16.06.2021

CHAPTER I

INTRODUCTION TO ACCOUNTING

Meaning of accounting

Accounting has rightly been termed as the language of business. The basic function of a language is to serve as a means of communication. Accounting serves this function by communicating the result of business operations to various parties who are interested in it. Accounting is an information system which receives data and inputs, process the same and given its output in the form of information which is useful for decision making.

Definition

According to American Institute of Certified Public Accountants (AICPA) 1941 *“ accounting is the art of recording , classifying, summarising in a significant manner and in terms of money, transaction and events which are, part at least of a financial character , and interpreting the result there of”*

Qualitative characteristics of accounting information.

1- **Reliability**

Accounting information is said to be reliable if it is free from error and bias. To ensure this it must be verifiable.

2- **Relevance**

For the purpose of decision making the accounting information should be relevant and it must be available in time.

3- **Understandability**

Accounting information must be understood by those to whom it is communicate. The content must be enough to clearly convey matters with all its implications.

4- **Comparability**

Accounting reports should be comparable with other firms to identify similarities and differences. To achieve this the period, the format, unit of measurement etc. should be same

Objective s of accounting

The primary objective of accounting is to provide information to facilitate business decisions. The other objectives of accounting are

1- **To maintain records of business**

It is very difficult to remember all the business transaction that take place. Accounting serves this purpose of record keeping by recording all the business transactions in the books of account.

2- **Calculation of profit and loss**

Accounting helps in ascertaining business result i.e., profit earned or loss suffered in business during a particular period. This is done through the preparation of profit and loss account or an income and expenditure account.

3- **Ascertain the financial position of the business.**

The business man is always interested in knowing his financial position i.e., where he stands, what he owes, and what he owns. That means the position of asset and liabilities. This objective is served by the balance sheet or position statement.

4- **Providing information to users**

The accounting information obtained from records should be communicated to interested parties in the form of reports, statements, graphs charts etc.

Basic accounting terms

Entity- Entity means a reality that has a definite individual existence

Business entity- Business entity means a specifically identifiable business enterprise. Business entity is also called accounting entity.

Transaction- Transfer or exchange of something of value between two or more entities called transaction

Business transaction- The term business transaction refers to any business dealings or event which has a value measurable in terms of money and which involve transfer of money or money's worth between the business and others.

Debtors- Debtor is a person who owes money to the business

Sundry debtors- The total amounts of debtors are collectively known as sundry debtors.

Creditors- The creditor is a person to whom the business owes money.

Sundry creditors- The amounts due to various parties are collectively known as sundry creditors.

Bills receivable-

A bill is a document accepted by the debtor undertaking to pay for the value owed by him. When the goods are sold on credit the seller may insist the buyer to accept a bill, such bill is called bills receivable.

Bills payable

When goods are purchased on credit and bill is made such bill is called bills payable. In this bill the businessman undertakes to pay the value owed by him.

Accounts receivable- It includes amount due from debtors as well as on account of bills receivables.

16.06.2021

Account payable- It includes the amount due to creditors and bills payable.

Account- A summary of all business transaction that have taken place during a particular period arranged in relation to one person, thing, expense or income is called a account.

Debit side and credit side-

Accounts traditionally written in the form of 'T' having two equal halves, one on the left hand side and other on the right hand side. The left hand side is called debit side and the right hand side is called credit side.

Debiting and Crediting

The recording of transaction on the debit side is called debiting and the recording of transaction on the credit side is called crediting.

Entry- The record of a transaction in an account is called entry.

Debit entry and credit entry

If an entry is in the debit side of an account is called debit entry if it is in the credit side called credit entry.

Debit and Credit

Every transaction has two aspects i.e. receiving aspect and giving aspect. The receiving aspect is called debit and the giving aspect is called credit.

Asset

Assets are the material things or possessions or properties of the business including the amount due to it from others. Asset may be classified in to fixed asset and current asset.

Fixed asset

Assets which are required for relatively longer periods for carrying on the business are called fixed assets. They are help in the generation of income and are not meant for resale. Fixed assets are classified in to

1- Tangible asset

   Assets having definite shape and physical existence are called tangible asset. E.g. Land, building, machinery etc.

2- Intangible asset

   Asset having no physical value but are represented by rights in certain things are called intangible asset. E.g. Goodwill, patent, trademark etc.

16.06.2021

3- Wasting asset

Assets which exhausted to the extent of extraction are called wasting asset. e.g. Mines, quarries, oil fields etc.

4- Fictitious asset

Assets which have no real value but are shown in the books of accounts only for technical reasons are called fictitious asset. Eg. Preliminary expenses discount on issue of shares and debentures, underwriting commission etc.

Current asset

Assets which are held for a very short period are called current assets. These are assets acquired with the intention of converting them in to cash or consuming them during a year. E.g. Cash, stock, raw materials, finished goods, bills receivables etc.

Equity- The total claims of business are called equity

Creditor's equity

Liabilities are the claims of outsiders against the business and are called creditor's equity or outsider's equity

Owners' equity- Capital is the owner's claim against the business and is called owner's equity.

Liabilities

Liabilities are obligations or debts that an enterprise has to pay at some time in the future. Liability means amount which a business owes to others either for money borrowed or for goods and assets purchased on credit or for service rendered. Liabilities are divided in to two categories

Current liabilities

Liabilities which become due and payable within a short period i.e. within a year are called current liabilities. They arise out of normal trade activities. E.g. Creditors, bills payable, outstanding expenses etc.

