



VELS



INSTITUTE OF SCIENCE, TECHNOLOGY & ADVANCED STUDIES (VISTAS)
(Deemed to be University Estd. u/s 3 of the UGC Act, 1956)
PALLAVARAM - CHENNAI
INSTITUTION WITH UGC 12B STATUS

DCBGL-11

Financial Accounting - I



B.Com, BBA
ODL MODE
(Semester Pattern)

School of Management Studies and Commerce

Centre for Distance and Online Education

Vels Institute of Science, Technology and Advanced Studies (VISTAS)

Pallavaram, Chennai - 600117

**Vels Institute of Science, Technology
and Advanced Studies**

Centre for Distance and Online Education

BBA / B.Com- ODL Mode
(Semester Pattern)

DCBGL-11: Financial Accounting-I

(4 Credits)

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Further information on the VISTAS ODL Academic Programmes may be obtained from VISTAS-CDOE at Velan Nagar, P.V.Vaithiyalingam Road, Pallavaram, Chennai-600117 [or] www.vistas.ac.in.

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FOREWORD



Dr. Ishari K Ganesh
Chancellor

Vels Institute of Science, Technology and Advanced Studies (VISTAS), deemed to be a university, was established in 2008 under section 3 of the Act of 1956 of the University Grants Commission, Government of India, New Delhi.

VISTAS has blossomed into a multi-disciplinary Institute offering more than 100 UG & PG Programmes, besides Doctoral Programmes, through 18 Schools and 46 Departments. All the Programmes have the approval of the relevant Statutory Regulating Authorities such as UGC, UGC-DEB, AICTE, PCI, BCI, NCTE and DGS.

The deemed to be University aims to provide innovative syllabi and industry-oriented courses, and hence, the revision of curricula is a continuous and ongoing process. The revision is initiated by the faculty depending on the requirement and approved by the Board of Studies of the concerned Department/School. The courses are under Choice Based Credit Systems that enable students to get adequate freedom in choosing subjects.

I am pleased to inform you that VISTAS has been rendering its services to society to democratize the opportunities of higher education for those who are in need through Open and Distance Learning (ODL) mode.

VISTAS ODL Programmes offered have been approved by the University Grants Commission (UGC) – Distance Education Bureau (DEB), New Delhi.

The curriculum and syllabi have been approved by the Board of Studies, Academic Council, and the Executive Committee of the VISTAS, and they are designed to help provide employment opportunities to the students.

The ODL Programme (B.Com., BBA and MBA) study material have been prepared in the Self Instructional Mode (SIM) format as per the UGC-DEB (ODL & OL) Regulations 2020. It is highly helpful to the students, faculties and other professionals. It gives me immense pleasure to bring out the ODL programme with a noble cause of enriching learners' knowledge. I extend my congratulations and appreciation to the Programme Coordinator and the entire team for bringing up the ODL Programme in an elegant manner.

At this juncture, I am glad to announce that the syllabus of this ODL Programme has been made available on our website, www.vistas.ac.in, for the benefit of the student fraternity and other knowledge seekers. I wish that this Self Learning Materials (SLM) would be a nice treatise to the academic community and everyone.

CHANCELLOR

FOREWORD



Dr.S.Sriman Narayanan
Vice-Chancellor

My Dear Students!

Open and Distance Learning (ODL) of VISTAS gives you the flexibility to acquire a University degree without the need to visit the campus often. VISTAS-CDOE involves the creation of an educational experience of qualitative value for the learner that is best suited to the needs outside the classroom. My wholehearted congratulations and delightful greetings to all those who have availed themselves of the wonderful leveraged opportunity of pursuing higher education through this Open and Distance Learning Programme.

Across the world, pursuing higher education through Open and Distance Learning Systems is on the rise. In India, distance education constitutes a considerable portion of the total enrollment in higher education, and innovative approaches and programmes are needed to improve it further, comparable to Western countries where close to 50% of students are enrolled in higher education through ODL systems.

Recent advancements in information and communications technologies, as well as digital teaching and e-learning, provide an opportunity for non-traditional learners who are at a disadvantage in the conventional system due to age, occupation, and social background to upgrade their skills.

VISTAS has a noble intent to take higher education closer to the oppressed, underprivileged women and the rural folk to whom higher education has remained a dream for a long time.

