is gross loss. The form of Trading Account is given below:

Trading A/c

<i>for the year ended</i>					
		<i>Rs</i>			<i>Rs</i>
To Opening stock		xxx	By Sales	xxx	
To Purchases	xxx		Less: Returns	xxx	xxx
Less: Returns	xxx	xxx	By Closing Stock		xxx
To Wages		xxx			
To Direct Expenses:			By Gross Loss c/d (bal. fig.)	xxx	
Carriage/Cartage inward		xxx			
Freight		xxx			
Octroi		xxx			
Dock dues		xxx			
Excise Duty		xxx			
Royalty		xxx			
Motive power		xxx			
Coal, gas & water		xxx			
Factory expenses		xxx			
To Gross Profit c/d (bal. fig.)		xxx			
		xxxx			xxxx

Trading account is closed by transferring the balance (gross profit or gross loss) to the P/L account

Explanation of the Items of the Debit side of Trading A/c

1. Opening Stock: Opening stock means goods lying unsold in the beginning of the accounting year. This item can be seen in the debit column of trial balance. It should be noted that the

closing stock of last year becomes the opening stock of the current year. In the case of newly started business there will be no opening stock.

- 2. Purchases:** This item (Trial balance debit) includes both cash and credit purchases. Purchase return (Trial balance credit) should be deducted from purchase and the net value of purchase should be taken on the debit of Trading A/c.
- 3. Direct Expenses:** Direct expenses are those expenses which are incurred in connection with purchase and procurement of goods and in bringing the goods up to the point of sales. These include carriage inward, (carriage on purchase) wages, cartage, freight, octroi, import duty, excise duty, dock dues, coal, gas, water and power, factory expenses, royalty etc. These can be seen on the debit of trial balance. These are all debited to Trading A/c.

Explanation of Items on the Credit side of Trading A/c

- 1. Sales:** This item (Trial balance credit) includes both cash and credit sales. Sales return (trial balance debit) should be deducted from sales and the net value of sales should be taken on the credit of Trading A/c.
- 2. Closing Stock:** Closing stock means the value of goods remaining unsold at the end of the accounting period. It usually does not appear in the trial balance. It is given in the adjustment. Closing stock is always valued at cost price or market price whichever is less.

Example 1

Purchase	Rs. 5,00,000
Wages	60,000
Return outwards	10,000
Carriage inwards	2,000
Return inwards	14,000
Fuel, gas and water	3,500
Sales	7,50,000
Opening Stock	1,10,000
Closing Stock	1,27,000

Solution

Trading Account of M/s Ram Bros.

for the year ending 31-03-2009

To	Opening Stock		1,10,000		By Sales	7,50,000	
"	Purchases	5,00,000			<i>Less: Returns</i>		
	<i>Less: Returns outward</i>	10,000	4,90,000		inwards	14,000	7,36,000
To	Carriage inwards		2,000		By Closing Stock		1,27,000
"	Wages		60,000				
	Fuel, gas and water		3,500				

"	Gross profit		1,97,500		
			8,63,000		8,63,000

PROFIT AND LOSS ACCOUNT

The trading account shows only the gross profit or gross loss. It does not show the final profit or loss. Hence, it is necessary to prepare profit and loss account after preparing Trading Account. Profit and Loss account is prepared to ascertain the net profit or net loss of the business for an accounting period. It starts with the gross profit brought down from Trading account. The amount of gross profit is shown on the credit side of P/L account (If gross loss, it is shown on the debit side). After this, all expenses and losses other than those taken in Trading A/c (i.e. indirect expenses and non operating expenses and losses) are shown on the debit side of P/L Account. All incomes and gains are shown on the credit side. Then net profit or net loss is calculated. If credit (incomes) is more than debit (expenses), the difference is net profit. On the other hand, if debit is more than credit, the difference is net loss. The amount of net profit or net loss is then transferred to capital account on the liability side of the balance sheet.

Like Trading account, P/L account also is a flow statement. It is prepared for a particular accounting period. P/L account is also known as income statement. The AICPA in Accounting Terminology Bulletin No. 2 says that income statement is a “Statement which shows the principal elements, the positive and negative, in the derivation of income or loss, the claims against income, and the resulting net income or loss of accounting unit”. Positive elements are revenues. Negative elements are expenses. Income statement (or P/L A/c) is a summary of revenues and expenses.