Fixed or long term liabilities

Liabilities which are payable after a long period are termed as long term liabilities. E.g. Long term loan, debentures etc.

Capital

Capital refers to the money or money's worth introduced or invested by the owners into business. Capital is the owners claim against the business and is called owner's equity.

16.06.2021

Drawings

It is the amount of cash or other asset withdrawn by the owner for his personal purpose.

Revenue

Revenue represents the amount a business earns by selling its products or providing service to its customers. Sales are the major revenue of the business. E.g. Commission, interest, rent etc.

Expense

The term expense denotes the cost incurred by a business in the process of earning revenue. E.g. rent, salary, wages etc.

Expenditure

Spending money or incurring a liability for some benefit, service or property received is called expenditure. E.g. payment of rent, salary, purchase of goods, machinery etc.

Revenue expenditure

If the benefit of expenditure expires within a year it is treated as an expense and also called revenue expenditure. E.g. payment of rent, wages, salary, commission, etc.

Capital expenditure

If the benefit of expenditure lasts for more than a year it is treated as an asset and also called capital expenditure or expenditure which has been incurred to derive long term advantage for the business. Eg. Purchase of asset

Loss

It is the excess of expense over revenue. It decreases in owner's equity. It also refers money or money's worth lost without receiving any benefit in return. E.g. cash or goods lost by theft or fire, loss on sale of fixed asset etc.

Profit

Profit is the excess of revenue over expenses. It represents increase in owner's equity.

Gain

A profit that arises from events or transactions which are incidental to business such as sale of fixed asset, winning a court case, appreciation of value of asset etc. are called gain.

Income

Income is the increase in the net worth of an organisation either from business activity or from other activities. It includes profit also.

16.06.2021

Discount

Discounts are deductions allowed either on the selling price or on the amount due. Discounts are two types

Trade discount.

The concession given by the seller to the buyer for making bulk purchase is called trade discount. Normally trade discount is deducted from the actual price and the net amount is shown in the invoice. Therefore trade discount will not come in the books of accounts

Cash discount.

It is a deduction granted by the creditor to the debtor as an inducement for making prompt payment. The discount is a loss to the creditor and a gain to the debtor. When discount granted by the creditor it is called discount received and discount granted to the debtor it is called discount allowed.

Voucher

The documentary evidence in support of a transaction is known as voucher.

Goods

Goods are the Product and articles which are purchased and are meant for resale. For stationery merchant stationery items like books, pen, pencil etc. are goods and for a furniture dealer furniture items like table, chairs etc. are goods for correct accounting of goods they are called by different names purchase, sales, purchase return and sales return.

Purchase

The total amount of goods procured by a business concern both for cash and credit and is meant for resale is termed as purchase.

Purchase return

Return of goods already purchased to suppliers are called purchase return or return outward.

Sales

Sales are the total revenues from goods or services sold or provided to customers. Sales are the act of exchange of an item of value for cash or credit.

Sales return

Returns of goods already sold by customers are called sales return or return inward.

Stock

The goods lying with a business for sale on any given date are called stock.

Closing stock

The value of goods remaining unsold at the end of an accounting period is known as closing stock.

Opening stock

The closing stock of a particular period becomes the opening stock for the next period.

xxxxxxxxxxxxxxxxxx

Chapter 2

Theory base of accounting

Accounting is considered as the language of business. To make the language convey the same meaning to all people there are certain guidelines and practices that are followed while recording transactions and in preparing financial statements. Such principles and guidelines are called GAAP. The Generally Accepted Accounting Principles (GAAP) refers to the rules or guidelines adopted for recording and reporting of business transactions.

These principles are also referred as concepts or conventions. The term concepts refers to the necessary assumptions and ideas which are fundamental to accounting practice and the term convention denotes customs or traditions as a guide to the preparation of accounting statements. From the practicability view point, it is observed that the various terms such as principles, conventions, modifying principles, assumptions, etc. have been used interchangeably and are referred to as Basic Accounting Concepts. So GAAP include accounting concepts, accounting conventions and accounting standards.

Basic accounting concepts

1- **Business entity concept**

According to this concept the entity of business is different from its owners. It means that for the purpose of accounting business and its owners are to be treated as two separate entities. This principle states that the affairs of business will not be mixed up with the private affairs of the owner. According to this principle capital is treated as a liability of business towards owners.

2- **Money measurement concept**

As per this concept transactions involving money or money's worth will be recorded in the books of the business. Events or transactions which cannot be expressed in terms of money will not be recorded in the books.

3- **Going concern concept**

According to this concept it is assumed that the business will last for a long time. There is no intention to close the business in the immediate future. It is based on this assumption that the suppliers deliver goods on credit, fixed assets are recorded at original cost and are depreciated in a systematic manner, prepaid expense, outstanding income etc. are treated.

4- **Accounting period concept**

According to going concern concept the business is supposed to continue for longer period of time. The true result of the business can be ascertained through the preparation of financial statements only after the closure of the business unit. But information made available to the users after closure of the business will not serve its purpose. So the accounts are prepared periodically. The period of interval for which accounts are prepared and presented for ascertaining the result and financial position of business is called accounting period.

5- **Dual aspect or duality Concept**

This is the basic principle of accounting. As per this principle every transaction has two aspects, i.e. receiving aspects and giving aspect. *Accounting equation is developed on the basis of this principle.* The double entry system of book keeping is also based on this principle.

