

Focus Area – Public Examination- September-2021

Study Notes, Expected questions with answers (Unofficial)

Plus One – Accountancy with CA

എസ്.സി.ഇ.ആർ.ടി കേരളം പൊതുപരീക്ഷയ്ക്കായി കൂടുതൽ ശ്രദ്ധ നൽകേണ്ട പാഠഭാഗങ്ങൾ

ACCOUNTANCY WITH COMPUTERISED ACCOUNTING

Sl No	Name of Chapter	Focus Area
1	Introduction to Accounting	1. Meaning of Accounting 2. Qualitative Characteristics of Accounting information 3. Objectives of Accounting 4. Basic Terms in Accounting
2	Theory Base of Accounting	1. Basic Accounting Concepts 1.1 Business Entity Concept 1.2 Money Measurement Concept 1.3 Going Concern Concept 1.4 Accounting Period Concept 1.5 Dual Aspect Concept 1.6 Matching concept 1.7 Conservatism concept
3	Recording of Transactions -I	1. Accounting Equation 2. Rules of Debit and Credit 3. Books of original Entry 3.1 Journal 4 Ledger 5. Distinction between Journal and Ledger 6. Posting from Journal
4	Recording of Transactions -II	1. Special Journals 2. Single Column Cash Book 3. Double Column Cash Book 4. Petty Cash Book 5. Purchases Book 6. Sales Book
5	Bank Reconciliation Statement	1. Concept of Bank Reconciliation Statement 2. Causes of differences between the cash book and the bank passbook balances
6	Trial Balance and Rectification of Errors	1. Meaning of Trial Balance 2. Objectives of Preparing the Trial Balance 3. Preparation of Trial Balance - Balances Method
7	Financial Statements - I	1. Trading & Profit and Loss Account 1.1 Relevant items in Trading and Profit and Loss Account 1.2 Concept of Gross Profit and Net profit 2. Balance Sheet 3. Preparation of Trading and Profit and Loss Account and Balance Sheet (Simple problems)
8	Financial Statements - II	1. Treatment of the following adjustments in the Preparation of Financial Statements 1.1 Closing Stock 1.2 Outstanding Expenses 1.3 Prepaid Expenses

		1.4 Accrued Income 1.5 Income received in advance 1.6 Depreciation 2. Preparation of trading and profit and Loss Account and Balance Sheet with the above adjustments
9	Computerised Accounting System	1. Concept of Computerised Accounting System 2. Comparison between Manual and Computerised Accounting 3. Advantages of Computerised Accounting System

Chapter-1

Introduction to Accounting

Focus Area – Public Examination September-2021

1. Meaning of Accounting

2. Qualitative Characteristics of Accounting Information

3. Objectives of Accounting

4. Basic Terms in Accounting

Accounting is the systematic process of identifying, recording, classifying, summarising, interpreting and communicating financial information to users. Accounting shows the profit earned or loss incurred during the accounting period. It also displays the value and nature of assets, liabilities and capital. The primary objective of accounting is to provide accounting information to interested parties to facilitate right business decisions.

Definition

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

Business Transaction

In accounting, the business transaction (also known as financial transaction) is an event that must be measurable in terms of money and that essentially impacts the financial position of the business.

For example, purchased goods from Mohan Traders worth Rs.5,000 for cash, here cash Rs. 5,000 transferred from business to Mohan Traders and at the same time business received goods worth Rs.5000 from Mohan Traders.

Characteristics/ Nature/ Features of Accounting

The above said definition of accounting contains four essential characteristics of accounting:

1. Identifying and Recording Business Transactions (Economic Events only)

Business transactions are economic events that affect a business's financial position. Accounting records only those transactions that can be measurable in terms of money. Business transactions are recorded by using monetary unit, viz. rupees and paise as a measuring unit. If an event cannot be quantified in monetary terms, it is not considered for recording in financial accounts. The recording is done in a book called **Journal**.

*(There are also some events takes place in business which are also very important for the business too but which **cannot be measured in terms of money**. For example appointment of an efficient manager, death of an efficient employee etc. Effect of such events can't be measured in terms of money, so it **cannot be recorded**.)*

Example for business transaction / Economic Events	Example for Non-Economic Events
Commenced business with cash	Quarrel between Purchase manager and Production manager
Goods purchased on credit	Resignation of an able and experienced manager
Salary paid	Strike by employees
Withdraw cash for personal use	Starting of a new business by the competitor

Note: Non economic events can't be recorded in the books of accounts.

2. Classifying

After recording the transactions in subsidiary book or journal proper, the next step is its classifications. Classification is the systematic analysis of the recorded data with a view to bringing together items of a similar nature at one place (Account). The classification work is done in the book called **Ledger**, where various types of accounts are maintained.

3. Summarising

This involves presenting the classified data in a manner which is understandable and useful for internal as well as external users of accounting system. Summarising leads to the preparation of the following statements:

- Trial Balance
- Trading and Profit and Loss Account
- Balance Sheet

4. Analysis and interpretation

The financial data recorded is analysed and interpreted in such a manner that the end-users can make a meaningful judgment about the profitability and financial condition of the business.

5. Communicating

Finally, accounting involves communicating financial data to its users. Users includes owners, managers, employees, investors creditors etc. The accounting information should be communicated to the right person at the right time to take right decision.

Note:

The process of accounting starts with identifying transactions and ends with communicating information.

Need for accounting

At the end of an accounting year every businessman wants to know how much profit the business made last year. Further the owner wants to know the financial position of the business. In order to ascertain such information, it is essential to keep a complete and systematic record of each and every business transaction occurred during the year.

Objectives of Accounting

Main objectives of accounting are:

1. Maintaining Accounting records

The main objective of accounting is to maintain systematic record of business transactions and events. Business transactions are recorded in books of account in monetary terms and in a chronological order.

2. Ascertainment of result

The second objective of accounting is to ascertain the net profit earned or loss suffered on account of business transactions during a particular year. For this purpose a statement called 'Income statement' or 'Trading and profit and Loss Account' is prepared.

Trading and Profit and Loss Account provides the following information:

- How much goods have been purchased during a particular year?
- How much goods have been sold during a particular year?
- How much goods have remained unsold and what is its value?
- How much amount has been spent on various heads of expenditure?
- How much amount has been earned by various heads of revenue?

3. Determining the Financial Position

The business man wants to know the financial position of the business. For this purpose, a statement called 'Balance Sheet' is prepared, it displays the values of assets and liabilities of the business.

4. Provide Information to Various Parties

Accounting is the 'language of business'. It communicates the relevant accounting information to various interested parties

5. Meeting Legal Requirements

Accounting records are accepted as evidence by the court, if they are maintained systematically. Besides, the law such as Companies Act, Income Tax Act, GST Act etc. requires timely submission of returns.

6. Assistance to Management

Management often requires financial information for decision making and ensures efficient management. By providing timely information, accounting assists the management in the task of planning, controlling and decision making.

Users of Accounting Information

The accounting information generated by the accounting process is communicated in the form of reports, statements etc. to the users who need it in different decision situations.

Users of Accounting Information	
Internal Users (Parties within the business organization)	External Users (Parties outside the business organization)
Owners	Investors, banks
Managers	Creditors (Banks, financial institutions, debenture holders, other lenders)
Employees	Government authorities
	Trade Unions
	Stock Exchange, SEBI, Registrar of Companies
	Researchers
	Consumers
	General public

Accounting Process

In a business there are numerous transactions will take place. It is impossible for the business man to keep a memory of entire transactions of business. There must be documentary evidence of every financial transaction. Business transactions like purchase of goods, sale of goods, payment of wages etc. have an effect on the assets, liabilities and capital of the business. We can ascertain the result of the business in terms of profit/loss and value of assets and liabilities, if we maintain systematic and scientific record (Accounting) of all the transaction of financial nature. Accounting process can be briefly explained as follows:

Step-1 Identifying business transaction is the first step of accounting. These transactions are recorded in the subsidiary books and journal proper.

Step-2 With the help of subsidiary book we can prepare Ledger accounts.

Step-3 The balances shown by ledger accounts are used for preparing Trial Balance, which serves as the basis for the preparation of financial statements.

Step-4 Preparation of Financial Statement-Financial statement is classified as Income Statement and Position Statement.

Income statement consists of Trading account which shows Gross Profit/Loss and Profit and Loss Account, which shows Net Profit/Loss.

Finally, Position statement (Balance Sheet) is prepared, which reflects the true position of assets and liabilities of the business.

Step-5 Analysis of financial statements and report it to various parties. The information helps them in taking sound and judicious decisions about the business entity.

Step-6 Communicating -It is concerned with the transmission of summarized, analysed and interpreted information to the end-users to enable theme to make rational decisions.

Qualitative Characteristics of Accounting Information

Accounting information should be prepared and presented in such a way that it should be useful to the end users and should possess the following qualitative characteristics.

1. Reliability

Accounting information must be reliable. Reliability means the users must be able to depend on accounting information. Reliable information should be free from error and bias and verifiable. Verifiability means it can be verified from the source documents such as cash memos, purchase invoices, sales invoices, agreements, property deed etc. Verifiability ensures the truthfulness of the recorded transactions.

2. Relevance

To be relevant, information is to be available on time and must help in prediction.

3. Understandability

Understandability of accounting information means users of accounting information must interpret it in the same sense as it is prepared and conveyed to them.

4. Comparability

Comparability means that the users should be able to compare the accounting information of an enterprise of the period either with that of other periods (Intra-firm comparison) or with the accounting information of other enterprises (Inter-firm comparison). Use of common unit of measurement and common format of reporting promotes comparability. Accounting information should be prepared and presented in such a way that it should be useful to the end users and should possess the following qualitative characteristics.

Basic Terms in Accounting

Entity

Entity means a reality that has a definite individual existence. Entity may be a person or business organization like sole trading concern, partnership, company etc.

Business entity means a specifically identifiable business enterprise like Wipro, Reliance Industries Ltd, ITC Limited, Kalyan Silks etc. An accounting system is always devised for a specific business entity (also called accounting entity)

Business Transaction

In accounting, the business transaction (also known as financial transaction) is an event that must be measurable in terms of money and that essentially impacts the financial position of the business..

It can be transactions like purchase of goods, receipt of money, payment to a creditor, incurring expenses; etc. It is a financial event expressed in terms of money which brings a change in the financial position of an enterprise. Business transaction may be a **cash transaction** or a **credit transaction**.

Examples:

- Purchased goods worth Rs 2000 from Rajan.
- Sold goods for cash Rs.5000
- Salary paid Rs.10,000
- Furniture purchased from A Ltd Rs.8000
- Anil started business with cash Rs.60,000

Features of business transactions

- It is concerned with money or money's worth
- It brings about a change in the financial position (i.e in Assets, liabilities or capital)
- Every transaction has dual aspects-Receiving (Debit) aspect and Giving (Credit) aspect
- After each transaction, the total assets of a business must be equal to its total liabilities and capital (Always, **ASSET= CAPITAL + LIABILITIES**). Therefore, the equality of the Balance Sheet cannot be disturbed by any transaction.

Assets

Assets are material things or possessions or properties of the business including the amounts due to it from others. Assets help to generate income.

- Physical properties include assets like land and building, furniture, motor car, cash, stock etc. owned by a business.
- Rights in certain things called intangible assets such as goodwill, patents, trademarks etc possessed by the business.
- Amount due to the business from others like debtors, bills receivables, accrued income etc

Example: Land and building, Plant and machinery, cash and bank balance, stock, bills receivable, money owing by debtors etc.

Assets can be classified into the following categories

- 1. Non-current Assets**
- 2. Current Assets**
- 3. Fictitious Assets**

1. Non –Current Assets (Fixed Assets)

Non-current asset refers to those assets which are held for continued use in the business for the purpose of producing goods or services and are not meant for sale. Non-current assets are held by the business from a long-term point of view. They are long term investments or fixed assets and its value can't be realised within a year.

Example-Fixed assets like Land and building, plant and machinery, furniture, computer, motor vehicles and long-term investment

Non-current assets are further classified into:

(a) Tangible assets

Tangible assets are those assets which have physical existence, i.e., they can be seen and touched.

Example: Land, building, machinery, furniture etc.

(b) Intangible assets

Intangible assets are those assets which do not have physical existence i.e., they cannot be seen and touched.

Example: Patents, good will, trademarks, computer software, prepaid expenses etc.

Like tangible assets, intangible assets also help to generate income to the firm. For example, with the help of Patents businessman is able to produce goods and his goodwill helps in attracting customers easily.

2. Current Assets

Current assets are those assets which are meant for sale or which can be converted into cash within a year. For example, goods are purchased with a purpose to resell and earn profit, debtors can be converted into cash within a short period.

Example-Debtors, stock, bills receivable, cash in hand and cash at bank

3. Fictitious Assets

Fictitious assets are neither tangible assets nor intangible assets. They are losses not written off in the year in which they are incurred but in more than one accounting period.

Example- Discount on issue of debentures/debentures, preliminary expense, underwriting commission

Note:**Wasting Asset:**

A wasting asset is a type of asset whose useful life is limited, and its value decreases over time. As the asset is used, it depreciates, eventually having little or no residual value. For example, patents, mines, assets taken on lease, natural resources, such as crude oil, timber etc. are wasting assets that eventually are used and then have no remaining value.

Liabilities

It refers to the amount which the firm owes to outsiders. They represent creditors' claims on the firm's assets.

Liabilities = Assets – Capital

Example-Creditors, Bills Payable, Salary outstanding, Loan from bank

Both small and big businesses find it necessary to borrow money from bank at one time or the other, and to purchase goods on credit from suppliers.

Liabilities can be classified into two:

1. Current Liabilities
2. Non-Current Liabilities

1. Current Liabilities (Short term liabilities)

Current liabilities refer to those liabilities which are to be paid within 12 months from the end of the accounting period.

Example-Creditors, bank overdraft, bills payable, outstanding expenses, short term loans etc.

2. Non-Current Liabilities (Long term liabilities)

Non –Current liabilities are those liabilities which are to be paid after a period of more than a year from the end of the accounting period.

Example-Long-term loans, debentures

Note: Contingent Liability (Doubtful liability)

These are not real liabilities. **Future events can only decide** whether it is really a liability or not. Due to their uncertainty they are termed as contingent (doubtful) liabilities. The value of contingent liabilities never shown in the amount column at the liability side of Balance sheet. It is clearly state as a note inside/outside the Balance Sheet.

Example:

- Value of bills discounted (There is a chance to **dishonor** it)
- Cases pending in the court (Court's decision may be favorable or unfavorable)
- Guarantees undertaken by the business

Capital

Amount invested by the owner into the business is known as capital. Capital contribution may be in the form of cash or assets. Capital is an obligation to the business and it is the owner's claim on the assets of the business. Capital is also known as owner's equity.

Capital= Assets- Liabilities

Drawings

Cash or goods withdrawn by the owner for his personal use from the business or any private payments made out of business funds are called drawings. Drawings will reduce the owner's capital.

Example:

- Amount withdrawn by the owner for his personal use
- Goods taken by the proprietor for his personal use
- Acquiring personal assets with business funds.
- Owner's income tax paid by the business.

Sales

Sales means total revenue earned by a business through sale of goods or services. Sales may be cash sales or credit sales. It is the major source of revenue of any business. It is a direct income. The term 'sales' is used only for the sale of those goods which are purchased for resale purposes. (The term 'sales' is never used for the sale of assets).

Example: Sold goods to Biju for Rs.8,000, Cash sales Rs.5,000

Sales Return(Return inwards)

Sales return or return inwards is that part of sales of goods which is actually returned to us by customers. The return may be due to defective supply of goods, violation of terms of agreement etc.It should be deducted from sales to calculate Net Sales.

Example: Goods returned by Biju Rs.400

Purchases

It is the major expense of any business.It is the expense incurred for procurement of goods in a business. The term purchase is used only for the purchase of 'Goods'.

In case of manufacturing concern goods means purchase of raw materials for the purpose of conversion of finished products and then sale. In case of trading concern 'goods' are those

things which are purchased for resale. In both the cases the purpose is to make a profit by its resale. The term purchases include both cash and credit purchases of goods.

Example:

- Purchased goods from Anju traders Rs.5000
- Purchased goods for cash Rs.4000
- A furniture merchant purchased chairs for Rs.8000 is considered as purchase because here chair is his goods and its purpose is to resale and to earn profit. But if a furniture merchant purchase chairs for his office use, it is never considered as purchase, its purpose is not resale but helps to generate income. Here chair is an asset.

Purchase Return(Return outwards)

When purchased goods are returned to the suppliers, these are known as **purchase return or return outwards**. It should be deducted from purchase to calculate Net Purchase.

Example: Returned goods by Anju Traders Rs.300

Revenues

Revenue of a business constitutes sales revenue and other revenues. The amount earned by business by selling its products or providing services to customers are called sales revenue. Sales are the major revenue of a business. Other items of revenue common to many businesses are: commission received, interest received, dividend received, royalties, rent received etc.

Total Revenue = Sales Revenue + Other Revenue

Expenses

Expenses are costs incurred by a business in the process of earning revenue. It is the cost of things or services used for the purpose of generating revenue.

Example:

Cost of things like Purchase cost of goods, stationery etc.

Cost of services like salary, advertisement, insurance, electricity, telephone, repairs etc.

Decline in the value of asset caused by the use of such assets for business like depreciation.

Expenditure

An expenditure represents a payment with either cash or credit to purchase asset, goods or services. Expenditure is a wider term than expense. The term expenditure includes expenses also. Expenditure can be classified into capital expenditure and revenue expenditure.

Capital Expenditure

Expenditure which has been incurred to derive long term advantage for the business is a capital expenditure. Capital expenditures are non-recurring in nature and will increase fixed

assets or decrease liability. Its main purpose is to increase the earning capacity of the business. Capital expenditure yields benefit over a long period and hence written in Asset.

Example:

Amount spent to purchase fixed assets like land and building, P& M, Furniture, Goodwill, installation charges of machinery, repayment of bank loan (principal amount) etc.

Revenue expenditure

If the benefit of expenditure is exhausted within a year, it is called revenue expenditure. Revenue expenditures include the expenses required to meet the day-to-day operations of the business and they are recurring in nature. Example: Payment of salary, rent, depreciation of fixed asset, goods purchases

Revenue expenses are shorter-term expenses that are broken down into two categories:

Expenditures for generating revenue include expenses required to meet all day-to-day expenses needed to operate a business.

Example: Salaries, wages, rent, advertisement, depreciation etc.

Expenditures for maintenance of revenue-generating assets Revenue expenditures are often discussed in the context of fixed assets .It include expenses like ordinary repair and maintenance costs that are necessary to keep the asset in working order.

	Difference between Capital and Revenue Expenditure	
	Capital Expenditure	Revenue Expenditure
Definition	Capital expenditure is the money spent by the firm to acquire fixed asset or to improve fixed assets.	It is the money spent by business entities to meet the day to day expenses.
Purpose	To increase earning capacity	To maintain the earning capacity
Occurrence	Non recurring in nature	Recurring in nature
Time span	It produces benefits over several years	Its benefit will be consumed within an accounting year
Treatment in books of accounts	It appears as an asset in the Balance Sheet.	It appears in the Trading and Profit & Loss A/C
Potential benefits	Long- term benefit for the business	Short-term benefit for the business

Classification of receipts:

It is necessary to make a proper distinction between capital receipts and revenue receipts because the revenue receipts are shown on the credit side of the Trading and

Profit and Loss account whereas capital receipts are shown in the Balance Sheet. Receipts are classified as:

1 Capital Receipts

2. Revenue Receipts

1. Capital Receipts

Amount received from sale of fixed assets is capital receipts. If the receipts imply an obligation to return money or amount received from sale of fixed assets is capital receipts. Capital receipts are **non-recurring** in nature and the capital receipts are shown in the Balance Sheet as increase in liabilities or as reduction in the value of the asset. will increase liability or decrease asset.

Example for Capital Receipts:

1. Capital contributed by the owner
2. Amount received on sale of fixed assets or investments
3. loan taken from bank

2. Revenue Receipts

If a receipt does not incur an obligation to return the money or is not in the form of a sale of fixed asset, it is termed as revenue receipts.

Example for Revenue Receipts:

- 1) Cash received from sale of goods
- 2) Commission, interest, dividend, rent etc. received.

Deferred Revenue Expenditure

Deferred Revenue Expenditure is the expenditure is a revenue expenditure in nature but it is charged (written off) in more than one accounting period. The reason is that benefit of such expenditure will accrue in more than one financial year. Example: **Large advertisement expenditure**. It is estimated that it will give benefit for more than one accounting period.

Profit

Profit is the excess of revenues over expenses in an accounting year. Profit increases the investment/capital of the owner. Profit is calculated by deducting the cost from the sale. **Profit is earned by the business through regular business operations.**

Gain

A gain is referred to as any economic benefit derived from **outside of the usual business operations**. Gain is the profit that arises from events or transactions which are incidental to

business such as profit sale of fixed assets, winning a court case, appreciation in the value of an asset.

E.g. Consider an investor purchasing 1000 shares of a company at Rs. 15 each (value = Rs.15000) in 2017 and if the share price in 2018 has increased to Rs.20 each the value in 2018 is Rs. 20000, where the investor will make a **gain** of Rs. 5000 if the shares are sold in 2018.

E.g. If the book value (purchase cost- accumulated depreciation) of a machine is Rs.2,500 and it was sold for Rs.3,000 then the **gain** on disposal is Rs.500

Profit	Gain
Profit is the excess of total income over total expenses	Gain is the benefit derived from outside of the usual business operations like profit on sale of fixed assets etc
It is generated from usual business operations	It is generated outside of business operations

Income

Income is the increase in the net worth of an organization either from business activity or from other activities.

Income = Profit + Gain

Loss

Loss is excess of expenses of a period over its related revenues. It decreases in owner's equity. The term loss conveys two different meanings.

First it conveys the result of the business for period when total expenses exceeds total revenues.

Example-If revenues are 3, 00,000 and expenses are 3, 50,000, the loss will be Rs.50, 000.

Second, It refers to money or money's worth lost (or cost incurred) without receiving any benefit in return, e.g., cash or goods lost by theft or a fire accident, etc. It also includes loss on sale of fixed assets.

It may be noted that losses differ from expenses. Expenses are incurred to generate revenues whereas losses do not.

Discount

Discount is a rebate or an allowance given by the seller to the buyer. It is offered in two ways- discount offered **at the time of sale (Trade discount)** and discount offered **at the time of collection of sales prices from debtors (Cash discount)**

Trade Discount-When goods are purchased in bulk quantities, the seller may give certain concession on the listed price to the buyer. This concession is called trade discount. **It is not recorded in the books of account** as it is deducted in the invoice (bill) itself from the gross value of goods.

Example-Purchased goods worth Rs 50,000 from Rajan at a trade discount of 10%.Here value of purchase is recorded as Rs.45,000 (50000-5000).Therefore trade discount Rs.5000 never recorded in the books of account.

Cash Discount- Cash Discounts are the discounts or incentives given by the seller(Creditor) to the customer(Debtor) for making prompt (timely) payment. It is always recorded in the books of account. It is a loss to the creditor (discount allowed) and a gain to the debtor (discount received)

Example-Received cash from Mohan Rs.3850 allowed him discount Rs.150 and settled his account Rs.4000.

Debtors/Account Receivables

A debtor is a person who owes money to the business. In general, a debtor is a customer who has purchased a good or service and, therefore, owes the payment in return to the supplier.

'Debtor' refers not only to a goods and services client but also to someone who borrowed money from a bank or lender.

Example: Sold goods to Vijayan on credit Rs.40, 000.Here Vijayan owes Rs.40,000 to the business, so he is a debtor.

Creditors/Accounts Payable

Creditor is a person/or other entities to whom the business owes money as he has given some benefit to the business. The total amount standing to the favour of such persons and/or entities on the closing date is shown in the Balance Sheet as sundry creditors on the liabilities side.

- Purchased goods from Meera Traders on credit Rs. 3000.Here business owes Rs.30000 to Meera traders, so Meera Traders is a creditor to the business.

Goods

Goods include all those things which are purchased for resale or raw materials which are used for producing the finished products. Example: Kalyan Silks purchased 100 shirts for Rs.12500 from Aravind Mills Ltd.Here,shirt is the goods for Kalyan Silks.

Note: For a furniture dealer purchase of chairs and tables is termed as goods, while for others business firm it is furniture and is termed as an asset. For a stationery trader, stationery is goods, whereas for others it is expense.

Stock

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

Closing stock in case of manufacturing concern consists of raw-materials; work –in – progress and finished goods. Last year’s closing stock will be the opening stock of next year.

Voucher

Voucher is a documentary evidence of a business transaction. *For example*, we get **cash memo** when we purchased goods for cash, we get an **invoice** when we purchased goods on credit, we get a **receipt** when we made a payment and so on.

Father of Accounting- Luca Pacioli



Luca Pacioli-Father of Accounting

He was an Italian Mathematician. In 1494, the first book on double-entry accounting (*Summa de arithmetica, geometria, Proportioni et proportionalita*) was published by Luca Pacioli. He is considered as '**Father of Accounting and Bookkeeping**'.

Important Questions:

- A person who owes money to the business is a -----
 - Debtor
 - Creditor
 - Supplier
 - None of these**Ans: a**
- Amount spent for purchasing fixed asset is a -----
 - Revenue Expenditure
 - Deferred Revenue expenditure
 - Capital Expenditure
 - None of these**Ans: c**
- Rajesh, owner, draw Rs.2,000 from the business for paying tuition fees to his son. This amount is-----
 - Salary
 - Capital
 - Drawings
 - Direct Expense**Ans: c**
- is an example for internal users of accounting.
 - Creditors
 - Government
 - Manager
 - Debtor**Ans: c**
- Sold goods to Mohan on credit Rs.4,000. Here Mohan is a -----to the business.
 Ans: Debtor

6. Find the odd one and state the reason

- a) Debtors
- b) Creditors
- c) Cash at bank
- d) Stock

Ans: Creditors, all others are current assets.

7. Things or properties of value are called.....

- a) Assets
- b) Liabilities
- c) Capital
- d) Revenue

Ans: a

8. Complete the series based on the hint given:

a. Intangible Asset	Goodwill
b. Fictitious Assets	?
c. Current Asset	?