A specimen of P/L A/c is given below:

Profit and Loss A/c			
<i>for the year ended</i>			
	Rs.		Rs.
To Gross Loss b/d	xxx	By Gross Profit b/d	xxx
To Salaries	xxx	By Rent Received	xxx
To Rent, rates and taxes	xxx	By Discount Received	xxx
To Printing and Stationery	xxx	By Commission Received	xxx
To Postage Expenses	xxx	By Interest (Cr)	xxx
To Audit Fees	xxx	By Bad Debt Recovered	xxx
To General Expenses	xxx	By Income from Investment	xxx

To Repairs and Maintenance	xxx	By Dividend Received	xxx
To Fire Insurance Premium	xxx	By Profit on Sale of Asset	
To Legal Expenses	xxx	By Miscellaneous Income	xxx
To Office Lighting	xxx	By Net Loss (if any)	xxx
To Interest and Bank Charges	xxx		
To Bad Debts	xxx		
To Discount Allowed	xxx		
To Commission	xxx		
To Advertising	xxx		
To Traveling Expenses	xxx		
To Depreciation	xxx		
To Sundry Trade Expenses	xxx		
To Office expenses	xxx		
To Establishment expenses	xxx		
To Loss on sale of asset	xxx		
To Carriage outward	xxx		
To Distribution expenses	xxx		
To Warehouse expenses	xxx		
To Net Profit	xxx		
	xxxx		xxxx

In short, all office and administrative expenses, selling and distribution expenses, and financial expenses are debited to P/L A/c.

Points to remember while preparing P/L A/c

1. G/P should be taken from Trading A/c to the credit of P/L A/c (if G/L, take on the debit side)
2. Wages should be taken in Trading A/c, while salaries should be taken in P/L A/c. However, 'Wages and Salaries' or 'Salaries and Wages' should be taken in P/L A/c. Some authors opine that 'Wages and Salaries' should be taken in Trading A/c, while 'Salaries and Wages' should be taken in P/L A/c. This is not correct. When 'Wages' and 'Salaries' (or 'Salaries' and 'Wages') are mixed together, it is not possible to know how much is direct and how much is indirect.
3. Carriage inward (carriage on purchase) should be taken in Trading A/c, while carriage outward (carriage on sales) should be taken in P/L A/c.
4. All direct expenses should be taken in Trading A/c (debit side). All indirect expenses, losses and the remaining extra ordinary expenses (debit side) and incomes and gains (which have not been taken in Trading A/c) are shown in the P/L A/c (credit side).
5. Personal expenses such as domestic expenses, life insurance premium, income tax etc. should not be debited to P/L A/c. These should be charged to Drawings A/c.

Example 2

From the following details prepare the P/L A/c of M/s Ram Bros. for the year ending 31-03-2009. Gross Profit transferred from Trading A/c Rs. 1,97,500

Salaries	Rs. 86,000
Discount Allowed	4,200
Discount Received	5,000
Bad Debts	17,000
Printing and Stationery	1,400
Depreciation	15,000
Insurance	11,500
Carriage outward	3100
Interest received	6,700
Rent	24,000

Solution

P/L A/c of Ram Bros.

for the year ending 31-03-09

To Salaries	86,000	By G/P	1,97,500
" Discount allowed	4,200	" Discount received	5,000
" Bad debt	17,000	" Interest received	6,700
" Printing and Stationery	1,400		
" Depreciation	15,000		
" Insurance	11,500		
" Carriage outward	3100		
" Rent	24,000		
" Net Profit	47,000		
	2,09,200		2,09,200

MANUFACTURING ACCOUNT

A manufacturing concern buys raw materials, processes them and produces finished goods for sale. Hence a manufacturing concern has to find out the cost of goods manufactured by it during a period before finding out the gross profit. In such a case, an account called manufacturing account is prepared to ascertain the cost of manufacturing goods. Thus manufacturing account is an account prepared by manufacturing concerns to ascertain cost of goods manufactured during a period.

All the expenses relating to the manufacturing activity are debited to the manufacturing account. The total of all these expenses represent the cost of goods manufactured. The cost of

goods manufactured is then transferred to Trading Account. Following is a specimen of manufacturing account.

Manufacturing Account
for the year ended

	Rs		Rs
To Raw materials consumed:		By Closing Work in Progress	xxx
Op. stock of raw materials	xxx	By Sale of scrap	xxx
Add: Purchases less returns	xxx	By Cost of goods manufactured	xxx
	xxx	(Transfer to Trading A/c-bal.fig.)	
Less: Cl. st. of raw mat	xxx		
To Opening Work in Progress	xxx		
To Direct Wages	xxx		
To Carriage inward	xxx		
To Freight	xxx		
To Factory rent, rates and taxes	xxx		
To Factory lighting	xxx		
To Consumable stores	xxx		
To Works Manager's salary	xxx		
To Dep. of Plant & Machinery	xxx		
To Insurance of plant & machin.	xxx		
To Repairs of Plant & machin.	xxx		
To Coal, Gas and Water	xxx		
To Motive power	xxx		
To Other factory expenses	xxx		
	xxxx		xxxx

The item consumable stores represents engine oil, cotton waste, grease, soaps etc. These are consumed in the factory to keep the plant and machinery in good working condition and to avoid accidents. It is a factory expense. Rates mean the municipality or corporation taxes.