6- **Matching Concept**

These principles states that expenses incurred in an accounting period should be matched with revenues during that period in order to ascertain the profit or loss. *It is because of this principle the adjustment are made for outstanding expense, accrued income, prepaid expenses etc.*

7- **Conservatism/prudence Concept**

This principle states that while recording accounting information anticipated profits are not to be considered but only possible losses are considered. According to this principle a reasonable provisions are made for anticipated losses. *It is because of this principle stock are valued at market price or cost price whichever is less, creating provision for doubtful debts, discount on debtors, writing of intangible asset like goodwill patent etc.*

xxxxxxxxxxxxxxx

CHAPTER 3

Recording of Transaction –I

Business transactions are usually evidenced by an appropriate document such as cash memo, invoice, sales bill, pay in slip, cheque, salary slip etc. a document which provides evidence of the transaction is called the source document or a voucher. All such documents are arranged in chronological order and are serially numbered and kept in a separate file. All recording in books of account is done on the basis of vouchers.

Accounting equation

Accounting equation is a statement of equality between the debits and credits or assets and liabilities including capital.

Thus

Asset = equities

The properties owned by a business are called assets. Total claim against a business are called equities. Equity may be divided in to two. The claims of the outsiders and the claims of the owner. Thus

Asset = capital + Liabilities.

Capital = Asset- Liabilities

Liabilities = Assets – Capital

Assets- Capital – liabilities = Zero

A= C+ L

C = A- L

L = A- C

A- C- L= 0
B-

The accounting equation is also called balance sheet equation as it gives the fundamental relationship among the components of a balance sheet i.e. asset, liabilities and capital.

Modern Rules of accounting (Classification of Accounts):

Rules of debit and credit

To record transaction in the books of account, firstly we should identify the transaction with respect to debit and credit. For this business transactions are divided in to five categories

1- Asset
2- Liabilities
3- Capital
4- Revenue/Income
5- Expense

The rules for debit and credit in respect of various categories are;

Categories	Debit	Credit
Asset	Increase	Decrease
Expense	increase	Decrease
Capital	Decrease	Increase
Liabilities	Decrease	Increase
Income	Decrease	Increase

Recording of transaction

Accounting under double entry system is divided in to two stages

1- Transactions are recorded in journal
2- Items are posted from the journal to the ledger.

Journal

Journal is the book of original entry in which transactions are recorded one after another in the order in which they occur. The first record of a transaction is made in this book. Journal is also called book of prime entry or book of original entry because all the transactions are entered in this book at the first instance before being entered in any other book. The source document is required to record transaction the journal.

Journalising

The recording of a transaction in the journal is called journalising.

Journal entry.

The record of a transaction in the journal is called journal entry.

Simple journal entry

Any entry recorded in the journal which contains only one debit and one credit is called simple journal entry.

Compound journal entry

When there are two or more transactions of similar nature occurring on the same day and the entry for the same have more than one credit or debit, it is called compound journal entry.

Format of journal

Date	Particulars	L.F	Debit Amount Rs.	Credit Amount Rs.

L.F – Ledger Folio

The first column in a journal is date on which the transaction took place. The second column is particular column and in the particular column, the account title to be debited is written on the first line beginning from the left hand corner and the word ‘Dr’ is written at the end of the column. The account title to be credited is written on the second line leaving sufficient margin on the left side with a prefix ‘To’. Below the account title a brief description of the transaction is given which is called narration. After writing the narration a line is drawn in the particular column. The third column is ledger folio and which records the page number of the ledger book on which relevant account is appeared. This column is filled up at the time of posting. The debit amount column represents the amount against the account to be debited and the credit amount column records the amount against the account to be credited. The number of transactions is very large and these are recorded in number of pages in the journal book. Hence, at the end of each page of the journal book the amount columns are totalled and carried forward (c/f) to the next page where such amounts are recorded as brought forward (b/f) balances.

Banking transactions

1- When cash deposited in the bank
   Bank a/c Dr
   To cash a/c
2- When cash withdrawn from bank for business purpose
   Cash a/c Dr
   To bank a/c
3- When cash withdrawn from bank for personal purpose
   Drawings a/c Dr
   To bank a/c
4- When a cheque is issued to a person
   Person’s a/c Dr
   To bank a/c

5- Goods purchased and payment made by cheque

Purchase a/c Dr

To bank a/c

6- Asset purchased and payment made by cheque

Asset a/c Dr

To bank a/c

7- When a person remitted directly into bank

Bank a/c Dr

To person a/c

8- Cheque received from a person and deposited on the same day

Bank a/c Dr

To person's a/c

9- When cheque is received from a person and deposited on another day

When cheque received

Cash a/c Dr

To person's a/c

When the cheque sent to bank for collection

Bank a/c Dr

To cash a/c

10- When cheque deposited returned dishonoured

Person's a/c Dr

To bank a/c

11- When bank allows interest on deposit

Bank a/c Dr

To bank interest a/c

12- When bank charges against the deposit

Bank charges a/c Dr

To bank a/c

Ledger

It is a book where transactions of similar nature are grouped together in one place in the form of an account. Ledger is a book of secondary entry or final entry because transactions first entered in the journal are finally recorded in ledger. It is also called main book or the principal book of a business. A ledger is the collection of all the accounts debited or credited in the journal.