Ans:

a. Intangible Asset	Goodwill
b. Fictitious Assets	Discount on issue of shares or debenture, Preliminary Expenses
c. Current Assets	Cash, stock, debtors, bills receivables

9. **Explain the main objectives of accounting? (5 Score)**

Main objectives of accounting are:

1.Maintaining Accounting records

The main objective of accounting is to maintain systematic record of business transactions and events.

2.Ascertainment of result

The second objective of accounting is to ascertain the net profit earned or loss suffered on account of business transactions during a particular year.

3.Determining the Financial Position

The business man wants to know the financial position of the business. For this purpose, a statement called 'Balance Sheet' is prepared, it displays the values of assets and liabilities of the business.

4.Provide Information to Various Parties

Accounting is the 'language of business'.It communicates the relevant accounting information to various interested parties.

5.Meeting Legal Requirements

Accounting records are accepted as evidence by the court, if they are maintained systematically. Besides, the law such as Companies Act, Income Tax Act, GST Act etc. requires timely submission of returns.

6. Assistance to Management

Management often requires financial information for decision making and ensures efficient management. By providing timely information, accounting assists the management in the task of planning, controlling and decision making.

10. Explain the qualitative characteristics of accounting information?(5 Score)
- 1.Reliability:** Accounting information must be reliable. Reliability means the users must be able to depend on accounting information. Reliable information should be free from error and bias and verifiable.
- 2.Relevance:** To be relevant, information is to be available on time and must help in prediction.
- 3.Understandability:** Understandability of accounting information means users of accounting information must interpret it in the same sense as it is prepared and conveyed to them.
- 4.Comparability:**Comparability means that the users should be able to compare the accounting information of an enterprise of the period either with that of other periods (Intra-firm comparison) or with the accounting information of other enterprises (Inter-firm comparison).
11. Ramesh sold goods on credit to Satheesh Rs.50,000. What relation exist between them? What are the accounting terms involved in it?
- Satheesh - Debtor
Ramesh - Creditor
12. Distinguish between debtors and creditors.
- Debtors are the persons who owe an amount to the enterprise for the goods sold or service provided to them on credit.
- Creditor is a person or institution to whom an amount owing by the enterprise because they have provided a service or goods, or loaned money to the business.
- Example: Ramesh sold goods on credit to Satheesh Rs.50,000. Here Sathesh is the debtor and Ramesh is the creditor.
13. Give any two examples of revenue?
- Examples: Sales, rent received, interest received,commission received, interest received etc.
14. Distinguish between profit and gain.
- Profit is the excess of revenues over expenses in an accounting year. Profit is calculated by deducting the cost from the sale. Profit is earned by the business through regular business operations.
- A gain is referred to as any economic benefit derived from outside of the usual business operations. Gain is the profit that arises from events or transactions which are incidental to business such as profit sale of fixed assets, appreciation in the value of an asset etc.
- Income of the year = Profit + Gain

15. Distinguish between expenses and expenditure?

Expense is the cost incurred in producing and selling the goods and services . Thus it includes cost of goods sold (purchase and other direct expenses) and indirect expenses.

On the other hand, expenditure is a wider term which includes expense also. Expenditure is the amount spent for acquiring assets(capital expenditure), goods and services (revenue expenses).

16. What do you mean by assets? What are the different types of assets?

(Refer-Page-7)

17. Give two characteristics of a business transaction?

- 1) It results in a change in the financial position of the firm, i.e., a change in the value of some of the assets, liabilities and capital
- 2) The change may be capable of being expressed in terms of money.

Chapter-2

Theory Base of Accounting

Focus Area – Pubic Examination September-2021

1. Basic Accounting Concept

1.1 Business Entity Concept

1.2 Money Measurement Concept

1.3 Going Concern Concept

1.4 Accounting Period Concept

1.5 Dual Aspect Concept

1.6 Matching Concept

1.7 Conservatism Concept

Accounting is the language of business. Language should be understandable to everyone. There should be uniformity for this language. For making the accounting information meaningful to its internal and external users, it is important that such **information is reliable as well as comparable.** The comparability of information is required both to make inter-firm comparisons, i.e. to see how a firm has performed as compared to the other firms, as well as to make inter-period comparison, i.e. how it has performed as compared to the previous years. This becomes possible only if the information provided by the financial statements is based on consistent accounting policies, principles and practices. This calls for developing a proper theory base of accounting.

The theory base of accounting consists of principles, concepts, rules and guidelines developed over a period of time to bring uniformity and consistency to the process of accounting and enhance its utility to different users of accounting information. These principles and concepts provide foundation of recording transactions and preparing financial statements. It ensures uniformity and consistency to the process of accounting.

Generally Accepted Accounting principles (GAAP)

In order to ensure uniformity in accounting procedures and methods, certain accounting principles, concepts and conventions have been followed by accountants all over the world. These principles, concepts and conventions are usually called Generally Accepted Accounting principles (GAAP).

GAAP can be classified into the following four categories:-

Concepts/Assumptions	Conventions/Principles	Modifying principles	Accounting Standards
1.Accounting Entity 2.Going Concern 3.Money Measurement 4.Accounting period	1.Revenue realization 2.Verifiable Objective 3.Matching 4.Full disclosure 5..Dual aspect 6. Historical cost	1.Materiality 2.Consistency 3.Conservatism 4.Timliness	Issued by various Accounting Standards Boards

Various terms in GAAP (principles, concepts, conventions etc.) are inter-changeably used by different authors. Instead of going into the semantics of these terms, it is important to concentrate on the practicability of their usage. From the practicability view point, it is observed that the various terms such as principles, concepts, assumptions etc.have been used interchangeably and are referred to as **Basic Accounting Concepts**. All accounting procedures are developed on the basis of Basic Accounting Concepts.

Basic Accounting Concepts

1. Business Entity Concepts

2. Money Measurement concept

3. Going concern Concept

4. Accounting Period Concept

5. Dual Aspect Concept

6. Matching Concept

7. Conservatism Concept

8.Revenue Recognition (Realisation) Concept

9. Cost Concept
10. Full Disclosure Concept
11. Consistency concept
12. Materiality Concept
13. Objectivity Concept

1 Business Entity Concepts

Business entity concept assumes that business has a distinct and separate entity from its owner. As an accountant, we have to record business transactions from firm's point of view and never from the view point of proprietor's. **Owners are considered as creditors** of the business to the extent of their capital. This principle states that the affairs of business will not be mixed up with the private affairs of the owner. A Because of this concept, financial position of the business can be easily found out and earning capacity of the firm can be easily ascertained. In case this concept is not followed, affairs of the business will be mixed up with the private affairs of the proprietor and the true picture of the business will not be available.

Impact of business entity concept:

1. Proprietor is treated as **creditor** to the extent of his capital.
2. Personal assets and liabilities of the owner not considered while recording and reporting assets and liabilities of the business.
3. Amount withdrawn by the owner from the business for his personal purpose is to be considered as **drawings**.

Example: Owner's personal car should not be included in the fixed asset of the company

2. Money Measurement concept

According to this concept, only those transactions are recorded which can be expressed in terms of money or money's worth. The qualitative aspects of the business like efficiency of management, favourable location etc. are important for the business, but they cannot be recorded in the books of accounts because they can't be evaluated in terms of money.

Another important aspect of the concept of money measurement is that all transactions are to be recorded in money value.

Impact of money measurement concept:

1. Events or transactions which can't be expressed in terms of money will not be recorded in the books of accounts even though they may be very important for the business. For example **efficiency/inefficiency of management/workers, favorable conditions in the economy,**

government decisions, quarrel between department heads etc. are very important for the business but can't be recorded as per this concept.

2. All items/transactions are to be recorded in money value. The business can't record its accounting **records in meters, liters, kilograms, square feet** etc.

Example: Market conditions, technological changes and the efficiency of management would not be disclosed in the books of accounts.

3. Going concern Concept

This concept states that, a business firm will continue to carry on its activities for an indefinite period of time. There is no intention to liquidate the business in the near future. It is on account of this assumption that fixed assets are recorded at original cost and are **depreciated in a systematic manner**. If this principle is not followed in accounting, the entire cost of asset will be charged to profit and loss account of the current (asset purchased) year.

Impact of Going Concern Concept:

1. It is on this concept that we record fixed assets at their original cost and **depreciation** is charged on these assets without reference to their market value.
2. On the basis of this concept that outside parties enter into long-term contracts with the firm, give loans, purchase debentures etc.
3. On the basis of this concept, **prepared expenses** are eligible to **record as an asset** in the books of the firm.
4. Assets are classified as **current and noncurrent assets**. Without this concept such classification would be difficult to justify. It is same as in case of liabilities.

Example: Depreciation cost of a fixed asset is allocated over its useful life and it will not be considered as the current year only.

4. Accounting Period Concept

According to this concept though the business is a continuous affair, its life is divided into small time intervals for the measurement of the profit of the business. Twelve-month period is adopted for this purpose.

Strictly speaking, the true results of the business operations can be ascertained only at the end of its life. But ascertainment of result after a very long period will be of little use to various users and it will be too late to take corrective steps at that time. Thus, the entire life of the firm is divided into small time intervals for the measurement of the profits of the business.

Example: In India fiscal year starting April 1 would end on March 31 of the following year, in USA fiscal year starting from 1st Oct to 30th Sep of the following year.

5. Dual aspect Concept (Duality/Accounting Equation Concept)

Every business transaction has double effect. In other words, every transaction affects at least two accounts. If one account is debited, any other account must be credited. The system of recording transactions based on this principle is called as '**Double Entry System**'. **Double Entry Book keeping is based on this concept.** It is because of this concept that the two sides of the Balance Sheet are always equal and the following accounting equations will always hold good at any point of time:-

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

OR

$$\text{Assets} = \text{Owners Equity (capital)} + \text{Creditors Equity (Liability)}$$

Note: Everything of firm owns, it also owes out to somebody (Business Assets = Owners Equity (capital) + Creditors Equity (Liability))

Example: If John started a business with capital of Rs.50,000, here on the one hand the business has asset (Cash) of Rs.50,000, while on the other hand the business has to pay to the owner a sum of Rs.50,000 (Capital).

$$\text{Assets (Cash-50,000)} = \text{Capital (50,000)} + \text{Liabilities (0)}$$

6. Matching Concept

According to this concept expense should be matched to the revenue of the appropriate accounting period to determine correct profit/loss for the accounting period. As per this principle expense or revenue are recognized on the basis of period to which they relate and not when these are paid/received. It is because of this principle the adjustment is made for outstanding expense, accrued income, prepaid expenses, unearned income (income received in advance) etc.

Impact of matching concept

1. Adjustment required for **outstanding expenses, prepaid expenses, accrued incomes and income received in advance.**

Example: Wages paid in January 2020 relating to December 2019 should be treated as expenditure for the year 2019 and not 2020.

7. Conservatism Concept or Principle of Prudence

According to this concept all **anticipated losses should be recorded** in the books of accounts, but all **anticipated or unrealized gains should be ignored.** It is the policy of playing safe. This concept requires that profit should not be recorded until realized but all losses, even those which may have a remote possibility, are to be provided for in the books of accounts.

Impact of Conservatism Concept or Principle of Prudence

1. Provision for doubtful debts is created in anticipation of actual bad debts
2. **Closing stock is valued at cost price or market price whichever is less.**
3. Joint life policy is shown only at surrender value as against the amount paid.
4. Provision for a pending law suit against the firm, which may either, be decided in its favour.

Example: 1

Mr. Anil is a debtor of 4,00,000. There is possibility that he will be insolvent and only 40% of his dues will be received. According to principle of prudence, the business will make provision for doubtful debts for 60% of Rs.4,00,000 = Rs. 2,40,000.

Example: 2

A business owns a building that originally cost Rs.8,00,000. but due to the boom in the real estate market the building is now valued at Rs. 9,00,000. Should the firm value the building at Rs. 9,00,000 and record a revenue of Rs.1,00,000 in the books of accounts?. Answer is no because conservatism principle states that the gain should not be recorded until it is certain to occur, i.e, when the building is sold.

Frequently asked questions:

No	Questions/ situation	Ans. Related Concept
1	Fixed assets are depreciated over their useful life rather than over a short period	Going concern concept
2	Proprietor is treated as creditor to the extent of his capital	Accounting entity concept
3	The sale achieved by a salesman and the commission payable to him is recorded in the books of accounts. But efficiency and intelligence of salesman is not recorded	Money measurement concept
4	Mr.Sarojkumar, a sole trader, purchased a TV for Rs.20,000 for his personal use and asks his accountant to record this as business expense. But accountant, argue that it is the violation of accounting principle. Is accountant right?	Yes, Business entity concept
5	Accounting equation is based on....	Dual aspect concept
6	Closing stock is valued at cost or market price, whichever is less	Conservatism (Prudence) Concept
7	According to.....concept accountant are in favour of understating assets and revenue and overstating liabilities and expenses	Conservatism (prudence) Concept
8	Anticipate no profit and provide for all possible losses	Conservatism (Prudence) Concept

9	Create Provision for doubtful debts	Conservatism (Prudence) Concept
10	Increase or decrease in the market value of an asset can't be accounted	Cost concept
11	Wages outstanding is added to wages	Matching concept
12	Prepaid insurance should be deducted from insurance	Matching concept
13	Stock is valued at cost price or market price whichever is less	Conservatism (Prudence) Concept
14	10 Kg rice purchased @ Rs.45 by a grocery shop, recorded it as Rs.450 (Not in quantity)	Money measurement concept
15	Profit and loss account and balance sheet is prepared at the end of the year	Accounting period concept
16	In case of a contract work, profit is calculated on the basis of work certified for each year	Revenue recognition concept
17	Profit = Revenue of the year – Expenses of that year	Matching concept
18	Assets = Liabilities + capital	Dual aspect concept
19	The owner of a business can't wait till the closure of the business to know the result and financial position	Accounting period concept
20	Vouchers should be the base for recording a transaction in the books of accounts	Verifiable objective concept
21	All business events may not be recorded in the books of accounts	Money measurement concept
22	Closing stock is credited to Trading account	Matching concept
23	Efficiency of an employee cannot be recorded	Money measurement concept

24. Match the following

A	B
Closing stock is valued at cost or market price whichever is less	Money measurement concept
Proprietor is treated as creditor to the extent of his capital	Dual aspect concept
Every transaction will have two aspects	Conservatism (Prudence) Concept
All business events not recorded in accounting	Accounting entity concept

Ans:

A	B
Closing stock is valued at cost or market price whichever is less	Conservatism (Prudence) Concept
Proprietor is treated as creditor to the extent of his capital	Accounting entity concept
Every transaction will have two aspects	Dual aspect concept
All business events not recorded in accounting	Money measurement concept

25. A concept that a business enterprise will not be sold or liquidated in the near future is known as
- a. Going concern concept
 - b. Matching concept
 - c. Business entity concept
 - d. Dual aspect concept
- Ans: a**

26. Recognition of expense in the same period as associated revenues is calledconcept.
- Ans: Matching**

27. Explain business entity concept?

According to business entity concept, proprietor of the business is a separate and distinct entity from business. The transactions are recorded in the books of account from the point of view of business, not from the point of view of the proprietor. Based on this principle, the amount invested by the owner into the business is considered as **capital** and the amount or goods withdrawn by the owner from the business is treated as **drawings**.

28. Explain money measurement concept?

According to money measurement concept, transactions and events that can be measured in terms of money are recorded in the books of accounts. By following this principle, we **will not be able to record the value of efficiency of an employee**, loss of business due to the death of an efficient manager, effect of Government decision etc.

29. Explain going concern concept?

According to the going concern concept, it is assumed that the business will continue for a long period and there is no intention to close the operation in the near future. It is on account of this assumption that fixed assets are recorded at original cost and are **depreciated in a systematic manner**. If this principle is not followed in accounting, the entire cost of the fixed asset will be charged to profit and loss account as current (asset purchased) year expense.

Prepared by BINOY GEORGE, HSST, MKNM HSS, Kumaramangalam, Thodupuzha, Idukki Dt.

Chapter-3

Recording of transaction-I

Focus Area-Public Examination-September-2021

1. Accounting Equation

2. Rules of Debit and Credit

3. Books of original entry

3.1. Journal

4. Ledger

5. Distinction between Journal and Ledger

6. Posting from Journal

Accounting is the process of identifying and analyzing the business transactions, recording them, classifying and summarizing their effects and communicating it to the interested parties. Basic accounting concept will act as a guide in this process. In this chapter we will discuss the details of each step involved in the accounting process.

Accounting Equation

Accounting equation signifies that the assets of a business are always equal to the total of capital (owners claim) and Liabilities (outsiders claim). Accounting equation is a statement of equality between debits and credits.

Assets = Liabilities + Capital

The above equation can also be expressed as follows:

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

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

$$\text{Assets} - \text{Liabilities} - \text{Capital} = 0$$

$$\text{Assets} = \text{Equities}$$

$$\text{Assets} = \text{Owner's equity} + \text{Outsiders' equity}$$

$$\text{Assets} = \text{Owner's Claim (Capital)} + \text{Outsiders Claim (Liability)}$$

The accounting equation is often called as **Balance Sheet equation** as it shows the fundamental relationship among the components of Balance Sheet.

Assets, Liabilities and Capital are the three basic elements of every business transaction. **This equation set the foundation of double-entry accounting** and highlights the structure of the balance sheet.

No business transaction can break the relationship between these terms. A business transaction will result in the changes in either of the assets, liabilities or capital of the firm and even after the change the assets will be again equal to the total of capital and liabilities.

Process of preparing Accounting Equation

Step-1: Analyzing the transaction thoroughly, every transaction involves at least two aspects or accounts, i.e., assets, liabilities, capital, revenues and expenses.

Step-2: Analyses the effect of transactions in two accounts (asset, liabilities, capital, revenue or expenses) stated above. For example, purchased furniture for cash, in this transaction two accounts are furniture and cash. Effect is furniture increased and cash decreased.

Step-3: Record the effect on the relevant side of the equation.

Effects of Transactions on accounting Equation

Business transactions like purchase of goods, payment of salary, cash received from customers etc may affect either both sides of the equation, or one side of the equation only, by both increasing and decreasing it by equal amounts.

On the basis of effects on accounting equation, transaction can be divided into two:

1. Transactions affecting two items.
2. Transactions affecting more than two items.

1. Transactions affecting two items: Some transactions will affect two items of the accounting equation. We can again classify as:

1 (a) Transactions affecting opposite sides are:

Case-1 Increase in Asset, Increase in Capital: Introduction of capital by the proprietor increases asset (cash) and also capital.

Case-2 Increase in Asset, Increase in Liability: Transactions such as credit purchase of goods increases asset (stock) and also increases liability (creditor). Similarly loan taken from bank increases asset (cash/bank) and also increases liability (bank loan)

Case-3 Decrease in Asset, Decrease in Capital: Transactions like Drawings by the proprietor will decrease asset (cash/bank) and also decrease Capital.

Case-4 Decrease in Asset, Decrease in Liability: Transaction of payment to a creditor decreases asset (cash/bank) also decreases liability (creditor)

1 (b) Transactions affecting same side but in opposite direction

Case-5 Increase in one Asset and Decrease in another Asset: Transactions like cash purchases increase the value of one asset (goods) and decrease another asset (cash/bank). Another transaction, receipts from debtors, will increase the value of one asset (cash/bank respectively) and decrease another asset (debtors).

Case-6 Decrease in one Liability and Increase in another Liability: settlement of creditors by issue of Bills of Exchange (B/P) decreases a liability (creditor) and increases another liability (Bills payable)

2. Transactions affecting more than two items of the accounting equation /Balance Sheet: Some transactions affect more than two items of the accounting equation. For example, when a sale of goods is made in cash for Rs.10,000, it is made at cost (Rs.8,000) plus profit (Rs.2,000). Cost of goods sold (Rs.2,000) reduces asset (Stock), another asset (cash) increased by Rs.10,000 and the capital increased by the profit Rs.2,000. It should be noted that profit increases the capital and loss decreases it.

Illustration: Suppose Mr. Thomas starts a new business and the following successive transactions take place:-

Example for Case-1: Thomas started business with Rs.1, 00,000 as capital.

Effect: The business receives Rs.1, 00,000 in cash, which is an asset to the business and at the same time according to business entity concept it owes Rs.1,00,000 to the owner Thomas, i.e., capital.

	Assets		=	Liabilities + Capital	
	Cash			Liabilities	Capital
Capital Introduced	1,00,000			0	1,00,000

Example for Case-2: Purchased goods for Rs.3, 000 from Bharat Traders on credit.

Effect: As a result of this transaction, the stock of goods Rs.3,000 will increase and at the same time a liability sundry creditors will also increase.

	Assets		=	Liabilities + Capital	
	Cash	Stock		Creditors	Capital
Old equation	1,00,000			0	1,00,000
Credit purchase for Rs.3,000	0	+3,000		+3,000	0
New Equation	1,00,000	3,000		3,000	1,00,000

Example for Case-3: Rs.1, 000 with drawn by the owner Thomas for his personal use.

Effect: As a result of this transaction an asset (cash) will reduce and at the same time owner's claim against firm (capital) will also reduce.

	Assets		=	Liabilities + Capital	
	Cash	Stock		Creditors	Capital
Old Equation	1,00,000	3,000		3,000	1,00,000
Drawings Rs.1,000	-1,000	0		0	-1,000
New Equation	99,000	3,000		3,000	99,000

Example for Case-4: Cash paid to Bhart Traders (creditor) Rs, 2,000

Effect: The effect of this transaction is that asset cash will reduce and at the same time a liability creditor will also reduce.

	Assets		=	Liabilities + Capital	
	Cash	Stock		Creditors	Capital
Old Equation	99,000	3,000		3,000	99,000
Rs.2,000 paid to a creditor	-2,000	0		-2,000	0
New Equation	97,000	3,000		1,000	99,000

Example for Case-5: Purchased goods for cash Rs.5, 000

Effect: The effect of this transaction is that asset cash will reduce and at the same time another asset (stock) will increase.

	Assets		=	Liabilities + Capital	
	Cash	Stock		Creditors	Capital
Old Equation	97,000	3,000		1,000	99,000
Cash purchase of goods Rs.5,000	-5000	+5000		0	0
New Equation	92,000	8,000		1,000	99,000

Example for Case-6: Bill of exchange of Rs.5,00 drawn by Bharat Trader's (creditor) accepted (Bills payable)

Effect: As a result of this transaction a liability creditor will reduce and at the same time another liability Bills Payable will increase.

	Assets		=	Liabilities + Capital		
	Cash	Stock		Creditors	Bills Payable	Capital
Old Equation	92,000	8,000		1,000		99,000

Creditors Bills of Exchange accepted	0	0	-500	+500	99,000
New Equation	92,000	8,000	500	500	99,000

Example for case-7 Sold goods costing Rs.1, 000 on credit for Rs, 1,250

Effect: Effect of this transaction is that a debtor has come into existence to the extent of Rs.1250. The asset (stock) is reduced only by Rs.1, 000, being the cost of goods sold. The net increase in assets, Rs.250 (1250-1000) is the amount of profit and it will be added to capital.

	Assets			=	Liabilities + Capital		
	Cash	Stock	Debtors		Creditors	Bills Payable	Capital
Old Equation	92,000	8,000			500	500	99,000
Sold goods costing Rs.1,000 on credit for Rs, 1,250	0	-1,000	+1,250		0	0	+250
New Equation	92,000	7,000	1,250		500	500	99,250

important note:

1. Treatment of profit/loss, expenses, revenue etc.

Capital is increased by amount of profit on sale of goods and revenue like commission received, interest received etc. Capital is decreased by loss on sale of goods and amount of expenses like salary, rent etc.

Illustration (NCERT Text)

Analyse the effect of each transaction on assets and liabilities and show that the both sides of accounting equation remains equal.

1. Introduced Rs.8,00,000 as cash and Rs.50,000 by stock
2. Purchased Plant for Rs.3, 00,000 by paying Rs.15, 000 in cash and balance at a later date.
3. Deposited Rs.6, 00,000 into the bank.
4. Purchased furniture for Rs.1, 00,000 and made payment by cheque.
5. Purchased goods worth Rs.80, 000 for cash and Rs.35, 000 in credit.
6. Goods amounting to Rs.45, 000 was sold for 60,000 on cash basis.
7. Goods costing Rs.80, 000 was sold for Rs.1, 25,000 on credit.
8. Cheque issued to the supplier of goods worth Rs.35,000
9. Cheque received from customer amounting to Rs.75,000
10. Withdrawn by the owner for personal use Rs.25,000

Ans: Steps1. Analyze all the transactions carefully and fix how many heads required in table to complete the problem and give space for them. When analyzing the whole transactions, we can see that the space for the following assets and liabilities must be created in the table.

Assets:Cash,Plant,Bank,Furniture,Stock and Debtors. **Liabilities:** creditors **Capital:** Capital

		Assets			=	Liabilities + Capital			
		Cash	Bank	Stock	Dr.	Furniture	Plant	Cr.	Capital
1	Introduced Rs.8,00,000 as cash and Rs.50,000 by stock	+800000	0	+50000	0	0			+850000
2	Purchased Plant for Rs.3, 00,000 by paying Rs.15, 000 in cash and balance at a later date.	-15000	0	0	0	0	+300000	+285000	0
3	New Equation Deposited Rs.6, 00,000 into the bank.	785000 -600000	0 +600000	50000 0	0 0	0 0	300000 0	285000 0	850000 0
4	New Equation Purchased furniture for Rs.1, 00,000 and made payment by cheque.	185000 0	600000 -100000	50000 0	0 0	0 +100000	300000 0	285000 0	850000 0
5	New Equation Purchased goods worth Rs.80, 000 for cash and Rs.35, 000 in credit.	185000 -80000	500000 0	50000 +115000	0 0	100000 0	300000 0	285000 35000	850000 0
6	New Equation Goods amounting to Rs.45, 000 was sold for 60,000 on cash basis.	105000 +60000	500000 0	165000 -45000	0 0	100000 0	300000 0	320000 0	850000 +15000
7	New Equation Goods costing Rs.80, 000 was sold for Rs.1, 25,000 on credit	165000 0	500000 0	120000 -80000	0 +125000	100000 0	300000 0	320000 0	865000 +45000
8	New Equation Cheque issued to the supplier of goods worth Rs.35,000	165000 0	500000 -35000	40000 0	125000 0	100000 0	300000 0	320000 -35000	910000 0
9	New Equation Cheque received from customer amounting to Rs.75,000	165000 0	465000 +75000	40000 0	125000 -75000	100000 0	300000 0	285000 0	910000 0
10	New Equation Withdrawn by the owner for personal use Rs.25,000	165000 -25000	540000 0	40000 0	50000 0	100000 0	300000 0	285000 0	910000 -25000
	New Equation	140000	540000	40000	50000	100000	300000	285000	885000
Total 11,70,000 (Assets) = 2,85,000 (Liabilities) + 8,85,000 (Capital)									

Usage of Debit and Credit

Double entry system is the most progressive, scientific and complete system of recording the financial transaction of a business. According to this system there are **two accounts** involved in every business transaction. It may be asset, liability, capital revenue or expense. One of them is debited and the other is credited. For example, if the furniture is purchased in the business, furniture (asset) is increased whereas cash (asset) is decreased. When salary paid, salary (expense) is increased and cash is decreased. There is no transaction in the business which affects only one account or one aspect. As such, both the aspects (debit/credit) of every transaction are to be recorded under double entry system.