I assure you all that the Vels Institute of Science, Technology and Advanced Studies would extend all possible support to every registered student of this deemed to be university to pursue her/his education without any constraints. We will facilitate an excellent ambience for your pleasant learning and satisfy your learning needs through our professionally designed curriculum, providing Open Educational Resources, continuous mentoring and assessments by faculty members through interactive counselling sessions.

This university brings to reality the dreams of the great poet of modern times, Mahakavi Bharathi, who envisioned that all our citizens be offered education so that the globe grows and advances forever.

I hope that you achieve all your dreams, aspirations, and goals by associating yourself with our ODL System for never-ending continuous learning.

With warm regards,

VICE-CHANCELLOR

Course Introduction

The Course DCBGL-11: **Financial Accounting-I** has been divided in to five Blocks consisting of 15 Units.

The Block-1: **Introduction to Financial Accounting** has been divided in to four Units. Unit-1 deals with Accounting and Accountancy and Book keeping, Unit-2 explains about the Accounting Process, Concepts and Conventions, Unit-3 describes about the Accounting standards and Unit-4 deals with Accounting Equation, Double Entry System- Journal and Ledger.

The Block-2: **Subsidiary Books** has been divided in to three Units. Unit-5 deals with Purchase Book, Sales Book, Purchase Returns Book and Sales Return Book, Unit-6 explains about Cash Book- Single Column, Double Column and Three Column Cash Book and Unit-7 describes about the Petty Cash Book, Imprest System and Journal Proper.

The Block-3: **Rectification of Errors, Trial Balance and Final Accounts** has been divided in to three Units. Unit-8 deals with Trial Balance, Unit-9 explains about the Rectification of Errors and the Unit-10 describes about the Final Accounts with adjustments.

The Block-4: **Bank Reconciliation Statement and Computerised Accounting** has been divided in to two Units. Unit-11 explains about the Bank Reconciliation Statement and Unit-12 deals with Computerised Accounting.

The Block-5: **Depreciation, Single Entry system and Self Balancing Ledgers** has been divided in to three Units. Unit-13 deals with Depreciation, Unit-14 describes about the Single Entry System and Unit-15 presents the concepts of Self Balancing Ledgers.

DCBGL-11: Financial Accounting-I

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Block-1: Introduction

The Block-1: **Introduction to Financial Accounting** has been divided into four Units. (Unit-1 to Unit-4).

Unit-1: Accounting, Accountancy and Bookkeeping - By studying Unit-1, Students will be able to define accounting and outline its scope as well as to describe the advantages and limitations of accounting. Moreover Students will also be able to State the objectives of accounting and to understand the Limitations of accounting and know about the importance of book keeping in accounting and also to discuss the advantages and disadvantages of Accounting in detail. Further Students can also differentiate between the double entry system and single entry system of Accounting System.

Unit-2: Accounting Process, Concepts and Conventions - Students will be able to understand about the basic accounting principles to follow in accounting process and will be able to describe the accounting concepts and Importance of accounting conventions in accounting profession.

Unit-3: Accounting Standards - Students will be able to Understand about the basic Accounting Standards to follow in accounting process and will be able to describe the accounting concepts and Importance of accounting conventions in accounting profession.

Unit-4: Journal and Ledger - Students will be able to understand the different authorized accounting books in a business and will be able to know how to record the transactions in Journal and to differentiate between Journal and Ledger.

In all the units of Block -1: **Introduction to Financial Accounting**, the Check your progress, Glossary, Answers to Check your progress and Suggested Reading has been provided and the Learners are expected to attempt all the Check your progress as part of study.

Unit-1

Accounting, Accountancy and Book-Keeping

STRUCTURE

Overview

Objectives

1.1. Introduction

1.2. Need for Accounting

1.3. Objectives of Accounting

1.4. Definition and Scope of Accounting

1.5. Book-Keeping, Accounting and Accountancy

1.6. Users of Financial Accounting - Information

1.7. Accounting as an Information System

1.8. Branches of Accounting

1.9. Advantages of Accounting

1.10. Limitations of Accounting

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Let Us Sum Up

Check Your Progress

Glossary

Answers to Check Your Progress

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Overview

In this Unit, the Introduction, need, objectives, definitions of accounting and the scope of accounting, book keeping of accounting and accountancy, financial accounting – Information, Accounting as an Information System, Branches of Accounting, Advantages of Accounting, Limitations of Accounting and Functions of Accounting has been clearly explained.