Format of ledger account

Name of the account

Dr Cr

Date	Particular	JF	Amount	Date	Particular	JF	Amount

The name of the firm is written at the top of the format as the title of the account. Write 'Dr' on the left hand side that means debit side and 'Cr' on the right hand side means credit side. Date of transaction is recorded in chronological order in the date column. In the debit side particular column record the item credited in the journal and in the credit side particular column record the item debited in the journal. Journal folio records the page number of the journal on which relevant transaction is recorded. The amount column records the amount in numerical figures.

Posting

The process of recording transaction in ledger is called posting. Posting means grouping of all the transactions in respect to a particular account at one place for meaningful conclusion.

Difference between journal and ledger

Journal	Ledger
Journal is the book of original entry	Ledger is the book of final entry
All transactions are recorded first in the journal	All transactions are recorded finally in ledger
Transactions are recorded in a chronological order	Transactions are recorded in an analytical manner
Source document form the basis for writing transaction in journal	Entries in the journal form the basis for writing ledger
Balancing is not done in Journal	All ledger accounts are balanced
The process of recording entries in journal is called journalising	The process of recording entries in ledger is called posting
There is no uniformity in the keeping of various books of journal	There is a uniformity in the keeping of ledger

xxxxxxxxxxxxxxxxxxxxxxxxxxxx

Chapter 4-

Recording of Transaction II

Subdivision of Journal

In small concerns only one journal may serve the purpose, because the number of transactions is very small. But in large business concerns the number of transactions are numerous, just one journal will not do the job. That will cause much inconvenience i.e., if we have only one journal in a large scale business, it is not possible for one bookkeeper to record all the transactions in time.

A journal can be used as the only book of original entry because all transactions are recorded in journal first. Instead of recording all kinds of transactions in one journal for each kind of transactions like cash transaction, buying transaction, selling transaction etc. are recorded in separate journal. Such book or journal which is used to record one kind of transaction is known as a special journal

Types of special journal

1- **Cash book / cash journal**– For recording all cash transactions
2- **Purchase day book** – For recording of all credit purchases of goods
3- **Purchase return book** –For recording goods returned to supplier
4- **Sales book / or sales journal** – For recording all credit sale of goods
5- **Sales return book or journal** – For recording goods returned by customers.
6- **Bills receivable book or journal** – For recording bills received from customers
7- **Bills payable book or journal** – For recording bills given to suppliers
8- **Journal proper or General journal** – All other transaction that cannot be recorded in the special journal are entered in journal proper or general journal.

Cash book

Cash book used to record all transaction relating to cash receipts and cash payments. Cash book has two sides a debit side and a credit side. All cash receipts are entered on the debit side and all cash payments are recorded on the credit side. A cash book serves the purpose of both journal and ledger. Since all cash transactions are first recorded in cash book it is a book of original entry or journal. It also serves the purpose of ledger account because it is written on the form of an account with debit side and credit side. Cash book is divided in to single column cash book , double column cash book, triple column cash book and petty cash book.

Single column cash book

A cash book which contains only one column for amount on both sides is called single column cash book.

Format of single column cash book

Dr Single column cash book Cr

Date	Particular	L.F	Amount Rs.	Date	Particular	L.F	Amount Rs.
	(Receipts)				(Payments)		

Double column cash book

A business man generally opens a current account with a bank. The bank do not allow interest on the balance in current account but charge a small amount called incidental charges or bank charges for the service rendered.

For depositing cash/cheque in the bank account, a form has to be filled which is called pay in slip contains a counter foil also which is returned to the depositor with the signature of the cashier as receipt.

For withdrawing money from the bank the bank issues blank cheque forms to the account holder.

A cash book with two amount columns on both sides is called double column cash book. One column for cash and another column for bank. All remittance in to bank is recorded on the debit side bank column and all payments / withdrawals from the bank are recorded on the credit side bank column. The cash column of the cash book always shows a debit balance but the bank column of the cash book may show either a debit balance or even a credit balance. A Credit balance showed when there is an overdraft. Bank overdraft means withdrawal of amount more than deposited in bank.

Contra entries

When a transaction is recorded on both side of the cash book but in different columns such entries are called contra entry.

Format of double column cash book

Dr **Double column cash book** **Cr**

Date	Particular	L.F	Cash Rs.	Bank Rs.	Date	Particular	L.F	Cash Rs.	Bank Rs.
	(Receipts)					(Payments)			

Petty cash book

A petty cash book is an additional cash book to record all petty or small payments. The person who makes the small payments is called petty cashier.

Imprest system of petty cash book

In this system a fixed amount is advanced by the main cashier to the petty cashier in the beginning of the period. At the end of the period the petty cashier is reimbursed for the amount he has spent. Thus in the beginning of the period the petty cashier will have a fixed amount of cash balance always. The fixed predetermined maximum amount which a petty cashier will be allowed to hold at the beginning of each period for meeting petty expenses is known as imprest amount. And hence the system is called imprest system of petty cash book.

A petty cash book can be maintained in two ways

1- Simple petty cash book
2- Analytical petty cash book.

Simple petty cash book

A simple petty cash book is prepared just like a simple cash book with two sides debit side and credit side.

Analytical or columnar petty cash book

In analytical petty cash book there will be a number of columns for the amount on the payment side besides the first total amount column. The other amount columns are provided for items of specific payments that are common.