In manufacturing concerns certain scrap is unavoidable. It may or may not have sale value. If it has value (income), it should be credited to manufacturing account.

Note: After preparing the Manufacturing A/c, the Trading A/c is to be prepared to ascertain the G/P. It is prepared as follows:

Trading A/c (of a Manufacturing Firm)

for the year ended.....

	Rs		Rs
To Opening stock of finished goods	xxx	By Sale of finished goods less returns	xxx
To Cost of goods manufactured (transferred from manuf. A/c)	xxx	By Closing stock of finished goods	xxx
To Purchase of finished goods (if any)	xxx	By G/L (if any)	xxx
To Carriage on purchase of finished goods (if any)	xxx		
To G/P c/d (bal. fig.)	xxx		
	xxxx		xxxx

Note: If Manufacturing Account is not prepared, then all factory expenses will be debited to Trading A/c.

BALANCE SHEET

After having known the net result of business, the businessman wants to know what the financial position of his business is. For this purpose, he prepares another statement known as balance sheet. It is a list of all the good things and bad things about a business. The 'good things' are the things which have value. They are called the assets. The 'bad things' are the amounts owing to other people. They are called the liabilities. Hopefully, the good things outnumber the bad things and the excess is the capital or wealth of the proprietor.

Thus, balance sheet is a statement showing the assets, liabilities and capital of a business on a particular date. It reveals the financial position of a business. Hence it is also known as 'Position Statement'. This statement is known as balance sheet because it is a sheet containing balances remaining after preparing the trading and profit & loss account. In other words, it shows the balances of all ledger accounts which are not closed.

In the words of Francis R. Stead, 'Balance sheet is a screen picture of the financial position of a going business at a certain moment'. According to Cropper, Balance Sheet is a classified summary of the ledger balances remaining after closing all revenue items into the Profit and Loss Account.

Balance sheet is like a snap shot of a moving train. It is prepared on a particular date and not for a particular period. Hence, it is a static statement.

A balance sheet has two sides. The assets are shown on the right hand side and liabilities and capital are shown on the left hand side. The two sides must always tally.

FEATURES OF BALANCE SHEET

1. It is a statement, not an account

2. It is always prepared on a particular date and not for a period
3. It shows the financial position of a business concern
4. It shows what the firm owes to others (liabilities and capital) and what others owe to the firm (assets)
5. The totals of two sides are always equal.

NEED AND IMPORTANCE OF BALANCE SHEET

1. It indicates the financial position of the firm.
2. It provides information about the assets, liabilities and capital of a business
3. It helps to know the solvency of the business.
4. It serves as a basis for determining purchase consideration of the business.
5. Different ratios can be calculated from the Balance Sheet for the purpose of interpretation of business
6. It helps to find out the working capital of a firm. When we deduct current liabilities from current assets, we get working capital.

GROUPING AND MARSHALLING OF ASSETS AND LIABILITIES

For understating a balance sheet easily, it is necessary to group and marshal various items in the balance sheet. Grouping means putting items of similar nature under one head so as to distinguish them from other items. Thus all current assets (Cash and bank balance, stock, debtors etc. are grouped under the heading “Current Assets” All fixed assets (plant and machinery, land and building, furniture etc.) are grouped separately under the head “Fixed Assets”

The term marshalling refers to the manner or orders in which assets and liabilities are shown in the balance sheet. It simply refers to the arrangement of assets and liabilities in the balance sheet. The assets and liabilities are arranged in the balance sheet in two ways. (a) in the order of liquidity and (b) in the order of permanence.

In the order of liquidity: In this method an asset which is most easily convertible into cash (most liquid) is written first and it is followed by less liquid assets and least liquid assets are shown last. Similarly the liabilities are arranged in order of urgency of payment. The most urgent payment is written first followed by liabilities which are less urgent and then capital of the owner. Proforma of Balance Sheet showing assets liabilities and capital in the order of liquidity is given below:

Balance Sheet

as on

Liabilities	Rs	Assets	Rs
Current Liabilities		Current Assets	
B/P		Cash in hand	
Sundry Creditor		Cash at bank	
Bank overdraft		Sundry Debtors	
Outstanding expenses		Bills Receivable	
Income received in advance		Marketable securities	

	Stock
Long Term Liabilities	Prepaid expenses
Mortgaged Loan	Accrued income
Reserves	Long Term Investment
Capital	Fixed Assets
Add: N/P	Furniture and Fixtures
Less: Drawings	Motors vehicles
	Patents and trade marks
	Loose tools
	Plant and machinery
	Land and Building
	Goodwill

Note: (1) Net profit should be added to capital (if net loss, it should be deducted) and drawings should be deducted from capital. (2) This arrangement is usually followed by sole proprietorships and partnership firms

In the order of permanence: This method is quite reverse to the above liquidity order. In this method least liquid assets are shown first, followed by comparatively more liquid assets and ending with most liquid assets. On the liability side owners capital and funds are recorded first, then long term loans and finally current liabilities are shown.