Meaning of Debit and Credit

All accounts are divided into two sides. The left side of an account is traditionally called **Debit side** and the right side of an account is called **Credit side**. Normally account is prepared in 'T' shape. For example, all transaction relating to cash are recorded in a particular account known as Cash Account and its format will be as given below.

Debit (Dr.)		Cash Account		Credit (Cr.)	
Particulars	Amount	Particulars	Amount		
Debited in debit side		Credited in credit side			

Debit is written as **Dr.** and credit is written as **Cr.** An account is abbreviated as A/c.

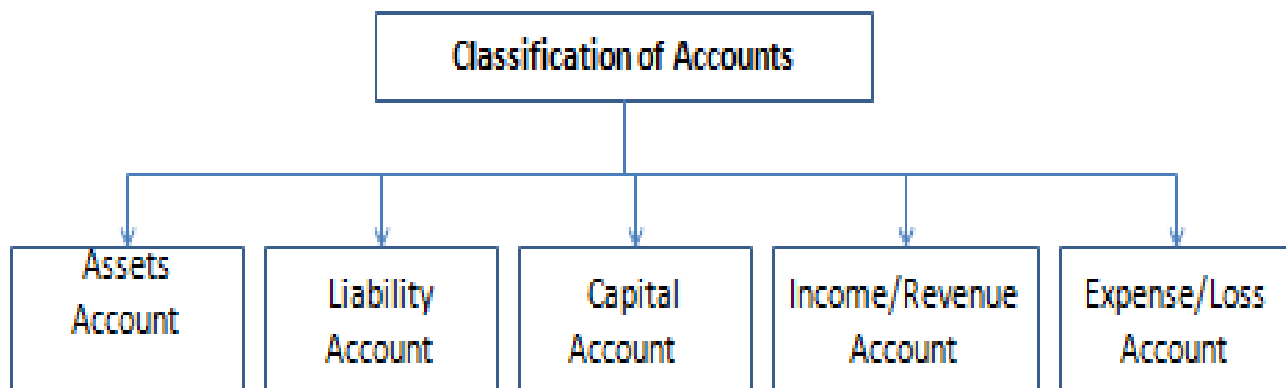
Rule for Debit and Credit

There are two approaches for deciding which account is to be debited and which account is to be credited.

- i. **American Approach or Modern Approach**
- ii. **English Approach or Traditional approach (Out of Syllabus)**

Modern approach

Under this approach all accounts are classified into the following five categories



The rules for debit and credit depend upon the nature of an account. For example, to increase the asset account balance, asset account should be debited, to decrease asset account balance, it should be credited. On the other hand to increase liability account balance, it should be credited and to decrease it, liability account should be debited.

Rules for Debit and Credit:

- 1. Asset Accounts** (Land and Building, Plant and machinery, furniture, stock, debtors, cash, bank etc)

Debit the increases and Credit the decreases.

- 2. Liability Accounts** (Creditors, bank loan, outstanding expenses, bills payable etc.)

Debit the decreases and credit the increases

- 3. Capital Account** (Capital account and drawings account)

Debit the decreases and credit the increases

- 4. Income/ Revenue account** (sales, discount received, interest received, commission received, discount received, bad debts recovered etc.)

Debit the decreases and credit the increases

- 5. Expenses/ loss Accounts** (purchases, wages, salary, depreciation, bad debts, rent, discount allowed etc.)

Debit the increases and Credit the decreases

Rules for Debit and Credit (Modern approach) at a Glance

Type of Accounts	To Increase ↑	To Decrease ↓
Asset (Nature-Debit)	Debited	Credited
Liabilities(Nature-Credit)	Credited	Debited
Capital(Nature-Credit)	Credited	Debited
Income/ Revenue(Nature-Credit)	Credited	Debited
Expenses/ losses(Nature-Debit)	Debited	Credited

Illustration:

On which side will increase in following accounts be recorded? Also, mention the nature of accounts are debited and credited?

1. Cash 2. Creditors 3. Bank loan 4. Stock 5. Rent received 6. Salary paid 7. Salary payable 8. Rajan (owner) 9. Soman (debtor) 10. Sharan (Customer) 11. Purchase 12. Sales 13. Interest Payable 14. Accrued Commission 15. Drawings 16. Discount received 17. Depreciation

Name of the Account	Nature of the account	Side in which Increase will be recorded
1. Cash	Asset	Debit
2. Creditors	Liability	Credit
3. Bank loan	Liability	Credit
4. Stock	Asset	Debit
5. Rent Received	Income/ Revenue	Credit
6. Salary Paid	Expenses/ losses	Debit
7. Salary Payable	Liability	Credit
8. Rajan (Owner)	Capital	Credit
9. Soman (Debtor)	Asset	Debit
10. Sharan (Customer)	Asset	Debit
11. Purchase	Expenses/ losses	Debit
12. Sales	Income/ Revenue	Credit
13. Interest Payable	Liability	Credit
14. Accrued Commission	Asset	Debit
15. Drawings	Capital	Credit
16. Discount received	Income/ Revenue	Credit
17. Depreciation	Expenses/ losses	Debit

Note: Items will be recorded in the just opposite side when decrease will takes place.

Example:1 Started business with cash Rs. 1, 00,000.

Rule: According to double entry system there are two accounts /elements involved in every business transaction. The elements may be asset, liability, capital, income or expenditure. One of them is debited and the other is credited.

Application: In the above transaction, started business with cash, there are two accounts involved- Cash A/c and capital a/c. Here Cash (Asset) increased and at the same time Capital is also increased. To increase Cash account, it should be debited, to increase capital account , it should be credited.

Now, we can write the journal entry as:

Cash A/c Dr 1, 00,000

To Capital A/c 1, 00,000

Dr. **Cash Account** **Cr.**

1,00,000 (Debited)	
--------------------	--

Dr. **Capital Account** **Cr.**

	1,00,000 (Credited)
--	---------------------

Example 2 Furniture Purchased on credit from Ajay traders Rs.40,000

Application: In this transaction, there are two accounts involved-Furniture (Asset) A/c and Ajay Traders Creditor, (liability) a/c. Here Furniture (Asset) increased and at the same time Ajay Traders (liability) is also increased. To increase Furniture account, it should be debited, to increase Ajay Traders account, it should be credited. Now, we can write the journal entry as:

Furniture A/c	Dr.	40,000
---------------	-----	--------

To Ajay trader's	40,000
------------------	--------

Dr. **Furniture A/c** **Cr.**

40,000(Debited)	
-----------------	--

Dr. **Ajay Trader's A/c** **Cr.**

	40,000(Credited)
--	------------------

Example; 3 Salary paid Rs.5, 000

Application: In this transaction, there are two accounts involved-Salary (Expenses) A/c and Cash (Asset) a/c. Here Salary (Expenses) A/c increased and at the same time Cash (Asset) is decreased. To

increase, Salary account it should be debited, to decrease Cash account, it should be credited. Now, we can write the journal entry as:

Salary A/c	Dr.	5,000	
	To Cash A/c		5,000

Dr.	Salary Account	Cr.
5,000(Debited)		

Dr.	Cash Account	Cr.
	5,000(Credited)	

Example: 4 Commission received Rs.2,000.

Application: In this transaction, there are two accounts involved- Cash (Asset) a/c and Commission (Income). Here Cash (Asset) A/c is increased and at the same time Commission (Income) is also increased. To increase Cash (Asset) account, it should be debited, to increase commission account, it should be credited. Now, we can write the journal entry as:

Cash A/c	Dr.	2,000	
	To Commission A/c		2,000

Dr.	Cash Account	Cr.
2,000(Debited)		

Dr.	Commission Account	Cr.
	2,000(Credited)	

Example : 5 Deposited Rs.10,000 into Canara Bank

Application: In this transaction, there are two accounts involved- Canara Bank (Asset) A/c and Cash (Asset) a/c. Here Canara Bank (Asset) A/c is increased and at the same time Cash (Asset) is decreased. To increase, Canara Bank Account it should be debited, to decrease Cash account, it should be credited. Now, we can write the journal entry as:

Canara Bank A/c	Dr.	10,000	
	To Cash A/c		10,000

Dr.	Canara Bank Account	Cr.
	10,000(Debited)	

Dr.	Cash Account	Cr.
		10,000(Credited)

Q. Analyse the following transactions, state the nature of accounts and state which account will be debited and which account will be credited on the basis of Modern Classification of Accounts

1. Started business with cash Rs.3,00,000
2. Purchased furniture for cash Rs.1,00,000
3. Purchased goods from B Ltd Rs.50,000
4. Cash paid to B Ltd Rs. 50,000
5. Sold goods for cash to Kaimal Rs.30,000
6. Paid rent Rs.2,000
7. Commission received Rs.3,000

Analysis of Transaction

Transactions	Accounts Involved	Nature of Accounts	How Altered	Debit	Credit
Started business with cash Rs.3,00,000	Cash Capital	Asset Capital	Increased Increased	3,00,000	3,00,000
Purchased furniture for cash Rs.1,00,000	Furniture Cash	Asset Asset	Increased Decreased	1,00,000	1,00,000
Purchased goods from B Ltd Rs.50,000	Purchase B Ltd	Expense Liability	Increased Increased	50,000	50,000
Cash paid to B Ltd Rs. 50,000	B Ltd Cash	Liability Asset	Decreased Decreased	50,000	50,000
Sold goods for cash to Kaimal Rs.30,000	Cash Sales	Asset Income	Increased Increased	30,000	30,000
Paid rent Rs.2,000	Rent Cash	Expense Asset	Increased Decreased	2,000	2,000
Commission received Rs.3,000	Cash Commission	Asset Income	Increased Increased	3,000	3,000

Books of Original Entry

This process of analysing transactions and recording their effects directly in the accounts is helpful as a learning exercise. However, real accounting systems do not record transactions directly in the accounts. The book in which the transactions are first recorded is called journal or book of original entry.

Journal

Journal is book of original entry in which transactions are first recorded. In journal transactions are recorded in chronological order, as and when they take place. The process of recording transactions in journal is called **journalising**. Journal entry is the basic record of a business transaction. The format of journal is given below:

JOURNAL

Date	Particulars	L.F	Debit (Rs.)	Credit (Rs.)

Column Details

- Date:** In this column, transaction date is written.
- Particulars:** In double entry system, both the aspect of a transaction is to be recorded. The name of the account to be debited is written first and the word 'Dr.' is also written towards the end of the column. In the second line, the name of the account to be credited is written. The credit account starts with the word 'To', a few spaces away from the margin to make it distinct from the debit account.**Narration:** After each entry, a brief explanation of the transaction together with necessary details is given. This explanation is called narration.
- Ledger Folio or L.F:** This column is used to the page number of the ledger account
- Debit:** The amount of account being debited.
- Credit:** The amount of account being credited

Journal Entry: The entry recorded in a journal is called Journal entry. It is the basic record of business transactions. It may be simple or compound.

Simple Journal entry:

When only two accounts are involved to record a transaction, it is called simple journal entry.

For Example: On 07-04-2020, Purchased furniture for cash Rs.80,000. In this transaction there is two accounts are involved, Furniture and cash. Furniture (asset) balance is increased, so furniture account should be debited. Cash (asset) is decreased, so it should be credited. This transaction is in the journal as follows.

Journal

Date	Particulars	L.F	Debit (Rs.)	Credit (Rs.)
07-04-2020	Furniture A/c Dr. To Cash A/c (Purchased furniture for cash)		80,000	80,000

Compound Journal Entry:

A compound journal entry is an entry in which there is more than one debit, more than one credit, or more than one of both debits and credits. It is a combination of several simple journal entries.

Example:

On 31-1-2017

Salary paid Rs. 1,000

Rent paid Rs. 2,000

Interest paid Rs.5,000

Here, It is a
combination 3
simple journal
entries.

Journal

Date	Particulars	L.F	Debit (Rs.)	Credit (Rs.)
31-01-2017	Salary A/c Dr Rent A/c Dr Interest A/c Dr To Cash (Being Salry,rent and interest paid)		1,000 2,000 5,000	8,000

Example: Purchased Machinery from Anand Traders on 1st April 2020 for Rs.50,000 and Rs. 20,000 is paid by cash immediately and balance of Rs.30,000 is still payable. This transaction increases Machinery (assets) by 50,000, decreases Cash (Asset) by Rs.20, 000 and increases liability (Anand Traders, creditor) by Rs.30, 000.

Journal

Date	Particulars	L.F	Debit (Rs.)	Credit (Rs.)
01-04-2020	Machinery A/c Dr. To Cash A/c To Anand Traders A/c (Purchased furniture from Anand Traders and paid Rs.20,000)		50,000	20,000 30,000

Illustration: Anna Traders furnishes the following information:

Journalise the following transactions:

1-1-2020 Started business with cash Rs. 2, 00,000

2-1-2020 Goods purchased from S Ltd Rs. 50,000

3-1-2020 Stationery purchased for cash Rs.10,000

4-1-2020 Sold goods to Biju Rs.10, 000

5-1-2020 Opened a bank account with SBI Rs. 25,000

5-1-2020 Sold goods to Sojan Rs.5,000 for cash

6-1-2020 Cheque issued to S Ltd Rs. 50,000

7-1-2020 Furniture purchased for cash Rs.10,000

8-1-2020 Interest received Rs.2,000

9-1-2020 Wages paid Rs.1,000

Date	Particulars	L.F	Debit (Rs.)	Credit (Rs.)
01-01-2020	Cash A/c To Capital A/c (Business started with cash)	Dr.	2,00,000	2,00,000
02-01-2020	Purchase A/c To S Ltd A/c (Goods purchased on credit)	Dr.	50,000	50,000
3-1-2020	Stationery A/c To Cash A/c (Purchased stationery for cash)	Dr.	10,000	10,000
4-1-2020	Biju A/c To Sales A/c (Sold good to Biju on credit)	Dr.	10,000	10,000
5-1-2020	Bank A/c To Cash A/c (Opened a bank account with SBI)	Dr.	25,000	25,000
5-1-2020	Cash A/c To Sales A/c (Sold goods for cash)	Dr.	5,000	5,000
6-1-2020	S Ltd A/c To Bank A/c (Cheque issued to S Ltd)	Dr.	50,000	50,000
7-1-202	Furniture A/c To Cash A/c (Furniture purchased for cash)	Dr.	10,000	10,000
8-1-2020	Cash A/c To Interest A/c (Interest received)	Dr.	2,000	2,000
9-1-2020	Wages A/c To Cash A/c (Wages paid)	Dr.	1,000	1,000

Note: Transactions can be classified into two, **cash transaction and credit transactions**. In cash transaction one of the aspect- debit aspect or credit aspect is always cash/bank

Banking transactions:

Nowadays, most of the payments and receipts are going through the bank. So traders usually open current accounts with banks. The following are the usual banking transactions and their journal entries:

1. When cash deposited.

Bank A/c Dr.
 To Cash A/c

2. When cash withdrawn 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 cheque received from a customer

Cash A/c Dr.
 To Customer

Note: The Cheque is treated like cash.

5. When cheque received from a customer paid into bank(next day)

Bank A/c Dr.
 To Cash A/c

6. When cheque received from a customer and the same deposited into bank (on the same day)

Bank A/c Dr.
 To Customer a/c

7. When interest on deposit allowed by bank

Bank A/c Dr.
 To Interest A/c

8. When bank charges charged by bank

Bank Charges A/c Dr.
 To Bank A/c

9. When cheque issued to a supplier

Supplier (Creditor) A/c Dr.
 To Bank A/c

10. When cheque received from a customer paid into bank for collection returned dishonored.

Customer A/c Dr.
 To Bank A/c

Transactions related to purchase account

Purchases: The term purchase is used only for the purchase of 'Goods'. In case of manufacturing concern goods means purchase of raw materials for the purpose of conversion of finished products and then sale. In case of trading concern 'goods' are those things which are purchased for resale. The term purchases include both cash and credit purchases of goods.

Example:

- Purchased goods from Anju traders Rs.5000 (eg.Credit purchase)
- Purchased goods for cash Rs.4000/ Purchased goods from Akhil Traders for cash Rs.4, 000/ Cash purchase Rs.4000 (eg. Cash purchase)
- A furniture merchant purchased chairs for Rs.8000 is considered as purchase because here chair is his goods and its purpose is to resale and to earn profit.
-

Note: Purchase is an **expense**. Expense will always be a debit balance. So to increase purchase (expense) account, it should be debited.

Transactions:

1. Purchased goods from Mahesh for Rs.50,000

Purchase A/c Dr.
To Mahesh A/c

2. Purchased goods Rs.10,000

Purchase A/c Dr.
To Cash A/c

3. Goods returned to Mahesh Rs. 200

Mahesh A/c Dr.
To Purchase return A/c

Note: If 'Purchase' is treated as an expense, **purchase return will be treated as 'Revenue'**. Here to increase purchase return (revenue) account balance, it should be credited.

4. Purchased goods and paid by cheque Rs.5,000

Purchase A/c Dr.
To Bank A/c

5. Goods withdrawn by the proprietor for his personal use Rs.500

Drawings A/c Dr.
To Purchase A/c

Note: Purchase is treated as an expense of the business. When goods withdrawn for personal purpose; here purchase A/c (goods purchased for sale, so purchase is a business expense) balance needs to be reduced. You have to credit the purchase account for that.

6. Goods costing Rs.1,200 given as charity

Charity A/c Dr.

To Purchase A/c

Note: 1. Charity is an expense, so it will be debited.

Note: 2 Purchase is the main expense of a business. Purchase means bought goods for the purpose of sale. Here the goods worth Rs.1, 200 not used for sale, but distributed for charity purpose. So the goods used for charity should be deducted from the purchase. To reduce purchase (expense) A/c, it should be credited.

7. Distribution of goods as free sample Rs.200

Free sample / advertising A/cDr.

To Purchase A/c

Note: 1. Free sample is an expense, so it will be debited.

Note: 2. Purchase means bought goods for the purpose of sale. Here the goods worth Rs.200 not used for sale, but distributed for as free sample. So the goods used for free sample should be deducted from the purchase. To reduce purchase (expense) A/c, it should be credited.

8. Loss of goods by theft Rs.5,000

Loss by theft A/c Dr.

To Purchase A/c

9. Loss of goods by fire Rs.6,000

Loss of goods by fire A/c Dr.

To Purchase A/c

Fixed Asset Related Transactions

Example:

- 1. When furniture purchased for Cash Rs. 20,000**

Furniture A/c Dr.

To Cash A/c

2. When furniture purchased from A Ltd on credit Rs.10,000

Furniture A/c Dr.
 To A Ltd A/c

3. Depreciation charged on furniture Rs.2,000

Depreciation A/c Dr. 2,000
 To Furniture A/c 2,000

4. When furniture sold for Rs.18,000

Cash A/c Dr.
 To Furniture A/c

5. Bricks worth Rs.10,000 purchased for the construction of building

Building A/c Dr.
 To Cash

6. Paid installation charges of machinery Rs.2,000

Machinery A/c Dr.
 To Cash A/c

7. Purchased Furniture for Rs.10,000 and spent Rs.100 for its carriage

Furniture A/c Dr. 10,100
 To Cash 10,100

Summarised presentation of important Journal entries

Transactions	Journal entry	Rule Applicable
1. Started Business with Cash	Cash A/c Dr. To Capital A/c	Asset Increased- Debited Capital Increased- Credited
2. Cash Purchase of goods	Purchase A/c Dr. To Cash A/c	Expenses increased- Debited Asset Decreased –Credited
3. Purchased goods on credit	Purchase A/c Dr. Supplier A/c	Expenses increased- Debited Liability Increased –Credited
4. Cash sales of goods	Cash A/c Dr. To Sales A/c	Asset Increased- Debited Income Increased- Credited
5. Credit sales of goods	Debtor A/c Dr. To Sales A/c	Asset Increased- Debited Income Increased- Credited
	Supplier A/c Dr.	Liability decreased- Debited

6.Purchase Return	To Purchase return A/c		Revenue Increased – Credited
7. Sales Return	Sales return A/c To Debtor A/c	Dr.	Expense Increased- Debited Asset decreased- Credited
8.Collection from Debtors	Cash A/c To Debtors A/c	Dr.	Asset Increased- Debited Asset Decreased- Credited
9. Collection from Debtors and discount allowed	Cash A/c Discount Allowed Dr To Debtors A/c	Dr A/c	Asset Increased- Debited Expense Increased-Debited Asset Decreased- Credited
10.Payment to Creditors	Creditors A/c To Cash A/c	Dr.	Liability decreased-Debited Asset Decreased-Credited
11. Payment to creditors and discount received	Creditors A/c To Cash A/c To Discount Received A/c	Dr.	Liability decreased-Debited Asset Decreased-Credited Income Increased- Credited
12.Payment of Expenses	Expenses A/c To Cash A/c	Dr.	Expense Increased-Debited Asset decreased – Credited
13.Receipt of Income	Cash A/c To Income A/c	Dr.	Asset Increased- Debited Income Increased – Credited
14.Depreciation on Asset	Depreciation A/c To Asset A/c	Dr.	Expense Increased-Debited Asset decreased – Credited
15.Interest on capital allowed	Interest on capital A/c To capital A/c	Dr.	Expense Increased-Debited Capital Increased – Credited
16.Outstanding Expenses	Expenses A/c To Outstanding Expenses	Dr.	Expense Increased-Debited Liability Increased – Credited
17. Prepaid Expenses	Prepaid Expenses A/c To Expenses A/c	Dr.	Asset Increased –Debited Expense Decreased – Credited
18.Withdrawal of goods for personal use	Drawings A/c To Purchase A/c	Dr.	Capital decreased-Debited Decrease in Expense- Credited

19. Goods given as charity	Charity A/c To Purchase A/c	Dr.	Expense Increased-Debited Decrease in Expense- Credited
20. Bad debts Written off	Bad debts A/c To Debtors A/c	Dr.	Expense Increased-Debited Asset Decreased- Credited
21.Bad debts recovered	Cash A/c To Bad debts Recovered	Dr.	Asset Increased –Debited Revenue increased – Credited
22.Income tax paid	Drawings A/c To Cash A/c	Dr.	Capital decreased-Debited Asset Decreased- Credited
23.Sale of asset more than book value	Cash A/c(Sales price) To Asset (book value) To Profit on Sale of Asset	Dr.	Asset Increased –Debited Asset Decreased- Credited Revenue increased – Credited
24.Sale of asset lesser than book value	Cash A/c(Sales price) Loss on Sale of Asset To Asset (book value)	Dr.	Asset Increased –Debited Expense Increased-Debited Asset Decreased- Credited
25. Sale of scrap	Cash A/c To Miscellaneous Receipts	Dr.	Asset Increased –Debited Revenue increased – Credited

Discount

The discount may be **1. Trade Discount 2. Cash Discount**

1. Trade Discount: Trade discount is an allowance given by the seller of goods out of the selling price (list price or catalogue price). It is usually allowed by the wholesaler to the retailer, when goods are purchased in large quantity. Trade discount is allowed on both on cash as well as credit transactions. Trade discount is related to the purchase and not to the payment. No separate entry is passed for the trade discount, as it is deducted in the invoice from the list price and the net amount only is recorded in the books of accounts.

Note: Trade discount is not separately recorded in the books of accounts.

Example: If Anil traders sells goods to Salman Traders of the list price of Rs.1,00,000 at 10% trade discount for cash.

Listed/catalogue price =1, 00,000. Trade discount= 10% of Rs.1, 00,000 i.e., Rs.10, 000

So selling price = 1, 00,000 – 10,000 = 90,000 (selling price is recorded in the invoice, so no separate recording is needed for trade discount)

Journal entry:

Journal (Anil Traders)

Date	Particulars	L.F	Debit (Rs.)	Credit (Rs.)
	Cash A/c To Sales (Sold goods for cash)	Dr.	90,000	90,000

2. Cash Discount

Cash discount is usually allowed by the supplier(Creditor) to the customer(Debtor) to encourage prompt or early payment. Cash discount is allowed only if the customer/debtor makes the payment within a fixed period. When cash discount is allowed, it is an expense and debited to 'Discount allowed Account' and when cash discount is received, it is a revenue and credited to 'Discount Received Account'. It is an expense for the business allowing and gain for the business availing it.

Example: John owes an amount of Rs.2,000 to Sunil. John makes the payment promptly and Sunil allows a discount of Rs.100.

The reduction of Rs.100 is the cash discount; it is revenue (Discount received) to John and expense (Discount allowed) to Sunil.

Journal Entry: On receipt of amount (in the books of Sunil)

Journal

Date	Particulars	L.F	Debit (Rs.)	Credit (Rs.)
	Cash A/c Discount Allowed A/c To John (Cash received from John and discount allowed Rs.100)	Dr. Dr.	1,900 1,00	2,000

Journal Entry: On payment of amount (in the books of John)**Journal**

Date	Particulars	L.F	Debit (Rs.)	Credit (Rs.)
	Sunil A/c To Cash A/c To Discount Received A/c (Cash paid to John and discount received Rs.100)	Dr.	2,000	1,900 100

Difference between Cash Discount and Trade Discount

Basis of difference	Trade Discount	Cash Discount
Meaning	It is usually allowed by the wholesaler to the retailer, when goods are purchased in large quantity	Cash discount is usually allowed by the creditor to the debtor to encourage early payment
Time	Allowed at the time of bulk purchase	Allowed when payment is made on or before a specified date.
Recording	It is not recorded separately in the books of accounts	It is recorded separately in the books of accounts.
Deduction from bill/invoice	Deducted	Not deducted

Ledger (book of final entry or principal book of accounts)

Business transactions are first entered in the primary book called Journal. The next step is to transfer the entries to respective accounts in Ledger. Ledger is a book in which various accounts are opened and transactions are posted from Journal. A ledger is also called the 'Book of Final Entry' or 'Secondary Entry', since all transactions recorded first in Journal and finally posted to various accounts maintained in Ledger. Ledger is the principal book of accounts.