Format of petty cash book

Dr **Analytical Petty cash book** **Cr**

Amount Received	Date	Vr. No	Particular	Total Amount	Analysis of payments			
					Postage	Stationery	Travelling exp.	Misc.

Purchase day book/ purchase journal

Purchase book is used to record all credit purchases of goods. The source document for recording entries in the purchase journal is purchase invoice. The purchase invoice is a formal business paper prepared by the supplier of goods containing brief description of goods, quantity, price, discount, tax, net amount payable etc. and send to the purchaser.

Format of purchase day book

Date	Invoice No.	Name of supplier	L.F	Amount Rs.

Sales day book/ sales journal

Sales day book or sales journal is used to record all credit sale of goods. Cash sales and sale of assets are not recorded in sales day book. The sales invoice or bill act as the source document for recording entries in this book. It is issued by the firm to the customer.

Format of sales day book

Date	Invoice No.	Name of customer	L.F	Amount Rs.

xxxxxxxxxxxxxxx

Chapter – 5

Bank Reconciliation Statement

It is a statement prepared by the depositor (customer) for the purpose of reconciling or making agree the cash book balance with the pass book balance on a certain date by making suitable adjustments. It is a statement prepared to show the causes of difference between the items shown in the pass book and the bank column of the cash book

Need for Reconciliation

If the bank balance shown in the firm's cash book and the pass book balance does not tally, we have to first ascertain the causes of difference and then prepare the bank reconciliation statement to reconcile the two balances.

Causes of differences between cash book balance and pass book balance

The differences between the cash book and the bank passbook are caused by:

- Timing differences on recording of the transactions.
- Errors made by the business or by the bank.

Timing difference

The disagreement between the balances of cash book and pass book due to timing difference is caused by the time gap in recording the transactions relating either to payments or receipts.

The factors affecting time gap includes

1. **Cheque issued but not presented for payment**

   When a trader issues cheque to a third person, he immediately enters in the cash book whereas; it will be entered by the bank only when the cheques are presented to the bank for payment.

2. **Cheque paid in but not credited /collected by bank**

   Cheque received from customers might have been paid into bank and entered on the debit side of the cash book by the trader. But the bank will credit the same only after realization of the cheque.

3. **Interest , dividend etc. collected and credited by bank**

   Interest allowed on bank balance and interest, dividends etc. collected by the bank will be credited in the pass book. But the trader may not enter the same in his cash book on the same day.

4. **Directs debits made by the bank on behalf of the customer**

   Bank charges, interest on overdraft, commission for collection of cheques, bills, etc. will be debited by the bank in pass book as and when they occur. But it will be entered by the trader only on a later date in his cash book as he may not be aware about them on the same day.

5. **Cheques credited but dishonoured**

   When cheque is discounted, bank will credit it in pass book and customer debits it in cash book, hence both the balances will be increased. Later on if this cheque is dishonoured, the bank will debit the customer's account (pass book) but it may not be entered by the trader in his cash book at that time.

6. **Amount directly deposited in the bank account**

   The customers of a trader might have deposited money into the trader's bank account directly. But it may not be intimated to the trader soon, hence it will not be recorded in the cash book.

7. **Direct payments made by the bank on behalf of the customer.**

   The bank might have made some payments on behalf of the customer under 'standing instructions' and debited the customer's account. But the customer may not have entered the same in his cash book.

8. **Dishonour of a bill discounted with the bank**

   Sometimes the customer discounts bills of exchange before maturity for urgent cash. If on the date of maturity, such a bill is dishonoured, the bank will debit the customer's account. The customer will make this entry in his book only after getting information from the bank.

<u>Differences caused by errors</u>

Sometimes the difference between the two balances may be because of an error on the part of the bank or an error in the cash book of the business.

1- Errors committed in recording transaction by the firm

   Omission or wrong recording of transaction relating to cheque issued, cheques issued and wrong totalling, etc. Committed by the firm while recording entries in cash book cause difference between cash book and passbook balance,

2- Errors committed in recording transaction by the bank

   Omission or wrong recording of transaction relating to cheque deposited and wrong totalling, etc. committed by the bank while recording entries in pass book cause difference between cash book and passbook balance,

xxxxxxxxxxxxxxxxxxxxxx

CHAPTER 6

TRIAL BALANCE AND RECTIFICATION OF ERRORS

A trial balance can be defined as a statement of balances or total of debits and credits of all the accounts in the ledger on a particular date prepared to test the arithmetical accuracy of the books kept under double entry system.

Objectives

1- To ascertain the arithmetical accuracy of ledger accounts
2- To find out mistakes and rectify them
3- To provide a basis for financial statements

Trial balance may be prepared under three methods

1- Total method
2- Balance method
3- Total cum balance method

Total method

Under this method the totals of debit sides of all accounts are placed in the debit column of the statement and the total of ll accounts are placed in the credit column.

Balance method

Under this method the balance of ledger accounts are shown in the trial balance. The account having debit balances are entered in the debit column of the trial balance similarly accounts showing credit balance are entered in the credit column.

Total cum balance method

This method is a combination of total method and balance method. Under this method four columns for amount are prepared. Two columns for writing the debit and credit totals of various accounts and two columns for writing the debit and credit balances of these accounts.

Preparation of trial balance

While preparing a trial balance the various ledger balances may be grouped as:

1- Assets and liabilities
All assets account will be a debit balance and all liabilities will have a credit balance. Capital is the liability of the business to the owner. Hence capital account will have a credit balance.
2- Expenses or losses and incomes or gains
Accounts representing expenses or losses will have a debit balance. But accounts representing income or gains will show a credit balance.