Classification of Assets: Assets may be classified in the following ways:

- 1. Fixed assets:** Fixed assets are those assets which are of a permanent nature and are used for the operation of business and not for resale. These assets help in earning revenue. These cannot be easily converted into cash. In short, fixed assets are long term assets. Land and building, Plant and machinery, Furniture and fittings, Motor vehicles etc. are examples of fixed assets.
- 2. Intangible assets:** Intangible assets are those assets which cannot be seen or touched, but their benefits accrue to the business. Goodwill, patent right, copy right etc. are examples.
- 3. Current assets:** Current assets are those assets which are held temporarily in course of business and converted into cash easily. Cash, bank balance debtors, stock, marketable (short term) securities, stock, B/R etc. are examples of current assets. Current assets are also known as *floating assets* or *circulating assets* because their value goes on changing.
- 4. Fictitious assets:** Fictitious assets are not real assets. They are not represented by tangible possessions. They appear in the assets simply because of debit balance in a particular account not yet written off. Debit balance in P/L A/c, advertisement suspense account, discount on issue of securities, underwriting commission, preliminary expense etc., are examples. These are written off over a period of time by debiting to P/L A/c

All fictitious assets are intangible. But all intangible assets are not fictitious assets. For example, goodwill is an intangible asset. But it is not a fictitious asset. This is because it is a real asset. It can be bought and sold for a value.

- 5. Wasting assets:** Wasting assets are those assets which are exhausted gradually in the process of their use. These assets become worthless once its utility is over or exhaust fully. Examples are mines, quarries, oil wells, timber resources etc. These are natural resources.
- 6. Contingent assets:** Contingent assets are probable assets which may or may not become assets depending upon occurrence or non- occurrence of a specified event. For example, if a business firm has filed suit for a particular property now in possession of other persons, the firm will get the property if the suit is decided in its favour. Till the suit is decided, it is a contingent asset. After that it becomes an asset.

Classification of Liabilities: Liabilities may be classified in the following manner.

- 1. Long term liabilities:** Liabilities which are repayable after a long period of time are known as long term or fixed liabilities. Long term loans, debentures etc. are examples. These are generally secured.
- 2. Current liabilities:** Liabilities which are payable within one year (or during the operating cycle) are known as current or short term liabilities. Examples are sundry creditors, Bill Payable, bank overdraft, outstanding expense, tax payable, dividend payable etc
- 3. Contingent liabilities:** Contingent liabilities are those liabilities which may or may not become actual liabilities in future. It depends upon happening of certain events. Examples are liability for bills discounted, liability for acting as surety, claim under dispute or pending in the court of law, liability for calls on partly paid shares etc. Contingent liabilities do not form a part of balance sheet. They are shown as footnote under the balance sheet.

Example 3

From the following balance of Mr. Abdul Majeed, prepare Trading and Profit and Loss Account and Balance Sheet as on 31st December, 2009 after passing closing entries:

Trial Balance as on 31st December 2009

<i>Particulars</i>	Debit Rs.	<i>Particulars</i>	Credit Rs.
Opening stock	8,000	Sales	50,000
Purchases	24,000	Purchase returns	2,910
Sales returns	2,700	Capital	10,000
Productive wages	1,000	Creditors	12,000
Carriage inward	1,400		
Salaries	2,400		
Coal gas and water	600		
Trade expense	1,000		
Stationery	1,400		
Land and Building	10,000		

Drawings	200	
Plant	8,000	
Cash in hand	4,400	
Debtors	2,000	
Investments	7,810	
	74,910	74,910

Closing stock on 31st December, 2009 was Rs. 12,000

Solution

Trading and Profit and Loss A/c

for the year ending 31st Dec. 2009

Particulars	Rs	Amount	Particulars	Rs	Amount
To Opening Stock		8,000	By Sales	50,000	
To Purchases			Less: returns	2,700	47,300
Less: returns	24,000		By Closing Stock		12,000
	2,910	21,090			
To Coal, gas and Water		600			
To Productive Wages		1,000			
To Carriage		1,400			
To Gross Profit		27,210			
		59,300			59,300
To Salaries		2,400	By Gross Profit		27,210
To Trade Expenses		1,000			
To Stationery		1,400			
To Net Profit		1,400			
		22,410			
		27,210			27,210