Features of Ledger

- Various accounts like asset accounts, liability accounts, capital account, expense accounts, revenue accounts are maintained in ledger.
- It is prepared from Journal.
- Trial Balance and Final Accounts are prepared from Ledger accounts.

Classification of Ledger Accounts

All ledger accounts are put into five categories, namely, assets, liabilities, Capital, revenue and expenses. All accounts may further be put into two groups, i.e. permanent accounts and temporary accounts.

Permanent accounts: All assets, liabilities, and capital accounts are permanent accounts. All permanent accounts are balanced and carried forward to the next accounting period. All permanent accounts will appear in the Balance Sheet.

Temporary Accounts: All revenue and expenses accounts are temporary accounts. Temporary accounts are not balanced, they are totaled at the end of the year and closed by transferring them to the Trading and Profit and Loss account by passing closing entries.

Posting from Journal

Posting is the process of transferring entries from the Journal to the Ledger.

Steps involved in posting:

A journal entry consists of two aspects, debit aspects and credit aspect. Each aspect is an account. Debit aspect is said to be debited in that particular account and the credit aspect is said to be credited in that particular account. The following are the steps in posting:

Step-1: Focused on the debit aspect of the journal entry and turn to the particular account in the ledger that is to be debited.

Step-2: Record the following items on the **debit** side of the account:

- a) Date in the date column
- b) Name of the other aspect (here, name of the credit aspect/account) of the journal entry in the particular column with or without the word 'To' .
- c) Page number of the journal in the J.F column
- d) Debit amount of the journal entry in the debit column of the account.

Step-3: Record the following items on the **credit** side of the account:

- a) Name of the other aspect (here, name of the debit aspect/account) of the journal entry in the particular column with or without the word 'By' .
- b) Page number of the journal in the J.F column
- c) Credit amount of the journal entry in the credit column of the account.

Example:

1-1-2019 Started business with cash Rs.2,00,000

Journal Entry

Date	Particulars	L.F	Debit (Rs.)	Credit (Rs.)
1-1-19	Cash A/c To Capital A/c (Started business with cash)	Dr.	2,00,000	2,00,000

Posting to the ledger account:

Dr. Cash Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
1-1-19	To Capital A/c		2,00,000				

Dr. Capital Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
				1-1-19	By Cash A/c		2,00,000

Balancing of Accounts

Balancing of accounts is the process of ascertaining the difference between the totals of debit side and the credit side of the account and inserting the difference on the side where the amount is less in order to make the totals of the account equal. Permanent accounts in the ledger are periodically balanced.

In case debit side exceeds credit side ,the difference is written on the credit of the account as ‘**By balance c/d**’ .In such a case the amount is said to have **debit balance** which means that the debit side is more.

In case credit side exceeds debit side ,the difference is written on the debit of the account as ‘**To balance c/d**’ .In such a case the amount is said to have **credit balance** which means that the credit side is more.

Journalising, Posting and balancing of account are illustrated below:

1-1-2019 Started business with cash Rs.20,000

2-1-2019 Machinery purchased Rs.5,000

3-1-2019 Purchased goods for cash Rs.3,000

4-1-2019 Received commission Rs.1,000

Prepare cash account and find out cash balance?

Date	Particulars	L.F	Debit (Rs.)	Credit (Rs.)
1-1-19	Cash A/c To Capital A/c (Started business with cash)	Dr.	20,000	20,000
2-1-19	Machinery A/c To Cash A/c (Machinery purchased for cash)	Dr.	5,000	5,000
3-1-19	Purchase A/c To Cash A/c (Cash purchase of goods)	Dr.	3,000	3,000
4-1-19	Cash A/c To Commission A/c (Commission received)	Dr.	1,000	1,000

Dr. Cash Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
1-1-19	To Capital A/c		20,000	2-1-19	By Machinery A/c		5,000
4-1-19	To commission		1,000	3-1-19	By Purchase A/c		3,000
					By Balance c/d		13,000
			21,000	5-1-19			21,000
8-1-19	To Balance b/d		13,000				

Trial Balance

Trial balance is a statement prepared to test the books kept under double entry system. It is prepared with the debit and credit balances of ledger accounts and also with the debit and credit totals of ledger accounts. If the total of the debit balances is equal to the total of credit balances, it is presumed that there is no mistake in posting and balancing.

Journalise the following transactions, prepare ledger accounts and also prepare Trial Balance.

1-1-2019 Started business with cash Rs.20, 000

2-1-2019 Machinery purchased Rs.5, 000

3-1-2019 Purchased goods for cash Rs.3, 000

4-1-2019 Received commission Rs.1, 000.

5-1-2019 Opened a bank account Rs.3, 000

6-1-2019 Purchased goods and paid by cheque Rs.5, 00

7-1-2019 Salary paid by cheque Rs.1, 000

8-1-2019 Sold goods for cash Rs.2, 000

9-1-2019 Sold goods to Biju Rs.5,00

Prepare cash account and find out cash balance?

Date	Particulars	L.F	Debit (Rs.)	Credit (Rs.)
1-1-19	Cash A/c To Capital A/c (Started business with cash)	Dr.	20,000	20,000
2-1-19	Machinery A/c To Cash A/c (Machinery purchased for cash)	Dr.	5,000	5,000
3-1-19	Purchase A/c To Cash A/c (Cash purchase of goods)	Dr.	3,000	3,000
4-1-19	Cash A/c To Commission A/c (Commission received)	Dr.	1,000	1,000
5-1-19	Bank A/c To Cash A/c (Cash deposited into bank)	Dr.	3,000	3,000
6-1-19	Purchase A/c To Bank A/c (Purchased goods and paid by cheque)	Dr.	5,00	5,00
7-1-19	Salary A/c To Bank A/c (Salary paid by cheque)	Dr.	1,000	1,000
8-1-19	Cash A/c To Sales A/c (Sold for cash)	Dr.	2,000	2,000
9-1-19	Biju A/c To Sales A/c (Credit sales of goods)	Dr.	5,00	5,00
			36,000	36,000

Dr. Cash Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
1-1-19	To Capital A/c		20,000	2-1-19	By Machinery A/c		5,000
4-1-19	To commission		1,000	3-1-19	By Purchase A/c		3,000
8-1-19	To Sales		2,000	5-1-19	By Bank		3,000
				10-1-19	By Balance c/d		12,000
			23,000				23,000
8-1-19	To Balance b/d		12,000				

Dr.

Capital Account

Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
10-1-19	To balance c/d		20,000	1-1-19	By Cash A/c		20,000
			20,000				20,000
				11-1-19	By Balance b/d		20,000

Dr.

Machinery Account

Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
2-1-19	To Cash A/c		5,000	10-1-19	By Balance c/d		5,000
			5,000				5,000
11-1-19	To Balance b/d		5,000				

Dr.

Purchase Account

Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
2-1-19	To Cash A/c		3,000				
6-1-19	To Bank A/c		5,00				
			3,500				

Dr.

Commission Account

Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
				4-1-19	By Cash		1,000
							1,000

Dr.

Bank Account

Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
5-1-19	To Cash A/c		3,000	6-1-19	By Purchase		5,00
				7-1-19	By salary		1,000
				10-1-19	By Balance c/d		1,500
			3,000				3,000
11-1-19	To Balance b/d		1,500				

Dr. Salary Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
7-1-19	To Bank A/c		1,000				
			1,000				

Dr. Sales Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
				8-1-19	By Cash		2,000
				9-1-19	By Biju		5,00
							2,500

Dr. Biju Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
9-1-19	To sales A/c		5,00	10-1-19	By Balance c/d		5,00
			5,00				5,00
11-1-19	To Balance b/d		5,00				

Trial Balance As on 10-1-19

Particulars	L.F	Debit	Credit
Cash A/c		12,000	
Capital			20,000
Machinery		5,000	
Purchase		3,500	
Commission			1,000
Bank		1,500	
Salary		1,000	
Sales			2,500
Biju		5,00	
		23,500	23,500

Advantages of journal:

1. It reduces the possibility of error
2. This practice provides a complete record of each transaction in one place and links the debits and credits for each transaction.
3. Narration: Journal entries bear narrations, which provide complete information about the transaction. It enables us to understand the entry.

4. Location of errors: Errors can be easily located through journal.

The source document is required to record the transaction in the journal.

Difference between Journal and Ledger

No.	Journal	Ledger
1	All transactions are first recorded in journal	All transactions recorded in journal are later transferred to ledger.
2.	In journal transactions are recorded in chronological order.	In ledger transactions are recorded in analytical order, i.e , all transactions pertaining to a particular account are contained at one place in the ledger.
3	Final accounts can't be prepared with the help of journal	Final accounts can be prepared with the help of ledger.
4	Process of recording entries in journal is called journalising.	Process of recording entries in the ledger is called posting.

Questions:

1. The book in which all accounts are maintained is known as:

(a. Cash Book b. Journal c. Purchase Book d. Ledger)

Ans: d

2. Recording of transaction in the journal is called.....

Ans: Journalising

3. Find the correct statement:

- i. Credit a increase in assets
- ii. Credit the increase in expense
- iii. Debit the increase in revenue
- iv. Credit the increase in capital

Ans:iv

4. Cash withdrawn by the proprietor should be credited to:

(a. Drawings A/c b. Capital A/c c. Cash A/c d. None of these)

Ans:c

5. Which of the following is correct:

- i. Liabilities = Assets + Capital
- ii. Assets = Liabilities – Capital
- iii. Capital = Assets – Liabilities
- iv. Capital = Assets + Liabilities

Ans: iii

6. If a firm takes a loan from a bank, there will be

- i. Increase in capital
- ii. Decrease in capital

- iii. No effect on capital **Ans: iii**
7. Balancing of accounts meanse:
- Total of debit side
 - Total of credit side
 - Difference in total of debit and credit sides
 - None of these **Ans: iii**
8. Cash discount is allowed by :
- (a. Customer b. Debtor c. Creditor) **Ans: c**
9.discount is allowed on both on cash as well as credit transactions. **Ans: Trade**
10. Withdrawal of goods by an owner for his private use must bein the drawings account.
- (a. Debited b. Credited) **Ans: a.**
11. The transaction 'started with cash' results in.....
- Increase in Expense
 - Increase in assets
 - Decrease in assets
 - Decrease in liability **Ans: ii**
12. Accounts that normally have debit balances are
- Asssets, expenses and revenue
 - Assets, expenses and capital
 - Assets , liabilities and drawings
 - Assets , drawings and expenses **Ans: iv**
13. Journals prepared onbasis.
- a) Daily b. weekly c. monthly d. yearly) **Ans: a**
14. Math the following

A	B
Cash Book	Ledger
Salary Account	Allowed by creditor
Cash Discount	To increase sales volume
Trade Discount	Primary Book

Ans:

	B
Cash Book	Primary Book

Salary Account	Ledger
Cash Discount	Allowed by creditor
Trade Discount	To increase sales volume

15. Purchased goods from Johnson for cash. In this case which account is credited?

(a. Purchase b. Cash c. Johnson d. None of these) **Ans: Cash**

16. Fill in the blanks:

----- A/c Dr. 2,000

To General Traders 2,000

(Purchased furniture from General Traders) **Ans: Furniture**

17. Goods returned by customers are also known as

(a. Purchase return b. return outwards c. return inwards d. none of these) **Ans: c**

17. is the basic record of a business transaction

(a. Journal entry b. Ledger c. account d. posting) **Ans: a**

18. Complete the following as per hint given:

No.	Transaction	Effect on Business
1	Salary paid	<ul style="list-style-type: none"> ▪ Decrease in Asset ▪ Decrease in capital
2	Purchased goods from Ramesh	<ul style="list-style-type: none"> ▪ ? ▪ ?
3	Commission received	<ul style="list-style-type: none"> ▪ ? ▪ ?
4	Purchased machinery for cash	<ul style="list-style-type: none"> ▪ ? ▪ ?
5	Cash received fro Ramesh	<ul style="list-style-type: none"> ▪ ? ▪ ?

Ans:

No.	Transaction	Effect on Business
1	Salary paid	<ul style="list-style-type: none"> ▪ Decrease in Asset ▪ Decrease in capital
2	Purchased goods from Ramesh	<ul style="list-style-type: none"> ▪ Increase in Asset ▪ Increase in Liability
3	Commission received	<ul style="list-style-type: none"> ▪ Increase in Asset ▪ Increase in capital
4	Purchased machinery for cash	<ul style="list-style-type: none"> ▪ Increase in asset ▪ Decrease in asset
5	Cash received fro Ramesh	<ul style="list-style-type: none"> ▪ Increase in asset ▪ Decrease in asset

17. Given below are some journal entries.

- i. Give suitable narrations to these entries
- ii. Explain the types of discount mentioned in the second entry.

1.	Drawings A/c Dr.	2,000	
	To Purchase A/c		2,000
)		
2.	Cash A/c Dr.	2,500	
	Discount A/c Dr.	500	
	To Rajan		3,000
)		

Ans: i. 1. Goods withdrawn for personal purpose, 2. Cash received Rs. 2500 and allowed a discount Rs.500)

Ans: ii Cash discount is usually allowed by the supplier(Creditor) to the customer(Debtor) to encourage prompt or early payment. It is an expense for the business allowing and gain for the business availing it.

19. a. Assets =+ Capital

b. Show the accounting equation on the basis of the following transactions

c. Prepare cash account from the above transactions.

- i. Started business with cash Rs. 1,00,000
- ii. Purchased goods for cash Rs. 20,000
- iii. Purchased goods from Sunny Rs.10,000
- iv. Commission Received Rs.1,000
- v. Salary paid Rs. 3,000

Ans: i Assets = Liabilities + Capital

Ans: ii

Transactions		Assets = Liabilities + Capital			
		Cash	Stock	Creditors	Capital
1	Started business with cash Rs. 1,00,000	+1,00,000	0	0	1,00,000
	New Equation	1,00,000	0	0	1,00,000
2	Purchased goods for cash Rs. 20,000	-20,000	+20,000	0	0
	New Equation	80,000	20,000	0	1,00,000
3	Purchased goods from Sunny Rs.10,000	0	+10,000	+10,000	0
	New Equation	80,000	30,000	10,000	1,00,000
4	Commission received Rs. 1,000	+1,000	0	0	+1,000

	New Equation	81,000	30,000	10,000	1,01,000
5	Salary paid Rs.3,000	-3,000	0	0	-3,000
	New Equation	78,000	30,000	10,000	98,000

Ans: iii

Cash A/c

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
1	To Capital A/c		1,00,000	2	By Purchase A/c		20,000
4	To commission		1,000	5	By Salary		3,000
					By Balance c/d		78,000
			1,01,000				1,01,000
	To Balance b/d		78,000				

20. Prepare Ajmal Traders A/c from the following information for the month of December

2019. Is Ajmal traders a debtor or creditor?

2019 Dec-1 Started business with cash Rs.2,00,000

Dec 1 purchased goods from Ajmal Traders Rs. 60,000.

2019 Dec 5 paid Rs. 40,000 to Ajmal Traders.

2019 Dec 10 sold goods to Ajmal Traders Rs. 70,000.

2019 Dec 15 purchased Furniture from Ajmal Traders Rs. 20,000

2019 Dec 20 purchased Machinery from Ajmal Traders Rs. 75,000.

2019 Dec 25 paid Rs. 30,000 to Ajmal Traders.

Ajmal Traders A/c

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
5-12-19	To Cash		40,000	1-12-19	By Purchase		60,000
10-12-21	To sales		70,000	15-12-19	By Furniture		20,000
15-12-21	To Cash		30,000	20-12-19	By Machinery		75,000
31-12-19	To Balance c/d		15,000				
			1,55,000				1,55,000

➤ **Ajmal Traders is a creditor to our business.**

21. Give a specimen of an account.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount

22. Should a transaction be first recorded in a journal or ledger? Why?

All business transactions are first recorded in a book called journal. Journal is book of original entry in which transactions are first recorded. In journal transactions are recorded in chronological order, as and when they take place.

23. Differentiate between cash discount and trade discount.

Trade Discount	Cash Discount
Trade discount is usually allowed by the wholesaler to the retailer	Cash discount is usually allowed by the creditor to the debtor to encourage early payment
Allowed at the time of bulk purchase	Allowed when payment is made on or before a specified date.
Not recorded in the books of accounts	It is recorded separately in the books of accounts.
Trade discount encourage bulk purchase	Cash discount encourage prompt payment
It is allowed on cash and credit sales of goods	It is related with credit sale of goods.

24. What are the difference between books of original entry(journal/prime entry) and Ledger (Secondary entry)

No.	Journal	Ledger
1	All transactions are first recorded in journal	All transactions recorded in journal are later transferred to ledger.
2.	In journal transactions are recorded in chronological order.	In ledger transactions are recorded in analytical order
3	Final accounts can't be prepared with the help of journal	Final accounts can be prepared with the help of ledger.
4	Process of recording entries in journal is called journalising.	Process of recording entries in the ledger is called posting.
5.	Balancing is not done in journal	All ledger accounts are balanced/totaled

25. Give the accounting equation after each transaction:

- Sunil Started business with cash Rs.90,000
- Purchased goods on credit from Sajan Rs.40,000
- Sold goods for cash Rs.30,000
- Paid rent Rs.5,000
- Purchased machinery for cash Rs.5,000

Transactions		Assets = Liabilities + Capital				
		Cash	Stock	Furniture	Creditors	Capital
a	Started business with cash Rs. 90,000	+90,000	0	0	0	90,000
b	Purchased goods on credit from Sajan Rs.40,000	0	+40,000	0	+40,000	0
	New Equation	90,000	40,000	0	40,000	90,000
c	Sold goods for cash Rs.30,000	+30,000	-30,000	0	0	0
	New Equation	1,20,000	10,000	0	40,000	90,000
d	Paid Rent Rs.5,000	-5,000	0	0	0	-5,000
	New Equation	1,15,000	10,000	0	40,000	85,000
e	Purchased machinery for cash Rs.5,000	-5,000	0	+5,000	0	0
	New Equation	1,10,000	10,000	5,000	40,000	85,000

Prepared by BINOY GEORGE, HSST, MKNM HSS, Kumaramangalam, Thodupuzha, Idukki Dt.

Chapter-4

Recording of Transactions-II

Focus Area: Public Examination September-2021

1. Special Journals
2. Single Column Cash Book
3. Double Column Cash Book
4. Petty Cash Book
5. Purchases Book
6. Sales Book

In case of small business, Journal is large and sufficient to record all transactions. But in large business, there are numerous transactions and it is impossible to record all transactions in one journal and division of work is not possible. So, in big business firms Journal is subdivided into special journals or Day Books. Separate journals are kept for recording transactions of a similar nature, so, journalising and posting will be easier and convenient.

Special Journal or Subsidiary Books

The journal in which transactions of similar nature only are recorded is called special journals or subsidiary book or Day Books.

Types of Subsidiary Books or Day Books

1. **Cash Book**- to record all cash and bank transactions
2. **Purchase Book**- to record all credit purchase of goods
3. **Purchase Return (Return Outwards) Book**- to record purchase returns of goods
4. **Sales Book**- to record all credit sales of goods.
5. **Sales Return (Return Inwards) Book**- to record sales returns of goods
6. **Journal Proper**

1. Cash Book

Cash Book is the special journal used to record all cash and bank transactions. It starts with cash or bank balances at the beginning of the period. All cash/bank receipts are recorded on the debit side and all cash/bank payments are recorded on the credit side. It serves the purpose both journal as well as ledger. So, when a cash book is maintained, transactions of cash are not recorded in the journal and no separate account for cash/bank is required in the ledger.

Cash Book is both Journal and a Ledger (Cash Book is both a subsidiary book and a principal book)

When cash book is maintained, cash transactions are recorded directly in the cash book and are not recorded in the journal. As all the cash transactions are recorded for the first time in the cash book, it is therefore a book of original entry, i.e. journal. Cash book is prepared and balanced like a ledger account. So when a cash book is maintained, no separate cash account is opened in the ledger. As such cash book is a journal as well as a ledger.

Features of Cash Book:

- 1) **All cash and Bank transactions** are recorded in the Cash Book.
- 2) Cash book itself is a cash account also.
- 3) It is a real account.
- 4) In cash book transactions are recorded **in chronological order**.
- 5) It performs the function of Journal and ledger in the same time.
- 6) Cash book **may be balanced daily, weekly or monthly** depending on the needs of the business. If cash book is balanced daily, one can ensure that balance shown in the cash book is the same as the balance in the cash box.
- 7) Cash book **always shows a Debit Balance**. It is because a businessman cannot pay more cash than what he has got. If the money is paid by borrowing from bank, it will first be recorded on the receipts side and only then it will be shown on the payment side.

Types of Cash Book

1. Single Column Cash Book

2. Double Column Cash Book

3. Petty Cash Book

1. Single Column Cash Book: Cash Book is the special journal used to record all cash and bank transactions. It starts with cash or bank balances at the beginning of the period. All cash/bank receipts are recorded on the debit side and all cash/bank payments are recorded on the credit side. It serves the purpose both journal as well as ledger. So, when a cash book is maintained, transactions of cash are not recorded in the journal and no separate account for cash/bank is required in the ledger.

Dr. Cash Book Cr.

Date	Receipts	L.F	Amount	Date	Payments	L.F	Amount

Illustration:

Enter the following transactions of Maria Traders in a single column cash book and post them to Ledger.

1-1-2019 Cash in hand Rs.50,000

2-1-19 Purchased goods for cash Rs.20,000

3-1-19 Sold goods for cash Rs.10,000

4-1-19 Purchased furniture for cash Rs.15,000

5-1-19 Purchased goods from Sojan Rs.3,000

8-1-19 Cash paid to Sojan Rs.3,000

10-1-19 Paid Salary Rs.2,000

11-1-19 Withdrew for personal purpose Rs.5,00

28-1-19 Deposited into bank Rs.2,000

30-1-19 Cash purchase Rs.1000

31-1-19 Received commission Rs.4,00

Dr. Cash Book Cr.

Date	Receipts	L.F	Amount	Date	Payments	L.F	Amount
1-1-19	Balance b/d		50,000	2-1-19	Purchase		20,000
3-1-19	Sales		10,000	4-1-19	Furniture		15,000
31-1-19	Commission		4,00	8-1-19	Sojan		3,000
				10-1-19	Salary		2,000
				11-1-19	Drawings		5,00
				28-1-19	Bank		2,000
				30-1-19	Purchase		1,000
				31-1-19	Balance c/d		16,900
			60,400				60,400
1-2-19	Balance b/d		16,900				

Books of Maria Traders

Dr. Sales Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
				3-1-19	Cash		10,000

Dr. Commission Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
				31-1-19	Cash		4,00

Dr. Purchase Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
2-1-19	Cash		20,000				
30-1-19	Cash		1,000				

Dr. Furniture account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
4-1-19	Cash		15,000				

Dr. Sojan Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
8-1-19	Sojan		3,000				

Dr. Salary Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
10-1-19	Cash		2,000				

Dr. Drawings Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
11-1-19	Cash		5,00				

Dr. Bank Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
28-1-19	Cash		2,000				

single column cash book and banking transactions

In a business where there is no double column cash book, the banking transaction is also recorded in the single column cash book itself.

Payment by cheque: Payment by cheques will not affect cash balance of the business, but it should be recorded in the single column cash book as cash book is the original entry for recording banking transactions also. In such a case it will be assumed that the money was withdrawn first from the bank and the expenses were paid with that money. Therefore, cash book is debited for such amounts and then credited with the same. It does not affect the cash book balance anyway.

Example: Rent paid by cheque Rs.2000

First Assumption: Cash withdrawn from bank

Cash A/c Dr 2,000

To Bank 2,000

(Cash withdrawn from bank)

Second Assumption: Expense was paid with that cash

Rent A/c Dr.	2,000
To Cash	2.000

(Rent paid)

Direct deposit by customers:

Customers often deposit money directly in the bank. This also needs to be recorded in the single column cash book. In such a case it will be assumed that the money was collected first from the customer and the same were deposited in the bank. In such a case it will be assumed that the money was collected first from the customer and the same were deposited in the bank. Hence, cash book is first debited and then credited with the same amount. It does not affect the cash book balance anyway.

Example: Mathew, a customer directly Rs.5,000 into bank.

First Assumption: Cash received from customer/Mathew

Cash A/c Dr 5,000

To Mathew A/c 5,000

(Cash received from Mathew)

Second Assumption: Cash deposited into bank

Bank A/c Dr.	5,000
To Cash A/c	5,000

(Cash Deposited into bank)

2. Double Column Cash Book

Double column cash book is the **cash book having two amount columns in each side**. One amount column is to record cash transactions and another amount column is to record bank transactions. When double column cash book is maintained, **there is no need to maintain separate cash or bank account**.

The cash column will always show a debit balance, but the opening balance of bank may be Debit or Credit. In case of overdraft, the bank balance will be the credit balance.

All cash receipts (example cash sales of goods and asset, commission received, cash received from Sunny etc.) are recorded in the cash column on the debit side. All cash payments (Example cash purchase of goods and asset, salary paid, cash paid to Jos etc.) are recorded in the cash column on the credit side.

The bank column on the debit side records those transactions (interest allowed/credited by bank, direct deposit by customers etc) which increases our bank balance. The bank column on the credit side records those transactions (Bank charges, interest charged by bank, payment made by bank on behalf of customers etc) which decreases our bank balance.

Contra Entries:

There are certain transactions which will appear on both sides of the cash book. This is so because one aspect of the transaction affects the cash balance and other aspect affects the bank balance. **The entries that affect both sides of the cash book are called contra entries.** Against such entries, the letter **C** (C stands for contra) should be written in the LF column on both sides to signify that **these entries are not be posted to the ledger.**

Example :(1) Deposit cash or cheque into the bank (2) Withdrawal of cash from bank for office use.

Cash Book (Double Column)

Date	Receipts	L.F	Cash	Bank	Date	Payments	L.F	Cash	Bank

Cash column-Debit side: All cash receipts.

Cash column-Credit side: All cash payments.

Bank column-Debit side: Transactions (interest allowed/credited by bank, direct deposit by customers etc.) which increases our bank balance.

Bank column- Credit side: Transactions (Bank charges, interest charged by bank, payment made by bank on behalf of customers etc.) which decreases our bank balance.