3- Trading account items
   Opening stock, purchase and sales return will show a debit balance and sales and purchase return will show a credit balance.
4- Special items
   Reserves and provisions accounts will generally show credit balance and drawings will show a debit balance.

Format of Trial Balance

Trial Balance of …………….as on ………………..

Account Title	L.F	Debit Balance	Credit Balance
Total			

xxxxxxxxxxxxxxxxxxxxxxxxxxx

Chapter -8

Financial Statements - I

Expenditure

Whenever payments are made for a purpose other than the settlement of an existing liability is called expenditure. The benefit of an expenditure may extend up to one accounting year is termed as revenue expenditure. Eg. Payment of salary, rent etc. the benefit of an expenditure extends more than one accounting period is termed as capital expenditure.

Distinction between capital expenditure and revenue expenditure

(a) Capital expenditure increases earning capacity of business whereas revenue expenditure is incurred to maintain the earning capacity.

(b) Capital expenditure is incurred to acquire fixed assets for operation of business whereas revenue expenditure is incurred on day-to-day conduct of business.

(c) Revenue expenditure is generally recurring expenditure and capital expenditure is non-recurring by nature.

(d) Capital expenditure benefits more than one accounting year whereas revenue expenditure normally benefits one accounting year.

(e) Capital expenditure is recorded in balance sheet whereas revenue expenditure is transferred to trading and profit and loss account.

Deferred revenue expenditure

Revenue expenditure which are likely to give benefit for more than one accounting period are treated as deferred revenue expenditure. E.g. Advertisement expense.

Receipts

If the receipts imply an obligation to return the money are called capital receipts. Eg. Additional capital introduced, loan from the bank, sale of fixed asset etc. if a receipt does not incur an obligation to return the money or is not in the form of a sale of fixed asset is termed as revenue receipts. Eg. Sales, interest received etc.

Financial statements

Financial statements are reports prepared by a company's management to present the financial performance (operating result) and position at a point in time.Financial statements are the main source of financial information for most decision makers. The basic objective of preparing financial statements is

1- To present a true and fair view of the financial performance of the business,
2- To present a true and fair view of the financial position of the business.

Financial statements are

1- Trading and Profit and loss account / income statement
2- Balance sheet / position statement

Profit and loss account is prepared to find out the operating result and balance sheet is prepared to find out the financial position

Income statement

Income statement is prepared to ascertain the profit or loss of a business during a period of time. Profit or loss is worked out in three stages

- Gross profit or gross loss
- Net profit or net loss
- Operating profit or operating loss

The income statement is divided in to two sections. The first section is called trading account and the second section is called profit and loss account. Trading account reveals the gross profit and profit and loss account shows the net profit. Operating profit is calculated separately which is not necessary for final accounts. It is prepared for guiding management in various business decisions.

Trading account

Trading account is an income statement prepared to ascertain trading result i.e., gross profit or gross loss.

Gross profit / Gross loss

The profit arising out of trading alone is called gross profit and if there is a loss it is called gross loss. Gross profit is the excess of net sales over cost of goods sold. Net sales means sales minus sales return. Cost of goods sold means opening stock plus net purchase plus direct expense minus closing stock. Net purchase means purchase minus purchase return.

Gross profit = Net sales - cost of goods sold.

Net sales = sales - sales return.

Cost of goods sold = opening stock + net purchase + direct expense - closing stock.

Net purchase = purchase - purchase return.

Gross loss = Cost of goods sold – Net sales

Direct expense

All expense directly associated with the purchase or production is called direct expense.

Net profit

Net profit is the ultimate profit arrived at after charging all business expenses. If the revenue exceeds the expense it is net profit and expense exceeds the revenue it is net loss.

Net profit = Gross profit + Other Income-Indirect Expense

Net profit = Operating profit – Non operating Expense + Non-Operating Income

Non-operating expense

A non-operating expense is an expense incurred by an organization that does not relate to its main activity. It include loss due to fire, loss on sale of fixed asset, interest tax etc.

Non-operating income

Non-operating income is gains from sources not related to the typical activities of the business or organization.it include gain on sale of fixed asset, interest received on investment, commission received, rent received etc.

Profit and loss account

In order to find out the net result of the business, i.e. net profit or net loss, profit and loss account is prepared.

Purpose and importance of profit and loss account

1- To ascertain net profit or net loss
2- To compare actual performance with desired performance
3- To calculate different ratios.
4- To determine future line of action.