Balance Sheet

as on 31.12.2005

	<i>Liabilities</i>	Rs.	<i>Assets</i>	Rs.
Capital	10,000		Land and Building	10,000
Add: Net profit	22,410		Plant	8,000
	32,410		Investment	7,810
Less: Drawings	200	32,210	Debtors	2,000
Creditors		12,000	Stock in trade	12,000
			Cash in hand	4,400
		44,210		44,210

FINAL ACCOUNTS WITH ADJUSTMENTS

Final accounts are prepared from trial balance. But the trial balance is not a complete tool to prepare final account. This is due to the reason that it contains the summary of only those transactions which have been already recorded in the books of accounts during a given period. It does not include information relating to pending transactions. For example, rent for a year is amounted to Rs. 60000. But rent paid (say, Rs. 50,000) would appear in trial balance. Similarly there might be expenses paid in advance. Hence while preparing final accounts certain adjustments should be made. Only then final accounts will reveal true values. Adjustments are made with the help of adjusting entries. The treatment of important adjustments is given below:

1. Closing stock: Generally closing stock is not given in trial balance. It will be given under adjustment. The adjusting entry is:

Closing Stock A/c	Dr.
To Trading A/c	

Generally closing stock is not given in trial balance because it is valued at the end of the year after the accounts have been closed. In other words, closing stock is not a ledger balance.

Treatment In Final Accounts

- (i) Closing stock is shown on the credit side of Trading A/c
- (ii) It also appears on the asset side of the balance sheet

Sometimes the value of closing stock appears in the trial balance. This means closing stock has already been adjusted in the purchases (deducted from purchases) in arriving at cost of goods sold. In such a case closing stock should be shown only in the balance sheet (asset side).

2. Outstanding expenses: Outstanding expenses are those expenses which remain unpaid at the end of the accounting period. In order to arrive at true profit or loss, it is necessary to take into account the outstanding or accrued expenses. The adjusting entry is:

Expenses A/c	Dr.
To Outstanding Expenses A/c	

Treatment in Final Accounts

- (i) Income received in advance should be deducted from the concerned income on the credit side of the P/L A/c
- (ii) It should also be shown on the liability side of the B/S

If this item is given in trial balance (Cr. balance) then it should be shown only in the B/S on the liability side.

6. Depreciation: Decrease in the value of fixed assets due to wear and tear, passage of time or obsolescence etc. is called depreciation. The entry for providing depreciation is:

Depreciation A/c	Dr.
To Asset A/c	

Treatment in Final Accounts

- (i) Depreciation should be shown on the debit side of Trading A/c (in case of depreciation on factory assets) or P/L A/c.
- (ii) It should be deducted from the concerned asset on the asset side of the B/S.

If depreciations is given in trial balance (i.e. the entry has already been made and the asset appearing in the trial balance is at a reduced value), the depreciation should be taken only at one place i.e. on the debit side of P/L A/c.

Increase in the value of asset is called *appreciation*. In this case the appreciation (increase) is credited to P/L A/c. It is also added to the cost of the asset in the Balance Sheet.

7. Provision for Depreciation: Sometimes the depreciation charge is credited to Provision for Depreciation Account (also called Depreciation Fund or Accumulated Depreciation) and not to the asset directly.

Treatment in Final Accounts

The current year depreciation should be debited to P/L A/c. The adjusting entry is

P/L A/c.	Dr.
To Provision for Depreciation A/c.	

The total Provision for Depreciation (i.e. existing provision as per T/B credit plus current year provision) should be deducted from the original cost of the asset on the asset side of the balance sheet.

8. Bad debts: When the amount due from debtors (to whom goods are sold on credit) is found irrecoverable it is called bad debts. In short, irrecoverable debt is known as bad debt. It is a loss to the business. The adjusting entry is as follows:

Bad Debt A/c	Dr
To Sundry Debtors	

The bad debt account is closed by transferring to P/L A/c

Treatment in Final Accounts

- (a) *When bad debt is given in trial balance:* In this case no adjusting entry is needed. It should be taken on the debit side of P/L A/c (appears at one place only).

(b) *When bad debt is given outside the trial balance:* In case bad debt is given outside the trial balance (i.e. in adjustments) it should be taken at two places. One is at the debit side of P/L A/c (added to bad debt already given in trial balance). The bad debt (given in adjustment) should also be deducted from debtors on the asset side of the Balance Sheet.