There are certain transactions (contra entries) which come both on the debit side and credit side of the cash book.

Business and bank

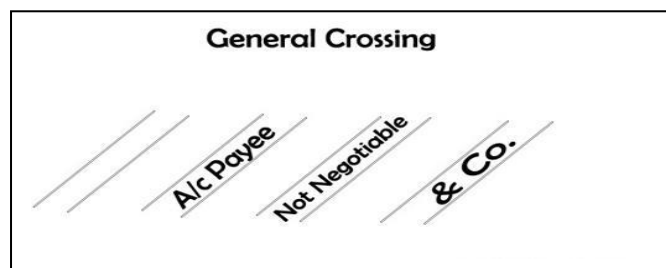
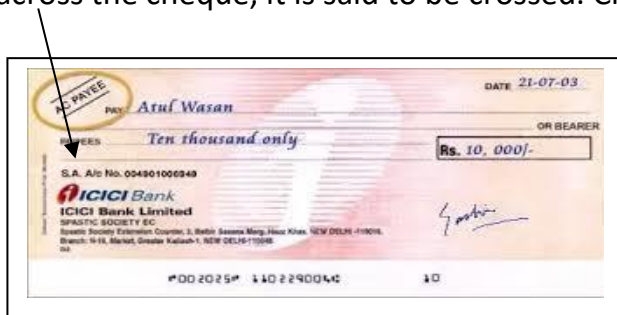
A business man generally opens a current account with a bank. In case of current account, there is no restriction regarding the number and amount of deposit and withdrawals. Account holder can remit amounts into bank account using the form called 'pay-in-slip' or through internet banking. The bank issues cheques, to the account holder for withdrawing money.

A **Cheque** is a document which orders a bank to pay a certain sum of money from a person's account to another. The **cheque** is used to make safe, secure, and convenient payments.

Cheque forms have the printed word bearer, which means payment is to be made to the person whose name has been written after the word "pay" or to the bearer of the cheques. When the word 'bearer' is struck off by drawing a line, the cheque becomes an 'order' cheque. It means payment is to be made to the person whose name is written on the cheque or to his order after proper identification.

Cheque crossing

Cheques are generally crossed in practice. Payment of a crossed cheque cannot be made direct to the party on the counter. It is to be paid only through a bank. When two parallel lines are drawn across the cheque, it is said to be crossed. Crossing ensures safety of payment.



Payment of different types of cheque

- 1. Account payee cheque/ crossed cheque** : The amount of the cheque can be deposited only in the account of the person whose name appears on the cheque.
- 2. Order cheque**: Payment is to be made to the person whose name is written on the cheque or to his order. Order cheque can be transferred by endorsement and delivery.
- 3. Bearer cheque**: Payment is to be made to the person who bear the cheque. It can be transferred by mere delivery.

Illustration:

- 1-1-18 Cash Balance Rs.60,000
- 1-1-18 Bank balance (debit) Rs.22,000
- 2-1-18 Cash paid to petty cashier Rs.1000
- 2-1-18 Sold goods for cash Rs.14,000
- 4-1-18 Cash received from Vijay Rs.2,000
- 8-1-18 Salary paid by cheque Rs.5,000

10-1-18 Paid Sunny by cheque Rs.3,000

12-1-18 Cash purchase Rs.5,000

14-1-18 Cash deposited into bank Rs.3,000

16-1-18 Cash sales Rs.4,000

21-1-18 Purchased furniture and payment made by cash Rs.8,000

22-1-18 Withdrew from bank for office use Rs.3,000

25-1-18 Received a cheque from Rajan and immediately deposited into the bank Rs.7,000

27-1-18 Rajan's cheque returned by bank dishnoured Rs,7,000

28-1-18 Paid charity Rs.2,000

31-1-18 Paid into bank Rs.10,000

Cash Book (Double Column)

Date	Receipts	L.F	Cash	Bank	Date	Payments	L.F	Cash	Bank
1-1-18	Balance b/d		60000	22000	2-1-18	Petty Cashier		1000	
2-1-18	Sales		14000		8-1-18	Salary			5000
4-1-18	Vijay		2000		10-1-18	Sunny			3000
14-1-18	Cash	C		3000	12-1-18	Purchase		5000	
16-1-18	Sales		4000		14-1-18	Bank	C	3000	
22-1-18	Bank	C	3000		21-1-18	Furniture		8000	
25-1-18	Rajan			7000	22-1-18	Cash	C		3000
31-1-18	Cash	C		10000	27-1-18	Rajan			7000
					28-1-18	Charity		2000	
					31-1-18	Bank	C	10000	
					31-1-18	Balance c/d		54000	24000
			83000	42000				83000	42000
1-2-18	Balance b/d		54000	24000					

Note:

1. Closing cash in hand is Rs.55, 000.
2. Closing cash at bank is Rs.24, 000.
3. There is no need to prepare separate Cash A/c and Bank A/c.

Dr. Sales Account Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
				2-1-18	Cash		14000
				16-1-18	Cash		4000

Dr. Vijay Account Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
				4-1-18	Cash		2000

Dr. Rajan Account Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
27-1-8	Bank		7000	25-1-19	Bank		7000

Dr. Petty Cashier Account Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
2-1-18	Cash		1000				

Dr. Salary Account Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
8-1-18	Bank		5000				

Dr. Sunny Account Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
10-1-18	Bank		3000				

Dr. Purchase Account Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
12-1-18	Cash		5000				

Dr. Furniture Account Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
21-1-18	Cash		8000				

Dr. Charity Account Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
28-1-18	Cash		2000				

3. Petty Cash Book

In every organization, a large number of small payments such as cartage, postage, telephone, stationery, bus fare etc. They are generally repetitive in nature. **If all these payments are made by the main cashier and are recorded in the main cash book, the cashier will be overburdened with the work and the cash book will also become very bulky.** To avoid this, it is usual to appoint an employee as 'petty cashier'. He is entrusted with the task of making small payments, say, below 1,000 and records them in a separate book, called petty cash book.

In some organisations, where all cash receipts are paid into bank and all payments are made by cheques, it becomes necessary to keep a separate subsidiary book known as petty cash book. **Petty cash book is used for recording cash payments which are too small to be paid by cheque.**

The petty cash book is maintained by a petty cashier who works under the supervision of the main cashier. The main cashier issues cheques or pay cash to the main cashier in the beginning of the specified period, say a week or month. This amount will be sufficient to meet petty expenses for that period.

Imprest system

Imprest means advance made to a certain person. **Petty cash book is usually maintained under imprest system.** Under imprest system, the petty cashier is given a definite sum of money, say Rs.1,000, at the beginning of a certain period. This amount is called 'imprest amount'. The petty cashier goes on making all small payments out of this imprest amount and when he has spent the substantial portion of the imprest amount, say Rs.800, he gets reimbursement of the amount spent from the main cashier. Thus, he again has the full imprest amount in the beginning of the next period. For instance, Rs.1,000 are advanced to the petty cashier on 1st January. If petty cashier spends Rs.850 by the end of January, he will be again given Rs.850 so that after including Rs.150, the balance amount, he will again restart with the original amount of Rs.1,000 on the 1st day of February. This system of petty cash book is called the imprest system. The reimbursement may be made on a weekly, fortnightly or monthly basis, depending on the frequency of small payments.

Accounting procedure

Petty cash book is prepared just like a simple cash book having the debit and credit sides. Amount received from the main cashier is recorded on the debit side, whereas the payments are recorded on the credit side. On the credit side, a separate column is provided for each class of most common expenses. Number of columns depends upon the nature of the particular business. Those expenses that are not entered in any separate column are entered in a column designated as 'Miscellaneous' Expenses.

When the petty cashier meets expenses, it is first entered in the total column on the payment side and then extended to the appropriate head of the expenditure column. At the end of the period, these analytical columns are added up. The sum total of these analytical columns will be equal to the total payment column. The difference between the receipt column and total payment column will give the petty cash balance. The sum of expenditure paid will be reimbursed by the main cashier to the petty cashier.

Posting the Petty Cash Book

Entries in the Petty Cash Book are posted into the ledger accounts at the end of the specified period. Petty cash book is considered as a memorandum book (A simple 'list of petty expenses' is used as a record so that business knows how much expenses paid as petty expenses).Petty expenses are not directly posted to the ledger accounts.A petty cash account is maintained in the ledger.

When Petty cash is advanced to the petty cashier, the main cashier records it on the credit side of the cash book as “By Petty Cash A/c”.

Journal entry:

1. When (beginning day) cheque or cash issued issued/paid by the main cashier to the petty cashier.

Petty Cash A/c Dr xxxx
To Bank/ Cash xxxx
(Cash paid to petty cashier)

At the end of the specified period (Say a week), for the total expenses paid a journal entry is passed by debiting individual petty expenses and crediting to Petty Cash account.

2. When all petty expenses posted to petty cash account

Expenses (Individually) xxxx
To Petty Cash A/c xxxx

(Petty expenses posted to petty cash account)

All the accounts relating to individual petty expenses are maintained in the ledger individually. Posting is made on the debit side of these accounts by writing “ To Petty Cash A/c” in the particular column.

Thus, in Ledger, there is a Petty Cash A/c as well as separate Ledger Accounts for each expenses.

Illustration:

Mr.John , the petty cashier of Ajmal Traders received Rs.3,000 on 1-4-2019 from the main cashier.For the month,details of petty expenses are listed here under. Prepare an Analytical Petty Cash Book on the Imprest System.

Date	Details	Amount
2-4-19	Auto fare	20
3-4-19	Cartage	20
4-4-19	Courier charges	60
5-4-19	Telephone charges	100
5-4-19	Postage stamp	70
6-4-19	Speed post charges	28
7-4-19	Refreshments	42
7-4-19	Office stationery	20
9-4-19	Auto fare	25
10-4-19	Registered postal charges	40
11-4-19	Bus fare	10
12-4-19	Photo stating charges	18
13-4-19	Auto fare	30
19-4-19	Cartage	27
21-4-19	Telephone charges	30
23-4-19	Courier charges	20
29-4-19	Office stationery	50
30-4-19	Bus fare	18

Books of Ajmal Traders

Petty Cash Book

Amount Received	Date	Particulars	Voucher No.	Amount Paid	Analysis of payments				
					Rs.	Postage	Telephone Charges	Travelling Expenses	Stationery
1000	01	Cash Received							
	02	Auto fare		20			20		
	03	Cartage		20					20
	04	Courier charges		60	60				
	05	Telephone charges		100		100			
	05	Postage Stamp		70	70				
	06	Speed post charges		28	28				
	07	Refreshment		42					42
	07	Office stationery		20				20	
	09	Auto fare		25			25		
	10	Reg. postal charges		40	40				
	11	Bus fare		10			10		
	12	Photo stating charges		18					18
	13	Auto fare		30			30		
	19	Cartage		27					27
	21	Telephone charges		30		30			
	23	Courier charges		20	20				
	29	Office stationery		50				50	
	30	Bus fare		18			18		
				628	218	130	103	70	107
	30	Balance c/d		372					
1000				1000					
372	May 01	Balance b/d							
628	01	Cash received							

Posting from the petty cash book

The petty cash book is balanced periodically. The difference between the total receipts and total payments is the balance with the petty cashier. The balance is carried to the next period and the petty cashier is paid the amount actually spent. A petty cash account is opened in the ledger. Petty cash book is considered as a memorandum book. When Petty cash is advanced to the petty cashier, the chief cashier records it on the creditside of the cash book as ' Petty Cash A/C'.

Journal Entry: When amount is advanced to the petty cashier by the main cashier

Petty Cash A/c Dr.

To Cash A/c

At the end of a specified period, for the total expenses paid a journal entry is passed by debiting individual petty expenses and crediting to Petty Cash A/c. All the accounts relating to petty expenses are maintained by in the ledger individually. Posting is made on the debit side of these accounts by writing " Petty Cash a/c"

Journal Entry: On Submission of Petty Cash A/c by the Petty Cashier.

Expenses A/c Dr.

To Petty Cash A/c

Note-1 Each expens is debited separately with the expenditure incurred during the period as shown by the petty cash book

Note-2 In the ledger, there is Petty Cash A/c as well as separate Ledger Account for each expense.

Books of Ajmal Traders

Journal

Date	Particulars	L.F	Debit (Rs.)	Credit (Rs.)
1-4-19	Petty Cash A/c Dr. To Cash A/c (Cash paid to petty cashier)		1,000	1,000
30-4-19	Postage A/c Dr. Telephone Charges A/c Dr. Travelling Expenses A/c Dr. Stationery A/c Dr. Miscellaneous Expenses A/c Dr. To Petty cash A/c (Petty expenses posted to petty cash account)		218 130 103 70 107	628
01-5-19	Petty Cash A/c Dr. To Cash A/c (Cash paid to petty cashier)		628	628

Books of Ajmal Traders

LEDGER

Dr. Petty Cash Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
1-4-19	Cash A/c		1000	30-4-19	Postage A/c		218
				30-4-19	Telephone Charges A/c		130
				30-4-19	Travelling Expenses A/c		103
				30-4-19	Stationery A/c		70
				30-4-19	Miscellaneous Expenses A/c		107
				30-4-19	Balance c/d		372
			1000				1000
1-5-19							
1-5-19	Balance b/d Cash		372 628				

Dr. Postage Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
30-4-19	Petty Cash A/c		218				

Dr. Telephone Charges Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
30-4-19	Petty Cash A/c		130				

Dr. Travelling Expense Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
30-4-19	Petty Cash A/c		103				

Dr. Stationery Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
30-4-19	Petty Cash A/c		70				

Dr. Miscellaneous Expenses Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
30-4-19	Petty Cash A/c		107				

Advantages of maintaining petty cash book

1. Saving of time and efforts of chief cashier: The chief cashier is not required to deal with petty disbursements. He can concentrate on cash transactions involving large amount of cash.
2. Effective control over cash disbursement: Cash control become easy because of division of work.
3. Easiness in posting: Only the total of each head of expense is posted into the ledger. As such, a lot of space is saved and the posting becomes very convenient.

Purchase Book or Purchase Day Book or Purchase Journal

All credit purchases of goods are recorded in the purchase book. The source documents for recording entries in the books are invoices or bills received by the firm from suppliers of goods. Entries are made with the net amount of invoice. Trade discount and other details of invoice need not be recorded in the book.

Following items are **not recorded** in the purchase day book:

1. Cash purchase of goods.
2. Purchase of assets. Cash purchases of assets are recorded in cash book. Credit purchases of assets are recorded in Journal Proper.

Purchase Day Book

Date	Invoice No.	Name of Supplier (Account to be credited)	L.F	Amount

Difference between Purchase Day Book and Purchase Account

Purchase Book	Purchase Account
Purchase book is a part of Journal	Purchase Account is the part of Ledger
Purchase book records only credit purchase of goods.	Purchase account records cash as well as credit purchase of goods.

Illustration : Consider the following details obtained from Anju Traders and prepare Purchase Day Book.

2019 Jan.1	Purchased from Bijoy Electronics (Invoice No.5588) 10 Miixi @ Rs.2500 per piece, 15 DVD players @ RS 1000 per piece. Trade discount on all items @10%.
Jan.7	Purchased from A Star Electronics (Invoice No. 4250): 10 Heaters @ Rs.350 per piece, 20 CFL bulbs @ Rs. 150 per bulb. Trade discount @ 20% on purchases.
Jan.10	Purchased furniture from Ale Furniture Mart as per invoice No.1216 2 Chairs @ 500 per Chair 3 Tables @ 2000 per Table
Jan.12	Bought from Bijoy Electronics (Invoice No 5599) 10 Colour TV @ Rs.12000 per TV, 10 Table Fans @ Rs.2000 per fan. Trade discount @ 10%.
Jan.17	Purchased from A Star Electronics (Invoice No. 4280): 20 Heaters @ Rs.350 per piece, 20 Tube lights @ Rs. 50 per tube light. Trade discount @ 20% on purchases.

Books of Anju Traders

Purchase Day Book

<i>Date</i>	<i>Invoice No.</i>	<i>Name of Supplier (Account to be credited)</i>	<i>L.F</i>	<i>Amount</i>
2019				
Jan.1	5588	Bijoy Electronics		36,000
Jan.7	4250	A Star Electronics		5,200
Jan.12	5599	Bijoy Electronics		1,26,000
Jan.17	4280	A Star Electronics		6,400
Jan.31				1,73,600

OR

Books of Anju Traders

Purchase Day Book (Traditional Method)

Date	Invoice No.	Name of Supplier (Account to be credited)	L.F	Amount
2019 Jan.1	5588	Bijoy Electronics: 10 Miixi @ Rs.2500 25000 15 DVD players @ RS 1000 <u>15000</u> 40000 Less: Trade discount @10%. <u>4000</u>		36,000
Jan.7	4250	A Star Electronics: 10 Heaters @ Rs.350 3500 20 CFL bulbs @ Rs. 150 <u>3000</u> 6500 Trade discount @ 20% <u>1300</u>		5,200
Jan.12	5599	Bijoy Electronics: 10 Colour TV @ Rs.12000 120000 10 Table Fans @ Rs.2000 <u>20000</u> 140000 Less:Trade discount @ 10%. <u>14000</u>		1,26,000
Jan.17	4280	A Star Electronics: 20 Heaters @ Rs.350 7000 20 Tube lights @ Rs. 50 <u>1000</u> 8000 Less:Trade discount @ 20% <u>1600</u>		6,400
Jan.31		Total		<u>1,73,600</u>

Posting from Purchase Day Book

1. Posting from purchase day book is done daily to their respective accounts with the relevant amounts on the credit side.
2. The total of the purchase day book is periodically posted to the debit of the purchases account normally on the monthly basis.

Books of Anju Traders

Purchase Ledger

Dr. Bijoy Electronics Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
				2019			
				Jan1	Purchase		36,000
				Jan 12	Purchase		1,26,000

Dr. A Star Electronics Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
				2019			
				Jan7	Purchase		5,200
				Jan 17	Purchase		6,400

General Ledger

Dr. Purchase Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
2019	Sundries as per						
Jan 31	Purchase Day						
	Book for January		1,73,600				

Sales Day Book or Sales Journal

All credit sales of goods are recorded in the Sales Day book. The source documents for recording entries in the books are invoices or bills issued by the firm to the customers.

Following items are **not recorded** in the Sales day book:

1. Cash sales of goods.
2. Sales of assets. Cash sales of assets are recorded in cash book. Credit sales of assets are recorded in Journal Proper.

Purchase Day Book

Date	Invoice No.	Name of Customer (Account to be debited)	L.F	Amount

Difference between Sales Day Book and Sales Account

Sales Book	Sales Account
Sales book is a part of Journal	Sales Account is the part of Ledger
Sales book records only credit sales of goods.	Sales account records cash as well as credit sales of goods.

Illustration : Record the following transactions of Anjana Traders un their sales book.

1-1-20 Sold goods on credit to M/s Raja traders (Invoice No.115):

40 shirts @ Rs.400

20 trousers @ Rs.100 each.

8-1-20 Sold goods on credit to M/s Sharan traders (Invoice No.116):

200 shirts @ Rs.400 each

800 trousers @ Rs.100 each

Less: Trade discount @ 10%

10-1-20 Sold goods on credit to M/s Raja traders (Invoice No.117):

100 shirts @ Rs.400 each

400 trousers @ Rs.100 each

Less: Trade discount @ 10%

13-1-20 Sold goods for cash to M/s Sundaram Traders (Invoice No.120)

100 shirts @ Rs.400 each

600 trousers @ Rs.100 each

Less: Trade discount @ 10%

Books of Anjana Traders

Sales day Book

Date	Invoice No.	Name of Customer (Account to be debited)	L.F	Amount
1-1-20	115	Raja traders:		16200
8-1-20	116	Sharan traders:		144000
10-1-20	117	Raja Traders:		72000
		Total		232200

Books of Anjana Traders (Traditional Method)

Sales day Book

Date	Invoice No.	Name of Customer (Account to be debited)	L.F	Amount
1-1-20	115	Raja traders: 40 shirts @ Rs.400 20 trousers @ Rs.100 each. Less Trade Discount 10%		
			16000	
			<u>2000</u>	
			18000	
			<u>1800</u>	16200
8-1-20	116	Sharan traders: 200 shirts @ Rs.400 each 800 trousers @ Rs.100 each Less: Trade discount @ 10%		
			80000	
			<u>80000</u>	
			160000	
			<u>16000</u>	144000
10-1-20	117	Raja Traders: 100 shirts @ Rs.400 each 400 trousers @ Rs.100 each Less: Trade discount @ 10%		
			40000	
			<u>40000</u>	
			80000	
			<u>8000</u>	72000
		Total		232200

Sales Ledger

Dr. Raja Traders Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
1-1-20	Sales		16200				
10-1-20	Sales		72000				

Dr. Sharan Traders Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
8-1-20	Sales		144000				

General Ledger

Dr. Sales Account Cr.

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
				31-1-20	Sundries as per sales book		232200

Important Questions:

- The purchase Day Book contains----- (March 2011)
 - All purchases
 - Credit purchases of goods
 - Cash purchases of goods**Ans:b**
- Which of the following is not a book of original entry? (March-2011)
 - Cash Book
 - Ledger
 - Purchase Book**Ans: Ledger**

Note: Ledger is a book of final entry/secondary entry
- Sales journal records all -----sales of goods. **Ans: Credit** (Marh-2010)
- Fixed asset purchased on credit is recorded in-----journal **Ans: Journal proper**
- Cash Book does not record-----transactions. **Ans: Credit**
- Credit balance shown by a bank column in cash book is..... **Ans: Overdraft**
- Cash purchase goods are recorded in-----book. **Ans: Cash Book**
- Cash discount is recorded in -----subsidiary book. **Ans: Journal proper**
- Double column cash book records transactions relating to.....and..... **Ans: Cash, Bank**
- Total sales made during a particular period can be arrived at from.....
 - Sales Book
 - Sales Account
 - Cash Book
 - None of the above**Ans: Sales Account**
- 'Debit Note' is associated with.....
 - Purchase returns
 - Sales returns
 - Purchases
 - Sales**Ans:a**
- When a firm maintains a cash book, it need not maintain:
 - Journal proper
 - Purchase Book
 - Bank and cash account in ledger**Ans: c**
- Total of these transactions is posted in purchase account:
 - Purchase of furniture
 - Cash and credit purchase of goods
 - Purchases return
 - Only credit sales of goods**Ans:b**

14. When a firm maintains a cash book, it need not maintain.....account in the ledger.

Ans: Cash

15. Which is not a contra entry in the cash book

- a. Cash deposited into bank
- b. Cash withdrawn from bank
- c. Cash withdrawn from bank for personal use
- d. None of these **Ans: c**

16. Which of the following is not recorded in cash book.

17.is the book used to record small cash payments. **Ans: Petty cash book**

- a. Trade discount
- b. Bad Debts
- c. Depreciation
- d. All the above **Ans: d**

18. A cheque received and deposited into bank the same day will be recorded in cash book in

- a. Cash column on debit side
- b. Cash column on credit side
- c. Bank column on debit side
- d. Bank column on credit side **Ans:c**

Match the followings:

1. Question

Answer

A	B	A	B
Purchase Day Book	Debit Note	Purchase Day Book	Invoice
Sales Return Book	Voucher	Sales Return Book	Credit Note
Cash Book	Credit Note	Cash Book	Voucher
Purchase Return Book	Invoice	Purchase Return Book	Debit Note

Match the followings:

2. **Question**

Answer

A	B	A	B
Debit Note	Petty Cash Book	Debit Note	Source Document
Cash Book	Return inwards book	Cash Book	Journal and ledger
Contra Entry	Source Document	Contra Entry	Two sides in cash book
Imprest system	Journal and ledger	Imprest system	Petty Cash Book
Sales Returns Book	Two sides in cash book	Sales Returns Book	Return inwards book

Short answers:

1. What are special purpose books?
2. What is a petty cash book?
3. What do you understand by imprest amount in petty cash book?
4. Briefly state how the cash book is both journal and a ledger?
5. What are the differences between Purchase Day Book and Purchase Account?
6. Define the purpose of maintaining subsidiary journal/Day Books?

Long Answers

1. What is cash Book? Explain the types of cash book.
2. What is contra entry? How can you deal this entry while preparing double column cash book?
3. What is petty cash book? Write the advantages of petty cash book?

Prepared by BINOY GEORGE, HSST, MKNM HSS, Kumaramangalam, Thodupuzha, Idukki Dt.

Chapter-5

Bank Reconciliation Statement [BRS]**Focus Area- Public Examination September-2021****1. Concept of Bank Reconciliation Statement****2. Causes of differences between the cash book and the bank passbook.**

In a business, there are numerous transactions takes place. Most of them are banking transactions. Business man will be recorded these banking transactions in the bank column of the cash book. Banks also records these transactions in their book called passbook. Due to various reasons like timing, errors etc., bank balance as per cash book may not tally with the balance reflected in passbook. Hence, we have to ascertain the causes of such difference. The account holder usually prepares a statement to find out the reason for the difference between cash book and passbook balance, which is called Bank Reconciliation Statement.

Bank Reconciliation Statement (BRS)

It is a statement prepared by the **account holder (customer)** of a bank to reconcile the bank balance as per cash book with the balance as per passbook. This statement will show the reasons for the disagreement between the cash book and passbook. In order to prepare a bank reconciliation statement, we need to have a bank balance as per cash book and pass book on a particular date along with details of both the books. **BRS is not a part of Bookkeeping.** It is a technique to reconcile/ resolve bank balance in Cash Book with balance reflected in Passbook.

Cash Book:

Closing balance of double column cash column reflects cash in hand and bank column reflects cash at bank /bank overdraft. **Debit** balance of Cash Book means **deposit/favorable** balance and credit balance means Overdraft

At the time of preparation of Bank Reconciliation Statement, we consider only **Bank column** of the double cash book.

Pass book:

Bank also records transactions and maintains accounts of every customers. Passbook is a copy of customer's account as it appears in the ledger of the bank It will be observed that a bank statement/passbook shows all deposits in the credit column and withdrawals in the debit column. Thus, if deposits exceed withdrawals it shows a credit balance and if withdrawals exceed deposits it will show a debit balance (overdraft). **Credit** balance of Passbook means **deposit/favorable** balance and debit balance in passbook means Overdraft.

Bank Overdraft:

Bank overdraft is the overdraft facility provided by the banks under which customers can withdraw money more than their account balance. Credit balance in cash book /Debit balance in passbook means 'Bank overdraft'.