Objectives

After studying this unit, the students should be able to:

- explain the need for accounting;
- identify the objectives of accounting;
- describe accounting as an information system;
- outline the scope and bases of accounting;

- distinguish between book-keeping, accounting and accountancy;
- identify the parties interested in accounting information;
- describe the functions and important branches of accounting;
- describe the advantages and limitations of accounting; and
- state the qualitative characteristics of accounting.

1.1. Introduction

In this unit, we shall discuss the functions, branches, advantages, limitations, and bases for accounting. In this unit, we also intend to elaborate on the need for accounting and then discuss the nature, scope and importance of accounting.

1.2. Need for Accounting

Let us elaborate on the need for accounting. Suppose you are given ten rupees to purchase vegetables and asked to account for the amount. You have purchased the vegetables— 1 kg of tomatoes for Rs. 4/-, 1 kg of potatoes for Rs. 3/-, and 1 kg of brinjals for Rs. 2/-. The total amount spent is Rs. 9/- and the balance of amount with you is Rs.1/-. Thus, you have rendered the account for Rs. 10/-. This is one time affair. Therefore, you could remember what you have spent.

Suppose, you are given Rs. 2,000/- and asked to manage the home for a month and render the account for the money at the end of the month. You will be purchasing groceries, milk, vegetables, paying for electricity, school/college fees, etc. You will be spending almost everyday. In that case, is it possible to remember all the payments you are making every day and render an account at the end of the month? No, it is not possible to remember, especially when the number of payments is more. Not only that, it is not even advisable to depend on memory. Therefore, it is better to write down (or record) whatever payments you have made. Further, it is advisable to obtain receipts or bills for the payments you have made, so that you can render the account, beyond doubt.

1.3. Objectives of Accounting

From the above discussion, the objectives of accounting can be stated as follows:

1. **To keep systematic records:** Accounting is done to keep a systematic record of financial transactions, like purchase of goods, sale of goods, cash receipts and cash payments. Systematic record of various assets and liabilities of the business is also to be maintained.

2. **To ascertain the net effect of the business operations i.e., profit or loss of business:** We know that the primary objective of business is to make profit and the businessman is very much interested in knowing the same. A proper record of income and expenses facilitates the preparation of the profit and loss account (income statement). The profit and loss account reveals the profit earned or loss incurred by the business firm during a particular period.
3. **To ascertain the financial position of the business:** The businessman is not only interested in knowing the operating results, but also interested in knowing the financial position of his business i.e., where it stands. In other words, he wants to know when the business owes to others and what it owns and what happened to his capital – whether the capital increased or decreased or remained constant. A systematic record of various assets and liabilities facilitates the preparation of a statement known as ‘balance sheet’ (position statement) which answers these questions.
4. **To provide accounting information to interested parties:** Apart from the owners, there are various other parties who are interested in knowing about the business firm, such as the management, the bank, the creditors, the tax authorities, etc. For this purpose, the accounting system has to furnish the required information.

1.4. Definition and Scope of Accounting

Accounting has been defined in different ways by different authorities on the subject. Accounting is a comprehensive discipline and it is difficult to explain satisfactorily through any single definition. However, two definitions are given below. This should help you to understand Accounting, Accountancy and Bookkeeping.

The American Accounting Association defines Accounting as the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information. This definition stresses three aspects viz., identifying, measuring and communicating economic information.

In the words of the Committee on Terminology appointed by the American Institute of Certified Public Accountants, “Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least of

financial character and interpreting the results thereof”. This is a popular definition of accounting and it outlines the Accounting, Accountancy and Bookkeeping activity.

A business is generally started with proprietor’s funds i.e., capital. The proprietor may also acquire additional funds from outsiders like banks and creditors. These funds are utilised to acquire the assets needed for business and also to carry out other business activities. In the process many transactions and events take place. The accountant has to identify all such transactions and events, measure them in terms of money, and record them in appropriate books of account. Then, he has to classify them under separate heads of accounts, summarise periodically in the form of Profit and Loss Account and Balance Sheet; and analyse, interpret and communicate the results thereof to the interested parties. Accounting can thus be broadly defined as follows;

Accounting is the process of identifying, measuring, recording, classifying, summarising, analysing, interpreting, and communicating the financial transactions and events in monetary terms.