9. Provision for bad and doubtful debts: A part of the debtors at the end of the year may be irrecoverable. This means some of the debtors are doubtful. A doubtful debt is the debt which may or may not be recovered. It is necessary to show every asset at its true value. Hence all enterprises based on their past experience create a provision for doubtful debts to meet such a probable loss in case it happens. The provision should be created during the current year itself because the debtors relate to the current year. When a debt is irrecoverable in the next year (future) it can be adjusted from this provision created. By creating such a provision for doubtful debts, it is possible to show debtors at its true value. Provision is created at a certain percentage (based on past experience) on sundry debtors. The entry for creating provision is:

P/L A/c	Dr
	To Provision for Doubtful Debts

Treatment in Final Accounts

(a) *Provision appearing in the trial balance:* The provision given in the trial balance (Cr) is the provision created last year i.e. opening provision. It is taken on the credit side of the P/L A/c (taken at one place only). Alternatively, the bad debt of the current year and the new provision will be adjusted against the opening provision. It should be noted that when Provision for Bad and Doubtful Debts exists, the bad debts are not to be transferred to P/L A/c. Instead they are debited to the Provision A/c by passing the following entry:

Provision for Bad and Doubtful Debts A/c	Dr
	To Bad Debt A/c

(b) *Provision given in the adjustments:* Provision given under adjustment is the provision to be created in the current year i.e. new provision. It should be taken at two places. One at the debit side of the P/L A/c. Second it is deducted from debtors on the assets side of the Balance Sheet. It is calculated at a given percentage of debtors. It should be noted that the provision (new) is to be calculated on sundry debtors after deducting additional bad debts, if any, given in the adjustment.

Example 4

Following are the extracts from the trial Balance of Mr. A

Trial Balance		
	Dr. Rs.	Cr. Rs
Sundry Debtors	40,000	
Bad Debts	5,000	
Provision for Bad Debts		3,000

Adjustments

- (a) Provide additional bad debts Rs.1,000
- (b) Create 5% provision for bad and doubtful debts.

Show how the above will be shown in the final accounts

Solution

		P/L A/c	
		Rs.	Rs.
To Bad debts (in T/B)	5,000	By Provision for bad and D/D	
To Bad debts (Additional)	1,000	(old or existing as per T/B)	3,000
To Provision for bad and doubtful debts (as per adjustment)	1,950		

Instead of showing the existing provision on the credit of P/L A/c, it can be deducted from new provision on the debit side. The effect is same.

		P/L A/c	
To Bad debts	5,000		
Add: Additional bad debts	1,000		
Add: New provision	1,950		
	7,950		
Less: Old provision	3,000	4,950	

Balance Sheet

Assets

Sundry Debtors	40,000	
Less: Bad Debts (additional)	1000	
	39,000	
Less: Provision	1,950	37,050

Note: New provision is to be calculated on the balance of debtors after adjusting the additional bad debts i.e. 5% on Rs. 39,000 ($39,000 \times 5/100 = \text{Rs. } 1,950$). It can be seen that items given in the trial balance appear at one place and items given in adjustments appear at two places.

Points to Remember

- (1) If bad debts written off (given in trial balance and given in adjustment) plus new provision as per adjustment is more than the existing provision (given in trial balance), the difference should be debited to P/L A/c.
- (2) In certain cases the total provision is more than the total of bad debt and new provision. In such a case the difference is credited to P/L A/c. Alternatively, old provision is taken on the credit side of P/L A/c and new provisions as well as bad debts are taken on the debit side of P/L A/c. To avoid this problem (whether the difference to be debited or credited), it is better to take the existing provision on the credit side of P/L A/c. This is better especially when the old or existing provision exceed the total of bad debt and new provision.

(3) Sometimes students are asked in the question to increase the new provision by certain amount or certain percentage on debtors. For example, the existing provision (given in trial balance) is Rs. 1500. In the question (in adjustments) you are asked to increase the provision to Rs. 2000 (i.e. to be increased by Rs. 500). Suppose debtors are Rs 24000, bad debts written off are Rs.1000 (given in trial balance). In this case new provision is Rs. 2,000 (i.e. old provision plus increase) and not Rs. 500. This new provision (Rs. 2000) should be deducted from debtors. The above items are taken in final accounts as follows:

P/L A/c

To Bad debts	1000	By Prov. for doubtful debts	1500
To Prov. for doubtful debts	2000		

Balance Sheet

Sundry Debtors	24000	
Less: Provision	2000	22,000

Note: In case provision is required to be reduced, the above treatment may be reversed.

(4) No provision is required on good debts (Full amount will be recovered). 100% provision is required on doubtful debts. If it is sure that the debts are irrecoverable, then such an amount must be written off as bad.

10. Provision for discount on debtors: It is a normal practice to allow cash discount to customers for prompt payment. Some amount of discount may have to be allowed in the next accounting year. However, this loss belong to the current period because the debtors relate to current period., Therefore, at the end of the accounting year a provision is created for the anticipated loss in the form of discount that is likely to be allowed to debtors. This is called provision for discount on debtors. The adjusting entry is:

P/L A/c	Dr.	
		To Provision for Discount on Debtors

Treatment in Final Accounts

Provision for discount on debtors should be debited to P/L A/c and is also deducted from debtors on the assets side of the Balance Sheet. The opening provision, if any, will be treated in the same way as provision for doubtful debts is treated.