Need and importance of preparing Bank Reconciliation Statement

BRS is prepared because of the following reasons:

1. BRS helps to ascertain the causes of difference between pass book and cash book.
2. It brings out errors if any, committed either in the Cash book or in the pass book.
3. Unnecessary delay in the clearance of cheques deposited is known from the reconciliation.
4. Reconciliation helps in verifying the accuracy of entries recorded in the cash book.
5. Regular reconciliation discourages embezzlements (fraudulent behavior).
6. It shows actual bank balance.

Causes of the difference between balance as per passbook and balance as per cash book

We can classify the reasons for the difference into two categories:

- I. **Difference Due to Timing:** There is always a time gap between recording a transaction in the Cash book and it being recorded by the bank. For example a cheque issued to a creditor is immediately recorded in the cash book but bank may record it only on a later date when it actually presented for payment. Thus ,there is always a time gap in recording entries in the two books, i e., cash book and pass book. If BRS is prepared in between the two dates, differences will exist.
- II. **Difference due toErrors:** Errors may be committed by the account holder or bank and these errors result in difference in the balances of cash book and pass book. For example, wrong balance may be carried forward, a transaction may not have been in the cash book or amount of a transaction may have been wrongly recorded in an account.

Causes of differences between the cash book and the bank passbook**I. Difference Due to Timing (Timing difference)**

- 1) *Cheque issued but not yet presented for payment:*
- 2) *Cheque paid(deposited) into the bank but not yet collected.*
- 3) *Interest credited (interest on investment/allowed) by bank recorded only in passbook.*
- 4) *Interest and dividend collected by bank:*
- 5) *Payments made by bank on behalf of the account holder.*
- 6) *A customer directly deposited into our bank account.*
- 7) *Dishonor of a Bill Discounted with the Bank*

II. Difference due to Errors

- 1) *Errors committed in recording transaction by the firm.*
- 2) *Errors committed in recording transaction by the bank.*

I. Difference Due to Timing (Timing difference)

1) **Cheque issued but not yet presented for payment:**

When a trader issued cheques to his creditors, he immediately recorded it in the credit side of the cash book, but the bank will record the same in pass book only when it is actually presented for payment. If we compare the cash book with passbook between these two days there will be a difference between the two.

2) **Cheques deposited into bank but not yet collected:**

Cheque deposited into bank for collection immediately recorded in the receipt/debit side of the cash book. It will increase the deposit balance of cash book. But bank credit the account holders account only after realization of the cheque. If we compare the cash book with passbook between these two days there will be a difference between the two.

3) **Interest credited (interest on investment/allowed) by bank recorded only in pass book.**

Interest on deposit will be credited by bank on time. It will increase the deposit balance of passbook. But the account holder will record the transaction in cash book only after receiving the notification. Till that time, the balance as per pass book would be higher than the balance as per Cash Book.

4) **Interest charged (interest on loan) and bank charges recorded only in pass book**

Bank debits the account holder's account in its book with the amount of interest on overdraft or Bank Charges. But account holder will record it in the credit side of the cash book only after receiving the notification. If we compare the cash book with passbook between these two days, balance as per passbook would be lower than the balance as per Cash Book.

5) **Interest and dividend collected by bank:**

Sometimes bank collects interest and dividend on behalf of the account holders and credit them to the account holders account. But account holder will record it in the debit side of the cash book only after receiving the notification. If we compare the cash book with passbook between these two days, balance as per pass book would be higher than the balance as per Cash Book.

6) **Payments made by bank on behalf of the account holder**

The bank might have made some payments like insurance premium, telephone bill etc. on behalf of the customer as per the standing instruction of the account holder and debited the customer's

account. When the bank makes the payment, it will debits the customer's account. But account holder will record it in the credit side of the cash book only after receiving the notification. If we compare the cash book with passbook between these two days, balance as per pass book would be lower than the balance as per Cash Book.

7) A customer directly deposited into our bank account

If payment is received by the bank directly, it will record (credit) it in the account holder's account. But the account holder will record the transaction in cash book only after receiving the notification. If we compare the cash book with passbook between these two days, the balance as per pass book would be higher than the balance as per Cash Book.

8) Dishonor of a Bill Discounted with the Bank

To meet the working capital requirements, the businessman usually discounts the bills of exchange with his bank. If on the date of maturity, such a bill is dishonored, the bank will debit the customer's account immediately. But the customer will make this entry in his book only after getting the notification from his bank. If we compare the cash book with passbook between these two days, balance as per pass book would be lower than the balance as per Cash Book.

II. Difference due to Errors

1) Errors committed in recording transaction by the firm.

Omission or wrong recording of transactions relating to cheques issued, cheques deposited and wrong totaling etc., committed by the firm while recording entries in the cash book cause difference between cash book and passbook balance.

2) Errors committed in recording transaction by the bank.

Omission or wrong recording of transactions relating to cheques deposited and wrong totaling etc., committed by the bank while posting entries in the passbook cause difference between passbook and cash book balance.

Important points

1. Date: Bank Reconciliation Statement is prepared on a **particular date**.
2. Bank reconciliation statement is prepared by the **customer** of a bank.
3. Debit balance of Cash Book means deposit/favorable balance and credit balance in cash book means Overdraft.
4. Credit balance of Passbook means deposit/favorable balance and debit balance in passbook means Overdraft.

QUESTIONS

Fill in the blanks :

- (i) Passbook is a copy of.....as it appears in the ledger of the bank. [Customer's Account]
- (ii) When money is with drawn from the bank, the bank the account of

the customer. [Credit] Hint: Credit balance of Passbook means deposit

(iii) Normally, the cash book shows a debit balance, passbook showsbalance. [Credit]

(iv) Favourable balance as per the cash book meansbalance in the bank column of the cash book. [Debit]

Select the Correct Answer:

1. A bank reconciliation statement is prepared by:

- (a) Creditors (b) Bank
- (c) Account holder in a bank (d) Debtors **Ans: C**

2. A bank reconciliation statement is prepared with the balance:

- (a) Passbook (b) Cash book
- (c) Both passbook and cash book (d) None of these **Ans: C**

3. Passbook is a copy of:

- (a) Copy of customer Account (b) Bank column of cash book
- (c) Cash column of cash book (d) Copy of receipts and payments **Ans: A**

4. Unfavorable bank balance means:

- (a) Credit balance in passbook (b) Credit balance in cash book
- (c) Debit balance in cash book (d) None of these **Ans: B**

5. Favourable bank balance means:

- (a) Credit balance in the cash book (b) Credit balance in passbook **Ans: B**
- (c) Debit balance in the cash book (d) Both (b) and (c)

6. A bank reconciliation statement is mainly prepared for:

- (a) Reconcile the cash balance of the cash book.
- (b) Reconcile the difference between the bank balance shown by the cash book and bank passbook
- (c) Both (a) and (b)
- (d) None of these **Ans: B**

7.-----balance in cash book means bank overdraft.

- a. Debit b. Credit c. Both debit and credit **Ans: Credit**

8. Bank charge is an -----to the customer.
(a.Expense b.Income c.Asset) **Ans: Expense**
9. Credit balance in the passbook means a/an-----to the account holder.
(a. Asset b. Liability c. Capital d. Expense e. Income) **Ans: Asset**
10. Bank reconciliation statement is prepared
- to know the payment made through cheques
 - to know the errors in the passbook
 - to compare the cash book with passbook and ascertain the differences
 - None of the above **Ans: C**

Q.Read the following transactions and identify the cause of difference on the basis of time gap or errors made by business firm/bank. Put a sign(X) for the correct cause.

Si.No	Transactions	Time Gap	Errors made by business/bank
1.	Cheque deposited but not cleared	X	
2.	Cheque issued but omitted to record it in the cash book		X
3.	Cheque issued but not presented for payment	X	
4.	Interest and dividend credited in the passbook only	X	
5.	Cheque amounting to Rs.15,000 issued to Sasidharan but recorded as Rs.5,000 in the cash book		X
6.	Direct payment by a customer to the bank	X	
7.	Bank charges seen only in passbook	X	

Short Answers Type Questions

- State the causes of difference occurred due to time lag.
- What is a bank overdraft?
- Briefly explain the 'favourable balance' as per cash book.
- State the need for the preparation of bank reconciliation statement (BRS)?
- Explain any two reasons on account of which the balance as shown by the pass book does not agree with the balance as shown by the bank column of the Cash Book?

Short Answers Type Questions

- What is a bank reconciliation statement? Why is it prepared?
- What are the various reasons for the difference between balance as per cash book and passbook?

Bank Reconciliation Statement(BRS) with Deposit Balance

Bank Reconciliation Statement As on-----

Particulars	(+)Amount	(-)Amount
Debit (Favourable) balance as per Cash Book	XXXX	
Cheque issued but not presented for payment	XXXX	
Interest credited by bank but not recorded in cash book	XXXX	
Direct deposit into bank account not recorded in the cash book	XXXX	
Dividend collected by bank recorded only in pass book	XXXX	
Cheque deposited but not yet collected and credited by bank		XXXX
Bank charges, interest on overdraft debited in the pass book not recorded in cash book		XXXX
Discounted bill recorded only in pass book		XXXX
Balance as per Pass Book	?	?
	XXXX	XXXX

prepared by- BINOY GEORGE, HSST,MKNNM HSS, Kumaramangalam, Thodupuzha, Idukki Dt.

Chapter-6**Trial Balance and Rectification of Errors****Focus Area-Public Examination September 2021****1. Meaning of Trial Balance****2. Objectives of preparing Trial Balance****3. Preparation of Trial Balance- Balance Method**

According to dual aspect concept every business transaction has two aspects, one aspect/account is to be debited and another aspect/ account is to be credited. Dual aspect concept assures that the sum of all debits equals the sum of all credits. The Trial Balance is a tool for verifying the correctness of debit and credit amounts. It is an arithmetical check under the double entry system which verifies that both aspects of every transaction have been recorded accurately. This chapter explains the meaning and process of preparation of trial balance and the types of errors and their rectification.

Trial Balance

Trial Balance is a statement showing balances or total of debit and credit of all the accounts prepared under double entry system. Its main purpose is to test the arithmetical accuracy of the ledger accounts. It also help to locating errors and act as a base for the preparation of financial

statements. It is normally prepared at the end of an accounting year. However, an organisation can prepare a trial balance at any time, which may be monthly, quarterly, half yearly or annually depending upon its requirements. Trial balance is not a part of double entry system. Its preparation is not compulsory, it is optional.

Format of a Trial Balance (Balance Method)

Trial Balance As on-----

Name of Accounts	L.F.	Debit	Credit
Total			

Objectives of Preparing Trial Balance

- 1) **To ascertain the arithmetical accuracy of the ledger accounts:** The trial balance provides a useful check upon the ledger posting. If a trial balance tallies, it is assumed that the posting to ledger account is correct.
- 2) **To help in locating errors:** If a Trial Balance does not tally, it indicates that some errors have occurred.
- 3) **To help in the preparation of final accounts:** For preparing final account, ledger account balances are essential. A trial balance provides all ledger account balances.

Methods of preparing Trial Balance

There are mainly two methods of preparing Trial Balance:

1. Balance Method
2. Total Method
3. Total-cum-balances Method

1. Balance Method: This is the **most widely used** method of preparing trial Balance. Under this method **trial balance is prepared by showing the balances of all ledger accounts**. The balance amount of accounts with debit balance will be recorded in the debit amount column of the Trial Balance and the balance amount of accounts with credit balance will be recorded in the credit amount column of the Trial Balance. The total of both the debit and credit columns must be equal.

2. Total Method: Under this method the **total of each side in the ledger (debit and credit) is ascertained separately and shown in the trial balance in the respective (Debit/ credit) columns**. The total of the debit and credit columns must be equal. This method is not widely used in practice as it does not help in assuming accuracy of balances of various accounts and preparation of financial statements.

3. Total-cum-balances 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 debits and credit totals of various accounts and two columns for writing the debit and credit balances of these accounts.

Trial Balance (Balance Method)

Name of Accounts	L.F.	Debit	Credit
Capital			XXXX
Bank Loans			XXXX
Overdraft			XXXX
Bills Payable			XXXX
Creditors			XXXX
Advance from Customers			XXXX
Commission /Discount/Interest /Rent Received			XXXX XXXX
Sales			
Sales return		XXXX	
Purchase		XXXX	
Purchase Return			XXXX
Interest/ Rent/ Discount/ Commission Paid		XXXX	
Depreciation		XXXX	
Bad debts		XXXX	
Advertisement		XXXX	
Cash in hand		XXXX	
Cash at bank		XXXX	
Debtors		XXXX	
Bills Receivable		XXXX	
Stock		XXXX	
Land		XXXX	
Building		XXXX	
Furniture		XXXX	
Equipment		XXXX	
Fixtures and Fittings		XXXX	
Drawings		XXXX	
Outstanding expense			XXXX
Income received in advance			XXXX
Prepaid Expenses		XXXX	
Accrued Income		XXXX	
Total		XXXX	XXXX

Steps in Preparing Trial Balance

In order to prepare a trial balance following steps are taken:

- 1. Ascertain the balances of each account in the ledger.**
- 2. The balance of each account should be placed in the debit or credit column of the Trial Balance, as the case may be.** (If an account has a zero balance, it may be included in the trial balance with zero in the column for its normal balance).
- 3. Compute the total of debit and credit balances columns of the Trial Balance.**
- 4. Verify that the sum of the debit balances equals the sum of credit balances.** If they do not tally, it indicates that there are some errors.
- 5. Creating suspense account. (if necessary)** If there is any difference in trial Balance and it can't be rectified before the preparation of financial statement, the difference is placed in a temporary account called **suspense** account.

Accounts can be classified into 5, i.e., assets, liabilities, capital, expenditure, income. Nature of the above said assets:-

Asset and Expenses- DEBIT Balances

Liabilities, Capital and Income – CREDIT Balance

Illustration

John started business on 1-1-2020 with a capital of Rs.2,00,000. His transaction for the month of January were as follows:

2020 Jan-1 Opened a current account with SBI Rs.30,000

Jan-3 Purchased Machinery from A Ltd and paid by cheque Rs.10,000

Jan-4 Purchased goods for cash Rs.15,000

Jan-7 Purchased goods from B Ltd Rs.8,000

Jan-8 Sold goods for cash Rs.1,000

Jan-9 Sold goods to Bimal Rs.500

Jan-10 Paid salary Rs.5,000

Jan-11 Received commission Rs.2,000

Jan-14 Purchased goods from Krishnan Rs. 6,000

Jan-15 Paid salary Rs.1,000

Jan-17 Purchased machinery from JK Furnitures Rs.10,000

Jan-18 Purchased goods from B Ltd Rs.5,000

Pass journal entries, prepare ledger accounts and also prepare Trail Balance under-Balance Method

Ans:

Journal

Date	Particulars	L.F	Debit (Rs.)	Credit (Rs.)
1-1-20	Cash A/c Dr. To Capital A/c (Started business with cash)		2,00,000	2,00,000
1-1-20	Bank A/c Dr To Cash (Deposited into bank)		30,000	30,000
3-1-20	Machinery A/c Dr To Bank (Machinery purchased and paid by cheque)		10,000	10,000
4-1-20	Purchase A/c Dr To Cash (Purchase goods for cash)		15,000	15,000
7-1-20	Purchase A/c Dr To B Ltd (Purchased goods from B Ltd)		8,000	8,000
8-1-20	Cash A/c Dr To Sales (sold goods for cash)		1,000	1,000
9-1-20	Bimal A/c Dr To Sales (Sold goods to Bimal)		5,00	5,00
10-1-20	Salary A/c Dr. To Cash (Salary paid)		5,000	5,000
11-1-20	Cash A/c Dr To Commission (Commission received)		2,000	2,000
14-1-20	Purchase A/c Dr To Krishna (Purchased goods from Krishna)		6,000	6,000
15-1-20	Salary A/c Dr To Cash (Salary paid)		1,000	1,000
17-1-20	Machinery A/c Dr To Jk Furnitures (Machinery purchased on credit)		10,000	10,000

18-1-20	Purchased A/c Dr To B Ltd (Purchased goods from B Ltd)		5,000		5,000
---------	--	--	-------	--	-------

LedgerDr. **Cash A/c** Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
1-1-20	To Capital		2,00,000	1-1-20	By Bank		30,000
8-1-20	To Sales		1,000	04-1-20	By Purchase		15,000
11-1-20	To commissiom		2,000	10-1-20	By Salary		5,000
				15-1-20	By Salary		1,000
				18-1-20	By Balance c/d		1,52,000
			2,03,000				2,03,000

Dr. **Bank A/c** Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
1-1-20	To Cash		30,000	3-1-20	By Machinery		10,000
				18-1-20	By balance c/d		20,000
			30,000				30,000

Dr **Capital A/c** Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
18-1-20	To Balance c/d		2,00,000	1-1-20	By Cash		2,00,000
			2,00,000				2,00,000

Dr. **Machinery A/c** Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
3-1-20	To Bank		10,000	18-1-	By Balance c/d		20,000
17-1-20	To JK Furnitures		10,000	20			
			20,000				20,000

Purchase Account

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
4-1-20	To Cash		15,000				
7-1-20	To B Ltd		8,000				
14-1-20	To Krshna		6,000				
18-1-20	To B ltd		5,000				
			34,000				

Dr. **Sales Account** Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
				8-1-20	By Cash		1,000
				9-1-20	By Bimal		5,00
							1,500

Dr. **Bimal A/c** Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
9-1-20	To Sales		500	18-1-20	By balance c/d		5,00
			5,00				5,00

Dr. **Salary Account** Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
10-1-20	To Cash		5000				
15-1-20	To Cash		1,000				
			6,000				

Dr. **Commission A/c** Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
				11-1-20	By Cash		2000
							2,000

Dr. **Krishnan A/c** Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
18-1-20	To Balance c/d		6,000	14-1-20	By Purchase		6,000
			6,000				6,000

Dr. **JK Ltd A/c** Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
18-1-20	To Balance c/d		10,000	14-1-20	By Machinery		10,000
			10,000				10,000

Dr.

B Ltd A/c

Cr.

Date	Receipts	J.F	Amount	Date	Payments	J.F	Amount
18-1-20	To Balance c/d		13,000	7-1-20	By Purchase		8,000
				18-1-20	By Purchase		5,000
			13,000				13,000
					By Balance bid		13,000

1. Trial Balance As on 18-01-2020 (Balance Method)

Name of Accounts	L.F.	Debit	Credit
Cash		1,52,000	
Bank		20,000	
Capital			2,00,000
Machinery		20,000	
Purchase		34,000	
Sales			1,500
Sundry Debtors		5,00	
Sundry Creditors			29,000
Salary		6,000	
Commission			2,000
Total		2,32,500	2,32,500

Sundry Creditors:

B Ltd- 13,000

Krishnan- 6,000

JK Furniture- 10,000

Total-**29,000**

Sundry Debtors:

Bimal- **500**

Significance of Agreement of Trial Balance

It is important for an accountant that the trial balance should tally. **Normally a tallied trial balance means that both the debit and the credit entries have been made correctly for each transaction but it is not an absolute proof of accuracy of accounting records.** There

can be errors, which affect the equality of debits and credits, and there can be errors, which do not affect the equality of debits and credits.

Important Questions:

1. Trial Balance is a.....
 - a) An account
 - b) A statement
 - c) Day book
 - d) Journal **Ans: b**
2. Which of the following statement is wrong regarding trial balance:
 - a) It is not an account
 - b) It is prepared to check the arithmetical accuracy
 - c) Trial balance is a part of double entry system
 - d) All of these **Ans: c**
3. Trial Balance is a list of the balances of
 - a) Only personal and real accounts
 - b) Only real and nominal accounts
 - c) Only nominal accounts
 - d) All accounts **Ans: d**
4. Trial balance is prepared according.....method.
 - a. Total method
 - b. Balance method
 - c. Balance cum total method
 - d. All the above **Ans: d**
5. Asset account showsbalance.
 - a) Debit
 - b) Credit
 - c) Debit or credit
 - d) All the above **Ans: a**
6. Preparation of trial balance is.....
 - e. Optional
 - f. Compulsory
 - g. As per Government decision **Ans: Optional**

Short Answer Type:

1. Trial Balance is not an account. Is it correct? Give reason?

Trial Balance is not an account. It is a statement which shows the names and balances of all accounts in the ledger and cash book of an organization at any given date.

2. Trial balance facilitates the preparation of final accounts (Trading profit and loss A/c and Balance Sheet). Is it correct? Give reason.

Yes. Trial Balance facilitates the preparation of Final Account of an enterprise by making available the balances of all the accounts at one place.

3. Give two features of Trial Balance?

- It can be prepared at any time
- It is a list of balances of all Ledger accounts and Cash Book

4. Give three objectives of preparing Trial Balance?

- To help in locating errors
- To facilitate the preparation of final accounts
- To check the arithmetical accuracy of the ledger accounts

5. What is a Trial Balance? What are the different columns of a Trial Balance?

Trial Balance is a statement showing balances or total of debit and credit of all the accounts prepared under double entry system. Its main purpose is to test the arithmetical accuracy of the ledger accounts. It also help to locating errors and act as a base for the preparation of financial statements. Its preparation is not compulsory, it is optional.

The Trial Balance has 4 columns.

First column is 'Name of Account' column: This column contains the list of all ledger accounts.

Second column is Ledger Folio column: This column contains the page number of different ledger accounts in the ledger.

Debit Column: If the Trial Balance is prepared by Balance Method, then the debit balance of account is written here.

Credit Column: If the Trial Balance is prepared by Balance Method, then the credit balance of account is written here.

6. Prepare a Trial Balance from the following information:

Name of the Account	Balance	Name of the Account	Balance
Stock	70,000	Capital	2,00,000
Debtors	3,00,000	Cash	1,70,000
Bank Loan	1,50,000	Creditors	90,000
Purchases	2,00,000	Sales	3,00,000
Commission Received	10,000	Salaries	10,000

Ans:

Trial Balance As on.....

Name of the accounts	L.F	Debit (Rs.)	Credit(Rs.)
Stock		70,000	
Debtors		3,00,000	
Bank Loan			1,50,000
Purchases		2,00,000	
Commission Received			10,000
Capital			2,00,000
Cash		1,70,000	
Creditors			90,000
Sales			3,00,000
Salaries		10,000	
		7,50,000	7,50,000

7. John started business on 1-1-2020 with a capital of Rs.2,00,000. His transaction for the month of January were as follows:

2020 Jan-1 Opened a current account with SBI Rs.30,000

Jan-3 Purchased Machinery from A Ltd and paid by cheque Rs.10,000

Jan-4 Purchased goods for cash Rs.15,000

Jan-7 Purchased goods from B Ltd Rs.8,000

Jan-8 Sold goods for cash Rs.1,000

Jan-9 Sold goods to Bimal Rs.500

Jan-10 Paid salary Rs.5,000

Jan-11 Received commission Rs.2,000

Jan-14 Purchased goods from Krishnan Rs. 6,000

Jan-15 Paid salary Rs.1,000

Jan-17 Purchased machinery from JK Furnitures Rs.10,000

Jan-18 Purchased goods from B Ltd Rs.5,000

Pass journal entries, prepare ledger accounts and also prepare Trail Balance under- Balance Method

Prepared by BINOY GEORGE, HSST, MKNM HSS, Kumaramangalam, Thodupuzha, Idukki Dt.

Chapter-9

Financial Statements-I

Public Examination, September-2021 Focus Area

Chapter-9 Financial Statements-I

1. Trading & Profit and Loss Account

1.1 Relevant items in Trading and Profit and Loss Account

1.2 Concept of Gross Profit and Net Profit

2. Balance Sheet

3. Preparation of Trading and Profit and Loss Account and Loss Sheet (Simple Problems)

Financial statement is the backbone of the whole accounting process. All business firms like to know the performance of its business operations in terms of profit or loss. It also likes to know the values of its assets and liabilities on the closing date of the accounting period. Financial statements are divided in two parts, i.e., Income Statements and Position Statements. The income statement is traditionally known as Trading and Profit and Loss account and position statement is known as Balance sheet. These statements are also known as Final accounts.

Final Accounts of a Sole Trader

Final accounts of a sole trader include **Trading A/c, Profit and Loss A/c** and a statement called **Balance Sheet**. The object of preparing a Trading and Profit and Loss A/c is to ascertain the true and fair view of the financial performance (profit or loss) of a business during a particular period, The object of preparing Balance Sheet is to present the true and fair view of the financial position on a particular date. The above two accounts and the statement is collectively called Financial Statements or Final Accounts of a business.

1.Trading Account

Trading account is a nominal account in nature. The object of preparing a trading account is to ascertain the Gross Profit earned or Gross Loss incurred as a result of the trading activities (buying and selling or production and selling) of a business. In trading account, two items are compared, i.e., sales (direct income) and cost of goods sold. If sale is more than cost of goods sold, there is a gross profit. Otherwise, a gross loss. Whatever it be the balance, which is transferred to profit and loss account. Trading account is debited with Opening Stock, Net Purchase and Direct Expenses other than purchase. It is credited with Sales (direct income) and Closing Stock.

Format of trading Account

Dr. **Trading Account for the Year Ended.....** Cr.

Particulars	Amount	Particulars	Amount
To Opening Stock	XXXX	By Sales	XXXX
To Purchase XXXX		Less: S. Return	XXXX
Less: Purchase Returns XXX	XXXX		XXXX
Direct Expenses:	XXXX	By Closing Stock	XXXX
To Wages	XXXX		
To Carriage/Carriage inwards	XXXX		
To Cartage	XXXX	[By Profit and Loss A/c	(xxxxx)
To Freight	XXXX	(Gross Loss c/d)]	
To Factory rent,power	XXXX		
To Fuel,gas,water	XXXX		
To Octroi	XXXX		
To Import duty	XXXX		
To Excise duty	XXXX		
To Royalty (on production)	XXXX		
To Dock dues	XXXX		
To Customs duty	XXXX		
To Primary packing materials	XXXX		
To Manufacturing Expenses	XXXX		
To Factory Expenses	XXXX		
To Profit and Loss A/c	XXXX		
(Gross profit c/d)			
	XXXXX		XXXXX
		By Gross profit b/d	XXXX

Gross Profit

Trading account is prepared to determine the gross profit earned or gross loss incurred in the accounting period. In trading account gross profit is calculating by comparing the revenue from 'sale of goods' with the 'cost of goods sold'. Gross profit represents the profit remaining after the production costs have been subtracted from revenue. Gross profit helps investors to determine how much profit a business earns from the purchase/ production and sale of its goods and services. Gross profit is sometimes referred to as gross income.