Preparation of trading and profit and loss account

Closing entries

Closing entries are the journal entries passed for transferring the balances of expenses and revenues accounts to the trading and profit and loss account

Entries to close Opening stock account, purchase account, direct expense accounts

Trading account Dr
To Opening stock a/c
To Purchase a/c
To direct expense a/c

Entry to close purchase return

Purchase Return a/c Dr
To Purchase a/c

Entry to close sales account

Sales a/c Dr
Trading a/c

Entry to close sales return account

Sales a/c Dr
To sales return a/c

Entry to close closing stock

Closing stock a/c Dr
To Trading a/c

Entry to close gross profit

Trading a/c Dr
To profit and loss a/c

Entry to close gross loss

Profit and loss a/c Dr
To Trading a/c

Entry for close indirect expenses

Profit and loss a/c Dr
To Expense a/c

Entry for closing incomes

Incomes a/c Dr
To profit and loss a/c

Entry to close net profit

Profit and loss a/c Dr
To Capital a/c

Entry to close net loss

Capital a/c Dr
To profit and loss a/c

<u>Format of trading and profit and loss account</u>

TRADING AND PROFIT AND LOSS ACCOUNT OF MR……… FOR THE YEAR ENDING ………

DR CR

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
Opening Stock	xxxx	Sales xxxx	
Purchase xxxx		Less- Returns	
Less- Returns xxx	xxxx	xxx	xxxx
Carriage / Carriage Inward	xxxx	Closing Stock	xxxx
Wages	xxxx		
Freight	xxxx		
Power	xxxx		
Water, Gas	xxxx		
G/P Transferred to P/L Account	xxxx		
	xxxxxx		xxxxxx
		G/P Transferred from trading account	xxxx
Salaries	xxxx	Commission	xxx
		Interest	
Rent Rates and Tax	xxxx		xxxx
Insurance	xxxx	Discount Received	xxxx
General expense	xxxx	Provision for discount on creditors	xxxx
Discount allowed	xxxx	Interest on Drawings	xxxx
Depreciation	xxx	Rent Received	xxxx
Carriage outward	xxx		
Trade Expense	xxx		
Bad Debt	xxxx		
Advertisement	xxxxx		
Provision for discount on debtors	xxx		
Interest on Capital	xxxx		
Travelling Expense	xxxxx		
Printing and Stationery	xxxx		
N/P Transferred to Capital	xxxxx		
	xxxxx		xxxxx

Balance Sheet

A balance sheet is a statement of asset and liabilities of a business. Prepared with a view to ascertain the financial position of the business as on a particular date.

A balance sheet has two sides the left hand side and the right hand side. Accounts of capital and liabilities are shown on the left hand side known as liabilities side. Asset and other debit balances are shown on the right hand side called asset side. Items which are generally included in a balance sheet are.

1- Current asset
   Current assets are those assets which are either in the form of cash or which can be converted in to cash with in a year. They include
   - Cash in hand
   - Cash at bank
   - Bills receivable
   - Sundry debtors
   - Closing stock
   - Prepaid expenses
   - Accrued income etc.
2- Fixed asset
   Those assets which are acquired and held permanently in the business and are used for earning revenue.
   - Land and building
   - Furniture and fixtures
   - Plant and machinery
   - Vehicle etc.
3- Current liabilities
   Liabilities that are to be settled with in a period of time of one year are called current or short term liabilities.
   - Sundry creditors
   - Bills payable
   - Outstanding expenses
   - Bank overdraft etc.
4- Long term liabilities
   Liabilities that are to be settled by after one year are called long term or fixed liabilities.
5- Capital
   It represents the amount originally contributed by the owner.

Grouping or marshalling

The arrangements of assets and liabilities in certain groups and in a particular order is called grouping and marshalling of balance sheet. Assets and liabilities can be arranged in to two ways.

1- In the order of liquidity
2- In the order of permanence

In the order of liquidity

In this method the assets are arranged in the order of their liquidity. Liquidity means the capacity to create cash. The assets which can be easily converted in to cash are stated first followed by other assets which cannot be so easily converted in to cash and liabilities are arranged in the order they are to be discharged.

In the order of permanence

In this method assets which are to be used for long term in the business and are not meant for sale are presented first. Liabilities which have to be discharged last are shown first and those which have to be discharged first are shown last.

<u>Format of Balance Sheet In the order of liquidity</u>

BALANCE SHEET OF MR........ AS ON			
LIABILITIES	**AMOUNT**	**ASSET**	**AMOUNT**
Bank Overdraft	xxxx	Cash in Hand	xxxx
Bills payable	xxxx	Cash at Bank	xxxx
outstanding Expense	xxxx	Bills Receivable	xxxx
Income received in advance	xxxx	Sundry Debtors	xxxx
sundry creditors	xxxx		
		Prepaid Expense	xxxx
Loan	xxxx	Accrued Income	xxxx
Capital xxxxx		Closing Stock	xxxx
Add- N/P xxxx			
(Less- N/L)		Fixed assets	xxxx
Add- Interest on capital xxxx		Land and building	xxxx
Less -Drawings xxxx		Plant and	xxxx
Less- interest on drawings <u>xxxx</u>	xxxx	machinery	
		Furniture	
		Goodwill	xxxx
	xxxxx		xxxxx

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

16.06.2021

Chapter -8

Financial Statements – II

Final accounts with adjustment

While preparing final accounts at the end of every accounting period, all expenses and income should be taken into consideration. The expenses of current year may be still payable or the expenses of next year might have been paid this year. Sometimes, income of the current year remains still receivable as well as the income of the next year might have been received in advance would not have been recorded in the books yet. According to accrual concept of accounting all these items should be recorded in the financial statements in order to get correct financial position and profit or loss. This process is called adjustments. The journal entries passed for the adjustments or recording all items which needs alteration are called adjustment entries. The items which usually need adjustments are:

1- Closing stock
2- Outstanding Expense
3- Prepaid Expense
4- Accrued Income
5- Income Received in Advance
6- Depreciation
7-

1- Closing stock

If the closing stock is not given in the trial balance and shown as an additional information outside the trial balance.