Note on calculation of provision: Cash discount will be given only to those debtors who make prompt payment. Therefore provision for discount on debtors is calculated on good debtors i.e. balance of debtors after deducting further bad debts and new provision for bad and doubtful debts.

Example 5

Following are the extracts from the Trial Balance of Mr. Chandran:

Trial Balance

	Dr. Rs.	Cr. Rs.
S. Debtors	20,000	
Bad debts	800	
Reserve for bad and doubtful debts		2,900

Adjustments

(a) Write off further bad debts Rs.1000 (b) Create a provision for bad and doubtful debts @ 5% of debtors. (c) Also create provision for discount on debtors @ 2% on debtors

Solution

P/L A/c		
To Bad debts (800+ 1000)	1800	By Provision for D/D 2,900
To Provision for bad debts (20,000-1000= 19,000x 5%)	950	
To Prov. for disc. on debtors (19,000-950 = 18,050 x 2%)	361	

Balance Sheet

<i>Assets</i>	Rs.	Rs
Sundry Debtors	20,000	
Less: Further bad debts	1,000	
	19,000	
Less: Prov. for D/D	950	
	18,050	
Less Prov. for discount	361	17,689

11. Provision for discount on creditors: If a firm makes early payment to its creditors, it will receive discount. When it receives discount from creditors regularly, it can make a provision for the discounts which is likely to be received in the next year from the current creditors. Provision for discount on creditors is a probable income. Hence P/L is to be credited for the same. The entry for creating provision is as follows:

Provision for Discount on Creditors A/cDr.
 To Profit & Loss A/c

Treatment in Final Accounts

Provision for discount on creditors is calculated on sundry creditors. It is shown on the credit side of P/L A/c. It will also be deducted from sundry creditors on the liability side of the Balance Sheet.

12. Sales Tax: This is an indirect tax. It is payable by the buyers. The firm collects the tax from buyers and pays the amount collected to the Govt.

Treatment in Final Accounts

(a) *When sales tax is given in the credit column of trial balance:* This means tax has been collected from customers but not paid in the Government treasury. This is a liability. Hence it is shown on the liability side of the B/S.

(b) *When sales tax appears in the debit column of trial balance:* This means tax collected has been paid to government. This should be shown on the debit side of P/L A/c.

Treatment in Final Account

This is deducted from purchase on the debit side of Trading A/c (or added to sales on the credit of Trading A/c). It is also shown on the debit side of P/L A/c as advertisement.

16. Interest on Loan Taken: Generally loan appears on the credit side of trial balance. It means the loan has been taken from outsiders. It is a liability. The interest on loan taken is an expense.

Treatment in Final Accounts

Interest on loan taken appears on the debit side of trial balance. Being expense it is debited to P/L A/c. If interest is outstanding, such outstanding amount should be added to interest (paid) given in trial balance. The outstanding interest is also added to loan on the liability side.

17. Interest on loan given: If the loan appears on the debit side of the trial balance it means that the loan is given to outsider Thus it is an asset. Then interest on such loan will be an income.

Treatment in Final Account

Interest on loan given appears on the credit side of trial balance. Being income it is credited to P/L A/c. If there is accrued interest the amount accrued is added to interest on the credit of P/L A/c. It is also added to Loan on the asset side of the B/S.

18. Interest on Capital: Sometimes interest is allowed or charged on capital. Interest on capital is an expense for the business, but it is an income to the proprietor. The entries are:

(i) Interest on Capital A/c Dr. (Expense)
 To Capital A/c (Capital increases)

(ii) P/L A/c Dr
 To Interest on Capital A/c

Treatment in Final Accounts

Interest on capital is debited to P/L A/c. At the same it is added to Capital A/c on the liability side of the B/S.

19. Interest on Drawings: Sometimes interest is charged on drawings. It is an income to the business. The adjusting entry is:

Drawings A/c Dr
 To Interest on Drawings A/c

Treatment in Final Accounts

It is shown on the credit side of P/L A/c. At the same time, it is deducted from capital in the B/S.

20. Deferred revenue expenditure: Deferred revenue expenditure is written off over a number of years. Heavy advertisement is an example. The entry to write of advertisement is:

P/L A/c Dr
 To Advertisement A/c

Treatment in Final Accounts

The amount to be written off is debited to P/L A/c. The balance is shown on the asset side of the B/S. For example, a firm spends Rs.5,00,000 on advertisement and it is expected that the benefit would last for 5 years. In the first year Rs. 1,00,000 is debited to P/L A/c. The balance Rs.4,00,000 is shown on the asset side of the B/S. In the next year again Rs. 1,00,000 will be debited to P/L and balance Rs. 3,00,000 will be shown on the assets side of the B/S. Thus the deferred revenue expenditure is proportionately charged to P/L A/c and the amount remaining to be written off is shown on the asset side of the B/S.