Gross Profit = Net Sales- Cost of Goods Sold

Gross Loss = Cost of goods sold – Net Sales

Cost of goods sold = Opening stock + Net Purchase + Direct expenses – Closing stock

Cost of goods sold (COGS): Cost of goods sold (COGS) is the cost of acquiring or manufacturing the products that a company sells during a period. It refers to direct expenses incurred up to the sale. Cost of goods sold is also referred to as "cost of sales."

For example, the COGS for a car manufacture would include the **material costs** for the parts that go into making the car plus the **labor costs** used to put the car together. The cost of sending the cars to dealerships and the cost of the labor used to sell the car would be excluded. It excludes indirect expenses, such as distribution costs and sales force costs.

Gross Profit = Net Sales- Cost of Goods Sold **[20=100-80]**

Therefore:

Cost of goods Sold = Net Sales – Gross Profit **[80= 100-20]**

Net Sales = Cost of Goods sold +Gross Profit **[100= 80+20]**

OR

Gross Loss = cost of goods sold – Sales **[30 = 230-200]**

Therefore:

Cost of Goods sold = Sales + Gross Loss **[230 = 200+30]**

Sales =Cost of Goods Sold – Gross Loss **[200 = 230-30]**

Explanation of Debit side of the Trading Account

1. Opening stock.

Stock means unsold goods. Unsold goods in the beginning of the accounting year is called opening stock. It may also be termed as '**Stock at the beginning**'. Previous year's closing stock is the opening stock of current year and current year's closing stock is the opening stock of the next year and so

on. In two circumstances there is no opening stock in the trial balance. One is the business is a newly started one and secondly when the purchase is adjusted.

Classification of opening stock

In case of trading concern opening stock does not have any classifications. In case of manufacturing concern, opening stock may be stock of raw materials, stock of work in progress or stock of finished goods.

2. Purchases.

Purchases includes all cash and credit purchases of goods. When there is purchase returns, it should be deducted from gross purchases and the net purchase is taken in the trading account. If the purchase includes purchases other than goods, it should be excluded from purchase.

- It also includes purchase of raw materials, semi-finished goods and finished goods.
- It does not include purchase of assets.

3. Direct Expenses.

All expenses incurred for purchasing/acquiring or manufacturing goods are called direct expenses. It is the cost incurred up to the saleable condition of a product.

Examples of direct expenses are: wages, productive wages, wages and salaries, carriage in ward (carriage on purchase/carriage), cartage, customs duty, clearing charges, octroi, import duty, coal, gas and water, power, royalty on production, all factory expenses, freight, dock charges, primary packing materials consumed, consumable stores, manufacturing expenses etc.

Description of some direct expenses:

a. Wages: Remuneration for workers in the factory.

b. Carriage Inwards/ carriage/carriage on purchase: The amount of transportation cost spent by the purchaser of the goods is termed as Carriage Inwards. It is also known as freight-in or transportation-in.

c. Consumable stores: It includes cotton waste, lubricating oil, grease etc. are used in the production process.

d. Royalty/Royalty based on production: Royalty is somewhat rent. It is the sum paid to a patentee for the use of a patent or to an author or composer for each copy of a book sold or for each public performance of a work. Royalty may be of two types based on production based on sale. Based on production is a direct expense. Royalty based on sales is an indirect expense.

e. Primary packing materials: It is the primary package necessary to make the goods in saleable condition. Example tube in case of toothpaste, container in case of coconut oil.

4. Closing stock.

Stock means unsold goods. Unsold goods at the end of the accounting year is called closing stock. Previous year's closing stock is the opening stock of current year and current year's closing stock is the opening stock of the next year and so on. According to conservatism concept closing stock is valued at cost price or market value whichever is less. (If closing stock is Rs.50,000 but its market value is Rs.45,000, closing stock will be taken at Rs.45,000)

5.Sales

Sales includes all cash and credit sales of goods. Sales mean sale of goods only. It includes cash sales and credit sales. When there is sales return, it should be deducted from gross sales and the net sales is taken in the trading account. If the sales include sales other than goods, it should be excluded from sales.

Journal Entries for preparing Trading account [Closing entries]

While preparing a Trading account, it should be kept in mind that closing entries are passed in the journal Proper. Closing entries are passed at the end of the accounting year to close and transfer nominal account (temporary account) balances to Trading and Profit and Loss account. Generally closing entries are compound journal entries.

Trading Account Debit Side:

1. Closing entry for opening stock:

Trading A/c Dr. xxxx
To Opening Stock xxxx

(Being transfer of opening stock to trading account)

2. Closing entry for purchase account

Trading A/c Dr. xxxxx
To Purchase A/c xxxxx

(Purchase account is closed by transfer it to trading account)

3. Closing entry for Sales return.

Sales A/c Dr. xxxx
To Sale Return A/c xxxx

(Sales return account is closed by transfer it to sales account)

Note: Usually sales return is deducted from the sales and net sales is shown in the trading account.

4. Closing entries for individual direct expenses like wages, carriage inwards, manufacturing exp etc.

Trading A/c Dr. xxxx
To Individual Direct Expenses xxxx

(Example-Wages, carriage inwards, fuel etc.)

(Direct expenses account closed by transfer it to the debit side of the Trading account)

The above 4 entries can be summarized as (Compound journal entry) :

Trading A/c Dr. xxxx
To Opening stock xxxxx
To Purchase xxxxx
To Wages xxxxx
To Carriage inwards xxxxx
To Manufacturing expense xxxxx

Trading Account Credit side:

5. Closing Entry for Sales Account

Sales A/c Dr. xxx
 To Trading A/c xxxxx

(Being sales account is closed by transfer it to trading account)

6. Closing entry for purchase return

Purchase Return A/c Dr. xxxxx
 To Purchase A/c xxxxx

(Purchase return account is closed by transfer it to purchase A/c)

Note: Usually purchase return is deducted from the purchase and net purchase is shown in the trading account.

7. Journal entry to bring closing stock into the books of accounts

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

(Being closing stock brought into the books)

The above credit side entries can be summarized (Compound journal entry) as :

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

8. Journal entry to transfer gross profit/ gross loss

The trading account is prepared in 'T' shape. The difference of the two sides of this account is gross profit or gross loss. If the total of the credit side of the trading account is more than the debit side, the difference is gross profit. If the total of the debit side is more than the total of the credit side, the difference is gross loss. The amount of gross profit or gross loss is transferred to the profit and loss account.

9. For transfer of gross profit

Trading A/c Dr. xxxxx
 To Profit and Loss A/c xxxxx

(Being transfer of gross profit to profit and loss account)

10. For transfer of gross loss (if any)

Profit and Loss A/c Dr. xxxxx
 To Trading A/c xxxxx

(Being transfer of gross loss to profit and loss account)

Profit and loss account

Profit and Loss Account is a nominal account prepared after preparing the trading account. It is prepared to determine net profit earned or net loss incurred by the business concern during an accounting period. Profit and Loss account starts with Gross Profit/Gross loss. All indirect expenses are transferred to the debit side of the profit and loss account. All revenues/gains other than sales are transferred to the credit side of the profit and loss account. The difference of the two sides of this account is net profit or net loss. If the total of the credit side of the profit and loss account is more than the debit side, the difference is net profit. If the total of the debit side is more than the total of the credit side, the difference is net loss. The amount of net profit or net loss is transferred to the capital account. Net profit increases the capital and net loss decrease it.

Indirect Expenses:

Indirect expenses are those expenses which are not directly associated with the manufacturing or purchase of goods. They include administrative, selling and distribution expenses such as salaries, taxes, postage, printing and stationery, advertising, insurance, bad debts etc.

Indirect Incomes:

Indirect incomes are those incomes which are not directly associated with sale of goods such as interest received, dividend received, profit on sale of fixed assets etc.

Features of profit and loss account:

- It is a **nominal** account.
- It starts with gross profit or gross loss brought forward from trading account.
- It is debited with gross Loss (if any) and indirect expenses.
- It is credited with Gross Profit and indirect income (revenues/gains other than sale).
- Balance of this account is Net profit or net loss.

Purpose of preparing Profit and Loss account

- Main purpose of preparing profit and loss account is to ascertain net profit earned or net loss incurred by the business during the accounting period.
- Profit determined by the profit and loss account for the accounting period can be compared with that of the previous year's profit.
- Indirect expenses are shown in the profit and loss account. These can be compared over the period.
- A Balance Sheet can be prepared only after ascertaining net profit/loss through the preparation of profit and loss account.

Format of Profit and Loss account

Dr. **Profit and Loss Account for the Year ended.....** Cr.

Particulars	Amount	Particulars	Amount
<i>[To Gross Loss b/d]</i>	XXX	By Gross Profit b/d	XXX
To Carriage Outwards	XXX	By Rent received	XXX
To Salaries	XXX	By Discount Received	XXX
To Rent	XXX	By Commission received	XXX
To Printing and Stationery	XXX	By Interest received	XXX
To Postage	XXX	By Bad debts recovered	XXX
To Telephone charges	XXX	By Income from investment	XXX
To Repairs and renewals	XXX	By Dividends received	XXX
To Interest paid	XXX	By Miscellaneous income	XXX
To Conveyance	XXX	By Profit on sale of assets	XXX
To Bank charges	XXX		
To General Expenses	XXX	[By Net loss transferred to capital	
To Electricity charges	XXX	A/c]	
To Commission paid	XXX		
To Discount allowed	XXX		
To Travelling Expenses	XXX		
To Advertising	XXX		
To Insurance	XXX		
To Audit fee	XXX		
To trade Expenses	XXX		
To Sundry expenses	XXX		
To Free samples	XXX		
To Trade expenses	XXX		
To Legal charges	XXX		
To Bad debts	XXX		
To Loss on sale of assets	XXX		
To Loss by fire/theft/damages	XXX		
To depreciation	XXX		
To Net profit transferred to capital			
A/c (B/F)	XXX		
	XXXX		XXXX

Explanation about Some indirect expenses

- 1. Salaries:** Salaries are paid to employees of the firm working in the office.
- 2. Rent:** Rent of the office, shop, show-room etc. is an example for indirect expense.
- 3. Commission:** The firm has to avail of the services of the agents

- 4. Trade Expenses:** These expenses are also known as sundry expenses, miscellaneous and office expenses.
- 5. Carriage and freight outwards:** It is incurred to send goods outward after sale. It is a selling and distribution expenses.
- 6. Printing and stationery:** It included all expenses of printing bills, invoices, letter heads etc. Stationery includes pen, pencil, paper, ink etc.
- 7. samples:** Certain samples are to be distributed among prospective customers as part of marketing.
- 8. Advertisement:** Expenses incurred towards advertisement is an indirect expense.
- 9. Bad debts:** Bad debts is the amount that has become irrecoverable from a debtor. It is an indirect expense.

Closing Journal entries regarding Profit and loss account:

Following closing entries are to be passed in the journal proper for preparing the profit and loss account:

- 1. Items of indirect expenses and losses are closed by transferring their balance to the debit side of the profit and loss account.**

Profit and Loss A/c Dr. xxxxx

To Individual Indirect Expenses account xxxxx

(Example: Salaries, rent, advertisement etc.)

(Being indirect expenses closed by transfer it to the debit side of P & L Account)

- 2. Items of indirect incomes and gains are closed by transferring their balance to the credit side of the profit and loss account.**

Individual indirect income A/c Dr. xxxxx

To Profit and Loss A/c. xxxxx

- 3. For transfer of net profit.**

Profit and Loss A/c Dr. xxxx

To Capital A/c xxxx

(Being net profit transferred to capital A/c)

- 4. For Transfer of net loss (if any)**

Capital A/c Dr. xxxx

To Profit and Loss A/c xxxx

(Being net loss transferred to capital A/c)

Operating Profit and Net Profit

Profit may be divided into two:

- I. Operating Profit
- II. Net Profit

Operating Profit (EBIT): It is the profit earned through normal operating activities of the business. It is calculated by deducting the Operating Expenses from the Gross Profit. Operating expenses include office & administrative expenses and selling and distribution expenses.

Operating Profit = Gross Profit – Operating Expenses

OR

Operating profit = Net profit + non-operating expenses – non-operating income

Operating Expenses: Operating expenses include any cost associated with running a business. Operating expenses include office & administrative expenses and selling and distribution expenses. For example, administrative expenses like salaries, rent, insurance, stationery, general expenses etc. and selling and distribution expenses like carriage outwards, advertising, bad debts etc. are operating expenses of a concern. It never includes non-operating expenses like interest on loan, loss on sale of furniture, loss by fire, donation etc. Operating expenses do not include cost of goods sold (Purchase and other direct expenses) or capital expenditures.

Non-operating Expenses: non-operating expense is an expense incurred from activities unrelated to core operations. Interest on capital, interest on loan, loss on sale of furniture, loss by fire, donation etc.

Non -operating Income: Non-operating income is the portion of an organization's income that is derived from activities not related to its core business operations. It can include profit on sale of fixed assets, dividend income, profits or losses from investments and other unusual incomes.

Balance Sheet:

Balance sheet is the statement prepared after preparing the Trading and Profit and Loss account.

After ascertaining the net profit or loss of the business firm, the business man would like to know the exact financial position of his business. For this purpose, a statement called Balance Sheet is prepared which contains all the assets and liabilities of the business. Balance Sheet is so called

because it is a sheet of balances of ledger accounts which are still open after the transfer of all nominal accounts are grouped as assets and liabilities. Assets are shown on the right side of the Balance Sheet and liabilities are shown on the left side.

Need for preparing Balance Sheet

1. The main purpose of preparing Balance Sheet is to ascertain the true financial position of the business on a particular date.
2. It helps in finding out whether the firm is solvent or not. The firm is solvent when the assets exceed the external liabilities.
3. It helps in preparing the opening entries at the beginning of the next year.

Features of Balance Sheet

1. Balance Sheet is a **statement and not an account**.
2. It has no debit or credit side. Its left side is known as liabilities and its right side is 'Assets'.
3. Balance Sheet is a summary of the Personal and Real accounts, which are still open.
4. The total of the two sides of the **Balance Sheet must be equal**. If the totals are not equal, there will be an error somewhere.
5. Balance Sheet is prepared on a particular date. It discloses the financial position of a business on a particular date and not for a period.
6. Assts and liabilities displayed in the Balance Sheet is true only for the date on which it is prepared because even a single transaction would cause a change in the assets and liabilities.

Grouping and Marshalling of Assets and Liabilities in Balance Sheet

The assets and liabilities shown in the Balance Sheet are properly grouped and presented in a particular order.

Grouping means putting items of a similar nature under a common accounting head. For example the amount owing from various customers will be shown under the heading 'Sundry Debtors'.

'Marshalling' is the arrangement of various assets and liabilities in a particular order in the Balance Sheet.

Marshalling can be done in any of the following two ways:

- I. In the order of liquidity
- II. In the order of permanence

1. In the order of Liquidity:

In this method assets are arranged in the order of their liquidity. Liquidity means the ability of an asset to convert into cash. According to this method cash is always presented first, followed by cash at bank, bills receivables, short term investments, sundry debtors, inventory, and then fixed assets.

Format of Balance Sheet-In the order of Liquidity

Liabilities		Amount	Assets		Amount
Bank Overdraft		XXXX	Cash in hand		XXXX
Bills Payable		XXXX	Petty Cash		XXXX
Sundry Creditors		XXXX	Cash at bank		XXXX
Outstanding Expenses		XXXX	Bill's receivable		XXXX
Income received in advance		XXXX	Short term investment		XXXX
Long -term Loans		XXXX	Sundry Debtors		XXXX
Capital	xxxx		Closing Stock		XXXX
Add: Net Profit	<u>xxxx</u>		Prepaid Expenses		XXXX
	xxxx		Accrued Income		XXXX
Less: Drawings	<u>xxxx</u>	XXXX	Furniture		XXXX
			Loose Tools		XXXX
			Vehicles		XXXX
			Plant and Machinery		XXXX
			Land and Building		XXXX
			Patents		XXXX
			Goodwill		XXXX
			Trade Mark		XXXX
		XXXXXX			XXXXXX

2. In the order of permanence

In this case assets and liabilities are arranged according to the order of permanence. Assets which are most difficult to be converted into cash such as goodwill, patents etc. are written first and the assets which are most liquid such as cash in hand are written last. Similarly, those liabilities which are to be paid last, will be written first. So, capital, which is the most permanent of all obligations of business is written first, followed by long-term loans and ending up with current liabilities.

Format of Balance Sheet-In the order of Permanence

Liabilities	Amount	Assets	Amount
Capital	xxxx	Trade Mark	XXXX
Add: Net Profit	<u>xxxx</u>	Goodwill	XXXX
Less: Drawings	<u>xxxx</u>	Patents	XXXX
Long -term Loans	XXXX	Land and Building	XXXX
Outstanding Expenses	XXXX	Plant and Machinery	XXXX
Income received in advance	XXXX	Vehicles	XXXX
Sundry Creditors	XXXX	Loose Tools	XXXX
Bills Payable	XXXX	Furniture	XXXX
Bank Overdraft	XXXX	Accrued Income	XXXX
		Prepaid Expenses	XXXX
		Closing Stock	XXXX
		Sundry Debtors	XXXX
		Short term investment	XXXX
		Bill's receivable	XXXX
		Cash at bank	XXXX
		Cash in hand	XXXX
	XXXXXX		XXXX

Relevant items in the Balance Sheet

Assets Side

- I. **Current Assets:** Current assets are those which are either in the form of cash or can be converted into cash within a year.

Example: Cash in hand/at bank, bills receivable, stock, debtors, short term investments, prepaid expenses, accrued income etc.

- II. **Fixed Assets/Block Capital:** Fixed assets are those assets, which are held on a long-term basis in the business. They are not acquired for the purpose of resale.

Example: Land and building, plant and machinery, furniture, vehicles etc.

- III. **Intangible Assets:** These are assets which can't be seen or touched. Example : Goodwill, patents, trademark, copy right etc.

- IV. **Investments:** Investments represents the funds invested in government securities, shares of the company etc.

Liabilities Side

- I. **Current Liabilities:** Current liabilities are those liabilities which are expected to be paid within a year and which are usually to be paid out of current assets. Example: Creditors, bank overdraft, bills payable, short term loans, outstanding expenses.

- II. **Long term liabilities/Non-current liabilities:** All liabilities other than current liabilities are known as long term liabilities. Such liabilities are usually payable after one year of the date of the balance sheet. Example: Long-term loans

- III. **Capital:** It is the excess of assets over external liabilities. It represents the amount originally contributed by the owner as increased by net profits and interest on capital and decreased by losses, drawings and interest on drawings.
- IV. **Drawings:** Amount or goods withdrawn by the proprietor is termed as drawings. If owners' personal expense are paid from the business, for example, Income tax paid for the trader, owner's son's tuition fees paid, these are example for drawings and it should be deducted from capital in the balance sheet. Normally drawings account is closed by transferring its balance to his capital account. Drawing's account is shown in the balance sheet by way of deduction from capital.

Q. Arrange the following items in the order of both permanence and liquidity. Also group them under logical heads:

Liabilities:	Assets:
Long-term loans	Machinery
Bank overdraft	Cash
Bills payable	Bills Receivable
Owner's Equity	Sundry Debtors
Short term loans	Land
Sundry Creditors	Stock
	Accrued Income

Answer: In the order of Liquidity

Current Liabilities:	Current Assets:
Bank overdraft	Cash
Bills payable	Bills Receivable
Sundry Creditors	Sundry Debtors
Short term loans	Stock
Non-current liabilities:	Accrued Income
Long-term loans	Non-Current Assets:
Owner's Fund:	Machinery
Owner's Equity	Land

Opening Entry

Opening entry is the entry made in the beginning of a financial year to open the books by debiting assets and crediting liabilities and capital, appearing in the Balance Sheet of the previous year. The balances of various accounts in balance sheet are carried forward from one accounting period to another accounting period. For this an opening entry is made which opens all the accounts contained in the Balance Sheet.

Balance Sheet As on 31-12-2020

Liabilities		Amount	Assets		Amount
Sundry Creditors		40,000	Cash in hand		20,000
Bank over draft		60,000	Cash at bank		10,000
Outstanding Salary		1,000	Sundry Debtors		30,000
Loan		1,00,000	Closing Stock		90,000
Capital	2,00,000		Plant and machinery		1,00,000
Add: Net Profit	<u>30,000</u>		Land and Building		1,21,000
	2,30,000		Goodwill		50,000
Less: Drawings	<u>10,000</u>	2,20,000			
		4,21,000			4,21,000

Opening Entry on 1-1-2021**Journal**

Date	Particulars	LF	Debit	Credit
1-1-21	Cash in hand A/c Dr		20,000	
	Cash at bank A/c Dr.		10,000	
	Sundry Debtors A/c Dr.		30,000	
	Closing Stock A/c Dr.		90,000	
	Plant and machinery A/c Dr.		1,00,000	
	Land and Building A/c Dr.		1,21,000	
	Goodwill A/c Dr.		50,000	
	To Sundry Creditors			40,000
	To Bank over draft			60,000
	To Outstanding Salary			1,000
	To Loan			1,00,000
	To Capital			2,20,000
	(Being all assets and liabilities are carried forward)			

Some Valuable Points:

- Gross profit is the total revenue/ gross income.
- Balance Sheet is a statement, not an account.
- In Trading and Profit and Loss account, opening stock appears on the debit side because it forms the part of the cost of goods sold for the current accounting period.
- Gross profit = Net Sales - Cost of goods Sold
- Operating Profit = Gross Profit – Operating Expenses
- Operating profit = Net profit + non-operating expenses – non-operating income
- 'Marshalling' is the arrangement of various assets and liabilities in a particular order in the Balance Sheet.
- Closing entries are passed at the end of the accounting year to close and transfer nominal account (temporary account) balances to Trading and Profit and Loss account.

Q. Give the format of a Trading and Profit and Loss Account **with Imaginary figures?**

Trading and Profit and Loss Account

Dr.		Cr.		
Particulars		Amount	Particulars	
		Amount		
To Opening Stock	10,000	By Sales	4,00,000	
To Purchase	3,00,000	Less: Return inwards	<u>4,000</u>	3,96,000
Less: Return outwards	<u>10,000</u>	Closing Stock		1,00,000
To Wages	20,000			
To Carriage inwards	1,000			
To Factory Lighting	4,000			
To Gross Profit c/d	1,71,000			
	4,96,000			4,96,000
To Salaries	20,000	By Gross Profit b/d		1,71,000
To Rent	3,000	By Interest received		1,000
To Carriage outwards	4,000	By Profit on sale of furniture		3,000
To Repairs	7,000			
To Trade Expenses	6,000			
To Advertisement	12,000			
To Bad debts	4,000			
To Depreciation	3,000			
To Interest on Loan	10,000			
To Net Profit c/d	1,06,000			
	1,75,000			1,75,000

Q. (On the basis of the above question) Calculate 'Operating profit'?

Operating Profit = Gross profit – Operating Expenses

In this problem Operating Expenses:

=Salaries+Rent+Repairs+Trade Exp+Advertisement+Bad debts+Depreciation

=20,000+3,000+4,000+7,000+6,000+12,000+4,000+3,000

Operating Expense=**59,000**

Operating profit = Gross profit – Operating Expenses

=1,71,000 – 59,000 =**1,12,000**

Operating profit can be calculated in **another way:**

Operating profit = Net profit + non-operating expenses – non-operating income

In this question Non-operating income = Interest received profit on sale of furniture

$$= 1,000 + 3,000 = 4,000$$

In this question Non-operating expense = Interest on loan = 10,000

Operating profit = Net profit + non-operating expenses – non-operating income

$$= (1,06,000 + 10,000) - 4000 = \underline{\underline{1,12,000}}$$

Some Valuable Points:

- Chronological order of profit ascertainment = Gross profit ---- Operating Profit ----- Net Profit
- Gross profit = Net Sales - Cost of goods sold
- Operating Profit = Gross profit – Operating Expense
- Net profit = Operating Profit + Non-operating Income – Non-operating Expenses
- Sales = cost of goods sold + profit

Q. Calculate the value of operating profit from the following? (March-2012)

Sales less return – 1,30,000

Cost of goods sold – 80,000

Administration Expense – 25,000

Loss on sale of furniture -20,000

Ans: Gross profit = Net sales - cost of goods sold

$$= 1,30,000 - 80,000 = 50,000$$

Operating Profit = Gross Profit – administration expense

$$= 50,000 - 25,000 = \underline{\underline{25,000}}$$

Note: Loss on sale of furniture is a non-operating expense. So it was not considered to find operating profit.

Q. Prepare Trading and Profit and Loss Account and Balance Sheet from the Trial Balance of Sri.Govind as on 31-03-2010

Trial Balance As on 31-03-2010

Particulars	Debit	Credit
Purchase	21,000	
Opening Stock	20,000	
Carriage Inwards	400	
Wages	6,000	
Carriage outwards	500	
Power	1,500	
Heating and lighting	600	
Printing and Stationery	2,500	
Investments	4,000	
Debtors	30,000	
Furniture	2,000	
Building	60,000	
Travelling expenses	500	
Discount Allowed	300	
Office Expenses	700	
Bills Receivables	2,000	
Repair Charges	300	
Interest on loan	2000	
Plant and Machinery	24,200	
Capital		49,000
Sales		60,000
Loan		35,000
Discount Received		5,000
Creditors		19,500
Bills Payable		10,000
	1,78,500	1,78,500

Closing stock is valued at Rs16,000

Ans:**Trading and Profit and Loss Account****For the Year ended 31-03-2010**

Particulars	Amount	Particulars	Amount
To Opening Stock	20,000	By Sales	60,000
To Purchase	21,000	Closing Stock	16,000
To Wages	6,000		
To Power	1,500		
To Carriage inwards	400		
To Heating & Lighting	600		
To Gross Profit c/d	26,500		
	76,000		76,000
To Carriage outwards	500	By Gross Profit b/d	26,500
To Printing and Stationery	2,500	By Discount received	5,000
To Travelling Expenses	500		
To Discount allowed	300		
To Office Expense	700		
To Repair charges	300		
To Interest on loan	2000		
To Net Profit transferred to capital account	24,700		
	31,500		31,500

Balance Sheet As on 31-03-2010

Liabilities	Amount	Assets	Amount
Bills Payable	10,000	Bills Receivables	2,000
Creditors	19,500	Investment	4,000
Loan	35,000	Debtors	30,000
Capital	49,000	Closing Stock	16,000
Add: Net Profit	24,700	Furniture	2,000
	73,700	Building	60,000
		Plant and Machinery	24,200
	1,38,200		1,38,200

Points to be noted:

- Trading account is prepared to find out gross profit
- Gross profit can also be calculated through an equation: **Gross Profit= Net Sales- Cost of Goods Sold**

- Direct expenses and direct incomes are recorded in trading account. Indirect expenses and indirect incomes are recorded in profit and loss account.
- Trading and profit and loss account is a nominal account.
- Profit and loss account is prepared to find out net profit or net loss.
- Balance sheet discloses the financial position of a business concern.
- We can see the reflection of the **Accounting Equation (Assets= Liabilities + Capital)** in the Balance Sheet.