The adjustment entry will be

Closing stock a/c Dr
To Trading a/c

Effect of the adjustment

1- Closing stock will be shown on the asset side of the balance sheet
2- In trading account the amount of closing stock will be credited.

If closing stock is given in trial balance

This means opening stock and closing stock are adjusted through purchase account. in this case opening stock will not appear in trial balance.

The adjustment entry will be

Closing stock a/c Dr
To Purchase a/c
Purchase a/c Dr
To Closing stock

Effect of the adjustment

1- Closing stock will be shown on the asset side of the balance sheet

16.06.2021

2-Outstanding Expense

Expenses which have been incurred during the year and whose benefit has been derived during the year but the payment has not been made are called outstanding expenses or unpaid expenses.

The adjustment entry will be

Expense a/c Dr

To Outstanding expense a/c

Effect of the adjustment

1- Add to the respective expenses and shown on the debit side of the trading and profit and loss account
2- It will be shown on the liability side of the balance sheet

3-Prepaid expense

The expenses which have been paid in advance, whose benefit will be available in future are called unexpired or prepaid expenses.

The adjustment entry will be

Prepaid expense a/c Dr

To expense a/c

Effect of the adjustment

1- Prepaid expense will be deducted from respective expenses and shown in the debit side of the Trading and profit and loss a/c

2- In the balance sheet it will be shown on the asset side.

4- Income earned but not received or Accrued Income

An income which has been earned but not received during the accounting year is called accrued income.

Adjustment entry

Accrued Income a/c Dr

To Income a/c

Effect of the adjustment

1- Accrued income will be added to the respective income and shown on the credit side of the profit and loss a/c.

2- It will be shown on the asset side of the Balance Sheet.

5- Income Received in advance

Income received but not due is called income received in advance or unearned income.

Adjustment entry

Income a/c Dr

To Income received in advance a/c

Effect of the adjustment

1- It should be deducted from the concerned income and shown in the creditside of the profit and loss account.

3- In Balance Sheet it is shown on the liability side.

16.06.2021

6- Depreciation

Depreciation means the decrease in the Value of asset. It is considered as a loss.

Adjustment entry

Depreciation a/c Dr

To Asset a/c

Effect of the adjustment

1- It is shown on the debit side of the profit and loss account as a separate item.

2-In balance sheet the amount of depreciation is deducted from concerned asset.

xxxxxxxxxxxxxxxxxxxxxxxxxx

16.06.2021

CHAPTER 9
Computerised Accounting System

Computerised Accounting System

It is an accounting system that process the financial transactions and events to produce report as per user requirements

Need for computers in accounting

The advent of globalisation has resulted in the size of business operation. Every medium and large sized organisationrequires well established information system in order to generate information required for decision making and achieving the organisational objectives.

Modern computerised accounting system is based on the concept of database. Data base is a collection of interrelated data shared and used for multiple purposes. A database is implemented using a database management system. DBMS is a set of computer programme or software that manages and organise data effectively and access to the stored data. It involves creation of database, updating the data, deleting, editing the data preparing reports etc.

Every computerised accounting system has two basic requirements.

1- Accounting framework

It consists of a set of principles coding and grouping structure of accounting.

2- Operating procedure

It is well defined operating procedure blended suitably with the operating environment of the organisation. That is maintenance of records and generation of reports.

Difference between manual accounting and computerised accounting

Manual Accounting	Computerised Accounting
1. whole accounting work are done by manually	Most of works are done with the help of computers
2.Alteration and additions are not easy	Alteration and additions are easy
3. time consuming	Speedy
4. periodic availability of results are very difficult	Periodic results are ascertained at any point of time
5. coding is not necessary	Most of the accounting software are using codes

16.06.2021

Advantages of computerised accounting system

1- Speed

Computers make calculations and data process at very fast rate. A computer can perform millions of calculations in seconds. Accounting data is processed faster by using computerised accounting system than it is achieved through manual accounting.

2- Accuracy

The possibility of error is reduced in computerised accounting system because the primary accounting data is entered once for all the subsequent usage.

3. Reliability

The computer system is well adapted to performing repetitive operations. They are free from tiredness, boredom or fatigue. As a result computers are highly reliable compared to human beings.

4. Up to date information

The accounting records in a computerised accounting system are updated automatically as and when accounting data entered and stored.

5. Real time user interface

Most of the accounting systems are interlinked through a network of computer. This facilitates the availability of information to various users at the same time.

6. Automated document procedure

Accounting reports that are generated automatically. Statements of accounts are obtained just by a click of a mouse.

7. Scalability

In a computerised accounting system the requirement of additional manpower is confined to data entry operators for storing additional vouchers. The cost of processing additional transactions is almost negligible.

8. Legibility

The data displayed on computer monitor is legible. This is because the characters are typewritten using standard fonts.

9. Efficiency

The computer based accounting system ensures better use of resources and time. This brings about efficiency in generating decisions useful information and reports.

10. Quality reports

The accounting reports are highly objective and can be relied upon.

11. MIS reporting

The computerised accounting system facilitates the real time production of management information report, which will help management to monitor and control the business effectively.

12. Storage and retrieval

The computerised accounting system allows the user to store data in a manner that does not require a large amount of physical space. The system permits fast and accurate retrieval of data and information.

13- Motivation and employee's interest

The computer system requires a specialised training of staff, which makes them feel more valued. This motivates them to develop interest in the job.

xxxxxxxxxxxxxxxxxxxxxxxxx