1.5. Book-Keeping, Accounting and Accountancy

Very often you will come across terms like bookkeeping, accounting, and accountancy in the literature on accounting. We propose to explain them in the following paragraphs:

You know Accounting involves a series of activities, as listed out in the scope of accounting. These activities are; (1) Identifying, (2) Measuring, (3) Recording,(4) Classifying, (5) Summarising, (6) Analysing, (7) Interpreting, and (8) Communicating the Financial Transactions and Events. –

Book-keeping is a narrow term, which means record keeping or maintaining books of account. It only covers the first four activities (1 to 4 above) of accounting.

The term ‘Accountancy’ refers to a systematized knowledge of accounting and is regarded as an academic subject like economics; statistics, chemistry, etc. It explains ‘why to do’ of various aspects of accounting. In other words, when accounting refers to the actual process of preparing and presenting the accounts, Accountancy tells us why and how to prepare the books of account and how to summarise the accounting information and communicate it to the interested parties. Thus Accountancy is a science, a body of systematised knowledge, whereas Accounting is the art of putting such knowledge into practice.

In general usage, however, Accountancy and Accounting are used as synonyms (meaning the same thing). But, of late, the term accounting is becoming more and more popular.

Check Your Progress-1

True/False

- a. Accounting is a comprehensive discipline and it is difficult to explain satisfactorily through any single definition.
- b. Tax authorities of the Government are interested in the financial statements so as to assess the tax liability of the enterprise.
- c. The term accounting is becoming more and more unpopular.
- d. A business is generally started with proprietor's funds i.e., capital.
- e. Owners contribute capital and assume the risk of business.

1.6. Users of Financial Accounting - Information

You have learnt that many groups of people are interested in accounting information which may help them:

- i) To understand the present position of the enterprise
- ii) To compare its present performance with that of its past years
- iii) To compare its present performance with that of similar enterprises.

Now, let us see who such parties are and how accounting information is useful to various parties.

Owners: Owners contribute capital and assume the risk of business. Naturally, they are interested to know the amount of profit earned by the business and so also its financial position. If however, the management of the business is entrusted to paid managers, the owners also use the accounting information to evaluate the performance of the managers.

Managers: Accounting information, supplemented by other information, is of immense use to managers. It helps them to plan, control and evaluate the operations of the business. They also need such information for various decision making.

Lenders : The funds are provided by the owners initially, but if the business requires more funds they are provided by banks and other lenders of money. Before they lend money, they would like to know the solvency (i.e., capacity to repay debts) of the enterprise, so as to satisfy

themselves that their money will be safe and that they can expect repayment on time.

Creditors: Those who supply goods and services on credit are called creditors. Like lenders, they too want to know about the solvency of the enterprise, so as to decide whether credit can be granted or not.

Prospective investors: A person who wants to become a partner in a partnership concern or a person who wants to become a shareholder of a company, would like to know how safe and rewarding the proposed investment would be.

Tax authorities: Tax authorities of the Government are interested in the financial statements so as to assess the tax liability of the enterprise.

Employees: The employees of the enterprise are also interested in knowing the state of affairs of the organisation in which they are working, so as to know how safe their interests are in that organisation.

1.7. Accounting as an Information System

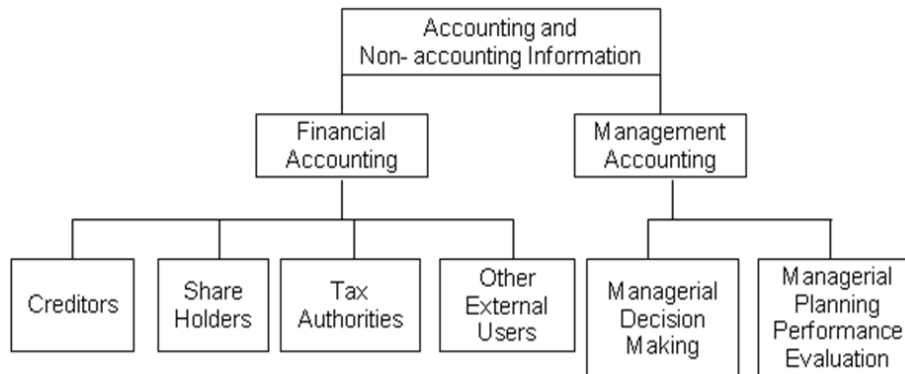
Accounting is part of an organization's information system, which includes both financial and non- financial data. Accounting is the process of identifying, measuring and communicating economic information to permit judgment and decisions by users of the information. The main objective of accounting is to provide information to the users. Accounting is also required to serve some broad social obligations since the accounting information is used by a large body of people such as customers, employees, investors, creditors and government.