Read the study notes carefully and find the correct answer

1. -----can be computed by deducting the cost of goods sold from sales. (March-2011)
2. The statement showing financial position of a business is known as ----- (SAY-2012)
3. Carriage inwards is debited to -----account. (Trading A/c, Profit and Loss A/c, Cash A/c)
4. Income tax paid for the sole trader from the business is treated as -----
5. Profit and Loss Account is transferred to ----- Account. (Trading A/c, Capital A/c, Asset A/c)
6. Financial statements consist of----- (a. Trial Balance, b. Trading and profit and loss account. c. Balance Sheet, d. Both b and c)
7. Loss on sale of old car is debited to -----account.
8. Return inwards appearing in the trial Balance is deducted from-----in the Trading Account.
9. Which of the following is not shown in the Balance Sheet?
(Opening Stock, closing stock, debtors, patents)
10. Purchased machinery for production is
(Capital expenditure, revenue expenditure, deferred revenue expenditure, none of these)
11. Give any two items that are credited to profit and loss account?
12. Give any 4 examples for current assets?
13. Distinguish between current assets and fixed assets?
14. Write a short note on drawings?
15. Balance of petty cash is a----- (Asset, expense, income)
16. Ascertain cost of goods sold and gross profit from the following.
(Opening Stock- 30,000, Purchase- 2,82,000, Direct Expenses – 30,000, Indirect Expenses- 40,000, Closing stock- 55,000, Sales- 4,05,000, Sales Return- 13,000)
17. Cost of goods sold + Gross Profit= -----
18. Trading Account is a -----Account (Personal, Real, Nominal)
19. Gross Profit – Operating Expense = -----
20. Closing stock is valued at ----- (Cost price, market price, cost price or market price whichever is lower)
21. Trade expense is an example for----- (Direct expenses, indirect expenses, asset)
22. **Trading A/c Dr 5,000**
To Wages 5,000
Is this a closing entry? What is meant by closing entry?
23. What do you mean by grouping and marshalling of assets and liabilities?

24. Explain the term current liabilities with an example? (March-2016)
25. Explain the need for preparing Balance Sheet
26. Which is the closing journal entry to close interest received account?

Prepared By BINOY GEORGE, HSST, MKNM HSS, Kumaramangalam, Thodupuzha, Idukki Dt.

Chapter-10

Financial Statements-II

Focus Area-2021- September Public Examination

Chapter-10 Financial Statement-II

1. Treatment of the following adjustments in the preparation of Financial Statements

1.1 Closing Stock

1.2 Outstanding Expenses

1.3 Prepaid Expenses

1.4 Accrued Income

1.5 Income Received in Advance

1.6 Depreciation

2. Preparation of Trading and Profit and Loss Account and Balance Sheet with the above adjustments

Final account is prepared on the basis of Trial Balance. But a trial balance contains only account balances of those items for which accounts have already been prepared. Sometimes, on the closing date of the accounting period, certain items may remain recorded in the books of accounts. According to accrual concept of accounting, all revenues earned during the year (whether received or not) and expenses incurred during the year (whether paid or not) are accounted. The expenses of current year may be still payable or the expenses of the next year might have been paid the current 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. Current year's depreciation, provision for doubtful debts etc. would not have been recorded in the books. So, we have to adjust these amounts in the final accounts of the current year to ascertain the correct profit or loss of the business concern as well as to display the correct financial position. For this, we have to pass some adjusting journal entries. The items which usually need adjustments are:

1. Closing stock
2. Outstanding Expenses
3. Prepaid/ unexpired expenses
4. Accrued income
5. Income received in advance
6. Depreciation
7. Bad debts
8. Provision for doubtful debts
9. Provision for discount on debtors
10. Manager's commission
11. Interest on capital

Adjusting entry

While preparing final accounts at the end of the accounting period, there may be some expenses due but not paid or some incomes due but not received or some expenses paid in advance or some incomes received in advance. Depreciation on fixed asset, provision for doubtful debts etc. may not be recorded in the books of accounts. These items do not appear in the Trial Balance. They are generally given as additional information (Adjustments). We follow accrual basis of accounting. According to accrual concept of accounting, all revenues earned during the year (whether received or not) and expenses incurred during the year (whether paid or not) are accounted. Therefore, we will have to pass adjusting journal entries for all above said items. **An adjusting journal entry is an entry that occurs at the end of an accounting period to record any unrecognized income or expenses for the period.** Adjustment journal entries are passed to get the adjustment effect to the above said items.

Need of adjustment

- I. To ascertain the true profit/ loss of the business concern
- II. To ascertain the true financial position of the business
- III. To make a record of business transactions omitted from the books.
- IV. To make a record those expenses which are due but not paid.
- V. To make a record those incomes which have accrued but have not been received
- VI. To provide for current year's depreciation and other provisions.

Effect of Adjustment items:

All adjustment items are reflected in the final accounts at **two places** to complete the double entry. Double entry system states that every financial transaction has equal and opposite effects in at least two different accounts. It is used to satisfy the accounting equation.

Adjusted Purchase = Purchase + Opening Stock – Closing Stock

If opening stock is adjusted with purchases, **opening stock will not appear in the Trial Balance**. Adjusted purchase will appear on the debit side of the trading Account. **In this case closing stock will not be shown on the credit side of the trading account**, as closing stock has already been adjusted through the purchase account. Moreover, **opening stock will not be separately reflected in the Trading Account**. In case of adjusted purchase, closing stock will appear only in the asset side of the balance Sheet. Closing stock here is a Trial Balance item and will reflect only in one place, but the adjustments items will be reflected in two places.

Journal entry:

1. When closing stock created and adjusted with purchase account

Closing Stock A/c Dr. xxxx

To Purchase A/c xxxx

(Closing stock is created and adjusted with purchase account)

2. When opening stock is closed by adjusted it with the purchase account

Purchase A/c Dr. xxxx

To Opening Stock xxxx

(Opening stock account is closed by transfer it to purchase account)

1 (b) Treatment of closing stock in the final accounts- When closing stock is given in Trial Balance (When purchase adjusted)

- I. Closing stock will be shown on the asset side of the Balance Sheet.
- II. Closing stock will not be shown in the Trading Account.
- III. Opening stock will not be separately shown in the Trading .
- IV. Adjusted purchase will be shown on the debit side of the Trading Account (Opening stock and closing stock adjusted with purchase account)

Treatment in Trading Account

Dr. **Trading Account For the Year Ended.....** Cr.

Particulars	Amount	Particulars	Amount
(Opening stock will not be shown in Trading A/c)			
To Adjusted Purchase	xxxx	(In this case Closing stock will not be shown in Trading Account)	

Note: Opening stock and closing stock will not be shown separately in trading account, both of them adjusted with purchase.

Balance Sheet As on.....

Liabilities	Amount	Assets	Amount
		Closing Stock	xxxx

2.Outstanding Expenses

These are expenses which have become due during the accounting period for which the final accounts have been prepared, but have not yet been paid. These expenses are related to the current year but remain unpaid. As they are the expenses of the current year, so they must be debited in the profit and loss account of the current year. Such expense remains unpaid so far during the current year, so they are the liability of the firm. Such items usually are outstanding wages, outstanding salaries, outstanding interest etc. The entry to bring such expenses into account is:

Concerned Expense A/c Drxxxx

To Outstanding Expense A/c xxxx

Outstanding Expenses-Treatment in Final Account

1. Outstanding expense should be added to concerned expense on the debit side of the Trading or Profit and Loss account.

2.The new account, outstanding expense account will be shown on the liability side of the Balance Sheet.

Example: Wages paid during the year 2020 amounts to rs.5,000. Wages outstanding on 31-12-2020 amounts to Rs.1,000.Pass the adjusting entries for wages outstanding and also show how it would appear in the trading account and balance sheet.

Adjusting entry:

Wages A/c Dr. 1,000

To Outstanding Wages 1,000

(Being wages outstanding Rs.1,000)

Treatment in Trading AccountDr. **Trading Account** Cr.

Particulars	Amount	Particulars	Amount
To Wages	5,000		
Add: Outstanding	<u>1,000</u>		
	6,000		

Treatment in Balance Sheet**Balance Sheet As on.....**

Liabilities	Amount	Assets	Amount
Outstanding Wages	1,000		

3. Prepaid Expenses

Prepaid or un expired expenses are future **expenses** that are paid in advance, whose benefit will be available in the next accounting years. At the end of the accounting year, it is found that the benefit of some portion of the expenses like insurance have not been fully received, a portion of its benefit would be received in the next accounting year. That portion of expense is termed as prepaid expenses and it should be carried forward to the next accounting period. The necessary adjustment in respect of prepaid expenses is made by recording the following entry:

Prepaid Expense A/c Dr. xxxxx

To Concerned Expense A/c xxxxx

Prepaid Expenses-Treatment in Final Account

1. Prepaid portion of the expense should be deducted from concerned expense on the debit side of the Trading or Profit and Loss account.

2. The new account, prepaid expense account will be shown on the assets side of the Balance Sheet as 'Prepaid Expenses'.

Example: Insurance premium paid during the year 2019 is Rs.12,000, of which 3 months insurance is prepaid. Pass necessary adjusting entry for the prepaid insurance and also show how it would appear in the financial statements.

Insurance Paid for 1 year=12,000

Prepaid insurance = 3 months insurance =12,000 x 3/12 = 3,000

Adjusting entry:

Prepaid Insurance A/c Dr. 3,000

To Insurance 3,000

(Being prepaid insurance Rs.3,000 recorded)

Treatment in Profit and Loss Account

Dr. Profit and Loss Account Cr.

Particulars	Amount	Particulars	Amount
To Insurance	12,000		
Less: Prepaid	3,000		
	9,000		

Treatment in Balance Sheet

Balance Sheet As on.....

Liabilities	Amount	Assets	Amount
		Prepaid Insurance	3,000

4. Accrued Income [Income earned but not received / outstanding Income]

An income which has been earned but not received during the accounting is called accrued income. Sometimes, items of income such as interest on investment, rent, commission etc. are earned during the current year, but have not been actually received by the end of the same year. Since these incomes actually relate to the current year, they are to be brought into account. The following adjustment entry will be passed to record accrued income:

Adjusting entry:

Accrued Income A/c Dr. xxxx

To Concerned Income xxxx

Accrued Income-Treatment in Final Account

1. The amount of accrued income will be added to the concerned income in the credit side of the Profit and Loss account.

2.The new account, 'Accrued Income' account will be shown on the assets side of the Balance Sheet.

Example:

Interest on investment received (as per trial balance) during the year 2020 amounts to Rs.4,000. On closing date interest accrued on investment amounts to Rs.1,500. Pass the adjusting entries for accrued interest and also show how it would appear in the Profit and Loss account and balance sheet.

Adjusting Entry:

Accrued Interest A/c Dr. 1,500
 To Interest on Investment 1,500
 (Being accrued interest adjusted)

Treatment in Profit and Loss Account

Dr. Profit and Loss Account Cr.

Particulars	Amount	Particulars	Amount
		By Interest on Investment 4,000	
		Add: Accrued interest 1,500	5,500

Treatment in Balance Sheet

Balance Sheet As on.....

Liabilities	Amount	Assets	Amount
		Accrued Interest	1,500

5.Income Received in Advance (Unearned Income)

Sometimes a portion of income received during the current year relate to the next accounting period. Such portion of the income which belongs to the next accounting period is called income received in advance and it should not be included as income of the current year. The following adjustment entry will be passed to adjust income received in advance:

Adjusting entry:

Concerned Income A/c Dr. xxxx
 To Income Received in Advance A/c xxxx

Income Received in Advance-Treatment in Final Account

1. Unearned portion of income will be deducted from the concerned income in the credit side of the Profit and Loss account.

2. The new account, ' Income received in advance' account will be shown on the Liabilities side of the Balance Sheet.

Example:

Commission received during the current year amounted to Rs.6,000. Half of the amount is in respect of services to be rendered in the next year. Pass necessary adjusting entry for income received in advance and also show how it would appear in the financial statements.

Commission Received in advance = $6,000 \times 1/2 = 3,000$

Adjusting Entry:

Commission A/c Dr. 3,000
To Commission Received in Advance 3,000
 (Being Commission received in advance adjusted)

Treatment in Profit and Loss Account

Dr.	Profit and Loss Account	Cr.
		By Commission 6,000
		Less: Commission
		 received in advance 3,000 3,000

Treatment in Balance Sheet

Balance Sheet As on.....

Liabilities	Amount	Assets	Amount
Commission Received in Advance	3000		

6. Depreciation (Given as an adjustment)

Depreciation is the decline in the value of assets due to wear and tear, passage of time etc. Depreciation on assets will affect profit of the business. It will reduce profit, so it should be debited to profit and loss account. Depreciation will also reduce the value of concerned asset, so

depreciation amount should be deducted from the concerned asset in the balance sheet. The following adjustment entry will be passed to record depreciation into the books of accounts:

Adjusting entry:

Depreciation A/c Dr.	xxxx
To Concerned Asset	xxxx

Depreciation (When given as an adjustment item) -Treatment in Final Account

1. The amount of depreciation will be shown on the debit side of the Profit and Loss account.

2. Current year's depreciation should be deducted from the particular asset in the asset side of the Balance Sheet.

NOTE: If depreciation given in the Trial Balance, it is taken only on the debit side of the profit and loss account.

Example

Machinery for Rs40,000 is purchased on 1-1-2020, 10% is the rate of depreciation. So, depreciation for the year 2020 is Rs.4,000 and it will be brought into account by passing the following adjustment entry:

Depreciation A/c Dr.	4,000
To Machinery A/c	4,000

(Being depreciation written off)

Treatment in Profit and Loss Account

Dr. **Profit and Loss Account** Cr.

Particulars	Amount	Particulars	Amount
Depreciation- Machinery	4,000		

Treatment in Balance Sheet

Balance Sheet As on.....

Liabilities	Amount	Assets	Amount
		Machinery	40,000
		Less: Depreciation	4,000
			36,000

Previous year's Public Examination Question

Q. The following is the Trial Balance of Mr. Santhosh as on 31-12-2020.

Particulars	Debit (Rs.)	Credit (Rs.)
Cash in hand	2600	
Cash at bank	8100	
Purchases	60000	
Sales		1,20,000
Returns	600	700
Insurance	300	
Wages	12,000	
Power and fuel	6,500	
Carriage inwards	3,800	
Carriage outwards	3,200	
Opening stock	10,000	
Commission		400
Interest		200
Building	42,000	
Machinery	36,000	
Patents	8,000	
Salaries	11,000	
Trade Expenses	3,000	
Capital		80,000
Drawings	9,000	
Sundry creditors		24,800
Sundry debtors	10,000	
	2,26,100	2,26,100

Santhosh furnishes the following additional information

- Closing stock on 31-12-2020 is Rs.16,000
- Wages outstanding Rs.2,000, salaries outstanding Rs.1,000
- Insurance was prepaid to the extent of Rs.100
- Interest accrued Rs.500
- Commission received in advance Rs.100
- Machinery and patents are to be depreciated @ 10% p.a and 20% p.a respectively. You are required to prepare Trading and Profit and Loss Account and the Balance Sheet of Mr. Santhosh as on 31-12-2020

Trading and Profit and Loss Account

Dr. for the Year ended 31-12-20 Cr.

Particulars	Amount	Particulars	Amount
To Opening Stock	10,000	By Sales	1,20,000
To Purchase	60,000	Less: Return inwards	<u>600</u>
Less: Return outwards	<u>700</u>	Closing Stock	16,000
To Wages	12,000		
Add: Outstanding	<u>2,000</u>		
To Carriage inwards	3,800		
To Power and fuel	6,500		
To Gross Profit c/d	41,800		
	1,35,400		1,35,400
To Insurance	300	By Gross Profit b/d	41,800
Less Prepaid Insurance	<u>100</u>	By Commission	400
To Salaries	11,000	Less Received in advance	<u>100</u>
Add: Outstanding	<u>1,000</u>	By Interest	200
To Carriage outwards	3,200	Add: Accrued Interest	<u>500</u>
To Trade Expense	3,000		
To Depreciation:			
Machinery	3,600		
(36,000 x 10%)			
Patents	<u>1,600</u>		
(8,000 x 20%)	5,200		
Net profit Transferred to Capital Account (B/F)	19,200		
	42,800		42,800

Balance Sheet as on 31-12-2020

Liabilities	Amount	Assets	Amount
Sundry Creditors	24,800	Cash in hand	2,600
Outstanding Salary	1,000	Cash at bank	8,100
Outstanding Wages	2,000	Sundry Debtors	10,000
Commission received in advance	100	Prepaid Insurance	100
		Accrued Interest	500
Capital	80,000	Closing Stock	16,000
Add: Net Profit	<u>19,200</u>	Patent	8,000
	99,200	Lee: Depreciation	<u>1,600</u>
Less: Drawings	<u>9,000</u>	Machinery	36,000
	90,200	Less: Depreciation	<u>3,600</u>
		Building	42,000
	1,18,100		1,18,100

Chapter 13

COMPUTERISED ACCOUNTING SYSTEM

Public Examination- September-2021 Focus Area

1. Concept of Computerised accounting System

2. Comparison between Manual and Computerised accounting

3. Advantages of Computerised Accounting System

Concept of Computerised Accounting System (CAS)

Computerised accounting is the process of entering business transactions and generating financial statements and reports with the help of computers. In simple words, accounting with the help of computers is called computerised accounting.

A computerised accounting system is an accounting information system that processes the financial transactions and events as per Generally Accepted Accounting Principles (GAAP) to produce reports as per user requirements. In CAS accounting transactions are taken as inputs and then processed through accounting software to generate reports like Day book, Ledger, Trial balance, Profit and loss account and Balance sheet.

Every accounting system, manual or computerized, has **two aspects**:

1. It has to work under a set of well-defined concepts called Generally accepted Accounting Principles (GAAP)
2. There must be a user defined frame work for maintenance of records and generation of reports.

Operating Environment in Computerised accounting System

The framework of storage and processing of data in computerized accounting system is called **Operating Environment**. It consists of hardware as well as software in which the accounting system works. Both hardware and software are interdependent. Modern computerized accounting systems are based on the concept of **database**. A database is implemented using a Database Management System (DBMS). DBMS is a software that enable the users to create and maintain a database. DBMS helps in collection of data, their storage, manipulation, retrieve etc.

Every Computerised accounting system has two basic requirements:

1. **Accounting Frame work:** It consists of set of accounting principles, coding and grouping the structure of accounting.
2. **Operating Procedure:** It is a set of operating procedures designed according to the need and the suitability of the operating environment of the particular organization.

Modern computerized accounting systems are based on the concept of database. In any database-oriented application has 4 basic requirements as mentioned below:

1. **Front-end interface:** It is an interactive link between the user and DBMS through which the user communicates to the back-end-database.
Example: A transaction relating to purchase of goods may be dealt with the accounting system through a purchase voucher, which appears on the computer's monitor of the data entry operator and when entered into the system is stored in the database.
2. **Back-end Database:** It is the data storage system that is hidden from the user and responds to the requirements of the user.
3. **Data Processing:** It is a sequence of actions that are taken to transform the data into 'decision useful information'.
4. **Reporting System:** The report generator extracts useful information from DBMS files and displays it in structured format based on defined specifications. This information may be used for further analysis, decision making, or business intelligence.

Comparison between Manual and Computerised Accounting

Accounting is the systematic process of identifying, recording, classifying, summarising, interpreting and communicating financial information to users. Its purpose is to produce the financial reports for their ultimate analysis. Let us understand these activities in the context of manual and computerised accounting system.

1. **Identifying:** The identification of transactions, based on application of accounting principles is, common to both manual and computerized accounting system.
2. **Recording:** In manual accounting, business transactions are recorded through the book of original entry (Journal). In computerised accounting system recording of transactions takes place in customised database.
3. **Classification:** In a manual accounting system, transactions recorded in the books of original entry are further classified by posting them into ledger accounts. This results in transaction data duplicity. In computerized accounting, no such data duplication is made. In order to produce ledger accounts, the stored transaction data is processed to prepare the desired result.
4. **Summarising :** In manual accounting system Trial Balance is prepared by ascertaining the balances of various accounts. As a result, preparation of ledger accounts becomes a

prerequisite for preparing the trial balance. However, in computerized accounting, the originally stored transactions data are processed and prepare trial balance directly.

5. **Financial Statements:** In a manual system of accounting, the preparation of financial statements pre-supposes the availability of trial balance. However, in computerised accounting, financial statements can be prepared by direct processing of originally stored transaction data.
6. **Closing the Books :** After the preparation of financial reports, the accountants make preparations for the next accounting period. This is achieved by posting of closing and reversing journal entries. In computerised accounting, there is year-end processing to create and store opening balances of accounts in database.
7. **Financial statements:** In a manual accounting system, financial systems are prepared at the end of the period. While in a computerized accounting system, your financial statements and trial balance are just a click away.

Difference between Manual Accounting and Coputerised Accounting

Manual Accounting	Computerised Accounting
1. Transactions are recorded manually	2. Transactions are recorded using computer
2. Transactions are recorded in volumes of books.	2. Transactions are recorded in well-designed database
3. Journal, ledger, trial balance, financial statements etc. are prepared manually	3. Once transaction recorded through vouchers, data are processed automatically and ledger, trial balance, financial statements etc. are automatically prepared.
4. Retrieval of data is very difficult in manual accounting	4. Retrieval of data is very easy in computerized accounting.
5. It takes lot of time.	5. It save lot of time.
6. Closing entries are necessary in Manual Accounting	6. Closing entries are not necessary in computerized Accounting
7. Possibility of errors are high.	7. Possibility of errors are less in Computerised Accounting

Advantages of computerized accounting system

The following are the advantages of computerized accounting system:

1. **Accuracy:** The reports generated in computerized accounting are free from mistakes. This is because the computers can carry out even complex calculations at high rate of accuracy.
2. **Simplicity:** In computerized accounting the job of an accountant is only to enter accounting transactions through appropriate vouchers. The computer system will automatically process data and generate various accounts, trial balance, financial statements etc.
3. **Storage and retrieval of data is very easy**
Under computerized accounting, a large volume of data can be stored in a very small space; further quick retrieval of data from the system is easily possible.
4. **No difficulty in alterations**
It is very easy to make corrections in computerized accounting.
5. **Preparation of bank reconciliation statement:** Preparation of bank reconciliation statement is possible in CAS. Hence an organization can reconcile its book with bank balance.
6. **Diligence:** A computer is free from tiredness and lack of concentration.
7. **Automatic carrying forward of balances:** While entering transactions, net closing balance of the ledger is obtained automatically. Hence, there is no need to carry forward previous year's closing balance as next year's opening balance.

Questions:

- 1) The physical components of a computer is called-----
[a. software b. Hardware c. Live ware] Ans: **Hardware**
- 2) -----is a software that create and manages a database.
Ans: **(DBMS – Database Management System)**
- 3) The framework of storage and processing of data is called as----- **(Operating environment)**
- 4) Processed data becomes----- Ans: **Information**
- 5) Database implemented using----- **(Database management system)**
- 6) A sequence of actions that are taken to transform the data into 'decision useful information' is called----- (Data Processing)

- 7) What is computerized Accounting System?
- 8) What are the basic requirements of a computerized accounting system?
- 9) Computerised accounting has some advantages over manual accounting. List out any five of such advantages?
- 10) What is computerized accounting? What are the differences between computerized accounting and manual accounting?
- 11) What are the advantages of computerized accounting system?

Prepared By BINOY GEORGE, HSST, MKNM HSS, Kumaramangalam, Thodupuzha, Idukki Dt

<p>പ്ലസ് വൺ ശേഷം സിഐയ്ക്ക് പോകാൻ താല്പര്യമുള്ളവർ പ്ലസ് വണ്ണിൽ തന്നെ കണ്ടിരിക്കേണ്ട ഒരു വീഡിയോ: https://youtu.be/9ryRIs4re6w</p>
<p>ഓൺലൈൻ ടെസ്റ്റ് പേപ്പർ നടത്താൻ പറ്റിയ ഗൂഗിൾ ഫോമിനെപ്പറ്റി അറിയേണ്ടതെല്ലാം മനസ്സിലാക്കാൻ കാണുക:</p> <p>Video 1: https://youtu.be/ICo-PuUwcto?list=PLyD2oU-LkPCGZ527W1PAEGryeNwQgh3h5</p> <p>Video: 2 https://youtu.be/PLC_JbCIMmk?list=PLyD2oU-LkPCGZ527W1PAEGryeNwQgh3h5</p>
<p>ഗൂഗിൾ മീറ്റിംഗ് അറിയാൻ അറിയേണ്ടതെല്ലാം മനസ്സിലാക്കാൻ കാണുക:</p> <p>Video: 1 https://youtu.be/0EBawImfHjs?list=PLyD2oU-LkPCHKgi5eY4qXvTfAO0QaCFQr</p> <p>Video: 2 https://youtu.be/atJS8jOYdBg?list=PLyD2oU-LkPCHKgi5eY4qXvTfAO0QaCFQr</p>
<p>പ്ലസ് വൺ അക്കൗണ്ടൻസി ഓൺലൈൻ വീഡിയോ ക്ലാസ്സുകൾ</p> <p>Video: 1 https://youtu.be/DyKxJyCC7Fs?list=PLyD2oU-LkPCGhJoybtiNca4N4w1FVLK77</p> <p>Video: 2 https://youtu.be/tQOAtDjN9P4?list=PLyD2oU-LkPCGhJoybtiNca4N4w1FVLK77</p> <p>Video: 3 https://youtu.be/06Lt50LOmeA?list=PLyD2oU-LkPCGhJoybtiNca4N4w1FVLK77</p>