21. Payment of personal expenses or liability: Payment or discharge of any personal liability of proprietor or partner (e.g. life insurance premium, income tax etc) should be treated as drawings. These expenses should not be debited to P/L A/c because they are not business expenses. These should be added to drawings and the drawings will be deducted from capital on the liability side of the B/S

22. Goods sent on approval basis: Sometimes goods are sent to customers on sale or return basis. If goods are approved by customers, it is treated as sold. If not, these are returned to the firm. However, when goods are sent on approval basis it is credited to Sales A/c and debited to Debtors A/c. If on the date of closing of books of account, such goods are still lying with the customer awaiting their approval, these should be treated as part of closing stock. The following adjustment entries are needed.

(a) To cancel the credit sales recorded at the time goods were sent on approval basis.

Sales A/c	Dr. (with sale price)
To Debtors A/c	

(b) To include the stock lying with customers into closing stock

Closing stock A/c	Dr. (at cost price)
To Trading A/c	

Treatment in Final Accounts

The goods which is sent to customers on sale or return basis lying in stock should be shown on the credit side of the Trading A/c by way of deduction from the sales at sales price and added to the closing stock at cost price. In the B/S assets side it will be deducted from debtors at sale price and added to closing stock at cost price.

Illustration 4

The following balances are extracted from the books of Raman on 31st December 2009.

Purchase	40,000	Sales	70,185
Purchase returns	1,410	Stock (1.1.2009)	5,730
Capital	50,500	Drawing	8,800
Bad debts	700	Bad debts reserve (1.1.2009)	1,620
Carriage inwards	1,155	Office expenses	670
Postage and stationary	330	Rates & Insurance	650
Discount (cr.)	115	Bills receivable	620

SCHOOL OF DISTANCE EDUCATION

Sales return	2,120	Wages	3,140
Building	13,000	Rent received	1,050
Cash at bank	6,200	Cash in hand	1,105
Office furniture	1,800	Salary	4,500
Commission paid	435	Postage	410
Sundry debtors	31,035	Sundry creditors	9,490
Building (new)	3,500	Sundry expenses	8,470

Prepare trading, profit and loss account for the year ending 31st Dec. 2009 and prepare a balance sheet on that date after considering the following:

- 1) Insurance unexpired Rs. 120
- 2) Provide interest on capital @ 5%
- 3) Rent not received Rs. 100
- 4) Depreciate on old building @ 2 1/2%, new @ 2% and office furniture @ 5%
- 5) Write off further bad debts Rs. 285
- 6) Increase the provision for bad debts at 6% on debtors
- 7) Salary outstanding Rs. 285
- 8) Stock on 31.12.2009 valued at Rs. 7,145

Solution

Trading & Profit and Loss Account of Raman

for the year ending 31st December 2009

To Opening stock	5,730	By Sales	70,185
To Purchase	40,000	Less returns	2,120
Less Returns	1,410	38,590	68,065
To Wages	3,140	By Closing Stock	7,145
To Carriage inwards	1,155		
To Gross profit	26,595		
	75,210		75,210
To Salaries	4,500	By Gross profit	26,595
Add: Outstanding	285	4,785	115
To Rates and insurance	650	Rent	1,050
Less: Prepaid	120	530	1,150
		Add: Outstanding	100

SCHOOL OF DISTANCE EDUCATION

To Office expense	670	
To Printing & Stationary	330	
To Postage	410	
To Sundry expense	8,470	
To Depreciation:		
Building (old)	325	
New	70	
Office furniture	90	485
To Provision for bad and doubtful debts:		
Bad debts	700	
Additional bad debts	285	
Add: New provision	1,845	
	2,830	
Less: Existing Prov.	1,620	1,210
To Commission	435	
To Interest on capital	2,525	
To Net profit transferred to balance sheet	8,010	
	27,860	27,860

Balance Sheet of Raman

as on 31st Dec. 2009

Sundry Creditors	9,490	Cash in hand	1,105
Capital	50,500	Cash at bank	6,200
Add: Net Profit	8,010	Bills receivable	620
	58,510	Sundry debtors	31,035
Add: Interest on cap.	2,525	Less: Bad debts	285
	61,035		30,750
Less: Drawings	8,800	Less: New Provision	1,845
Outstanding salary	285	Closing stock	7,145
	52,235	Office furniture	1,800
		Less: Depreciation	90
			1,710

SCHOOL OF DISTANCE EDUCATION

Interest accrued		100
Unexpired Insurance		120
Buildings:		
Old	13,000	
New	3,500	
	16,500	
Less: Total dep.	395	16,105
62,010		62,010