Accounting is commonly divided into (1) Financial Accounting, and (2) Managerial Accounting. Financial accounting refers to the preparation of general purpose reports for use by persons outside an organization. Such users include shareholders, creditors, financial analysts, labour unions, government regulations etc. External users are interested primarily in reviewing and evaluating the operations and financial status of the business as a whole.

Uses of Accounting Information

Managerial accounting, on the other hand, refers to providing information to managers inside the organization. For example a production manager may want a report on the number of units of product manufactured by various workers in order to evaluate their performance. A sales manager might want a report showing the relative profitability of two products in order to pinpoint selling efforts. The financial reports are available from the libraries or company themselves whereas managerial

accounting reports are not widely distributed outside because they often contain confidential information. The following figure shows that accounting is part of an organization system which includes both financial and non financial data:



Managerial decision making: Management is continuously confronted with the need to make decisions. Some of these decisions may have immediate effect while the others have in the long run. Decisions regarding the price of the product like make or buy the product or to drop it, to expand its area of operations etc., are some of the examples of decisions making. Management Accounting provides necessary information to arrive at the right conclusions.

Managerial planning, control and internal performance evaluation: Managerial accounting plays an important role in the planning and control. By assisting management in the decision making process, information is provided for establishing the standard. Accounting also provides actual results to compare with projections.

For example, where a marketing manager is given a target of sales revenues of Rs. 10 crores, the amount of Rs. 10 crores will serve as a standard for evaluating the performance of the marketing manager. If annual sales revenues vary significantly from Rs. 10 crores, steps will be taken to ascertain the causes for the difference. When the factors leading to the variance are not under the control of the marketing manager, then the marketing manager would not be held responsible for it. On the other hand the cause for variance is under the control of marketing manager then he will be held responsible in evaluating the performance of marketing manager. Accounting provides necessary information to measure the variance in the actual performance.

External financial reporting: Accounting has always been used to supply information to those who are interested in the affairs of the

company. Various laws have been passed under which financial statements should be prepared in such way that required information is supplied to shareholders, creditors, government etc. For example, the investors may be interested in the financial strength of the business, creditors may require information about the liquidity position, government may be interested to collect details about sales, profit, investment, liquidity, dividend policy, prices etc. in deciding social and economic policies. Information is required in accordance with generally accepted accounting principles so that it is useful in taking important decisions.

1.8. Branches of Accounting

Accounting, as we know it today, has evolved over many centuries in response to the changing economic, social and political conditions. The development of modern accounting was influenced by a number of factors such as industrial revolution, growth of large enterprises like companies, introduction of compulsory audit of companies, legal regulations, establishment of professional organisations like the Institute of Chartered Accountants of India, the Institute of Cost and Works Accountants of India, American Institute of Certified Public Accountants, etc. Economic development and technological improvements have resulted in an increase in the scale of business operations and the advent of company form of organisation. This has made management function more and more complex. These factors have increased the importance of accounting and have given rise to special branches of accounting. The important branches of accounting are briefly explained below:

Financial Accounting: The purpose of this branch of accounting is to keep a record of financial transactions and events so that:

- a) the net result of the operations of the business (profit or loss) during an accounting period can be ascertained;
- b) the financial position (assets, liabilities and capital position) of the business as at the end of the period can be ascertained; and
- c) relevant financial information can be provided to management and other interested parties.

Cost Accounting: The purpose of cost accounting is to analyse the expenditure so as to ascertain the cost of each product, operation, service, etc. The price of an article is nothing but the cost plus a certain amount of profit. Unless cost is known, price cannot be fixed rationally.

Cost accounting helps not only in ascertaining the costs but also assists the management in controlling the costs.

Management Accounting: The purpose of management accounting is to assist the management in taking rational policy decisions and to evaluate the impact of its decisions and actions. Examples of such decisions are: pricing decisions, capital expenditure decisions, etc. This branch of accounting is primarily concerned with presenting information that may be needed by management in such decision-making.

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1.9. Advantages of Accounting

The following are the advantages of a properly maintained accounting system:

1. **Replaces memory:** Since all the financial events are recorded in the books, there is no need to rely on memory. The books of account will serve as historical records. Any information required at any time can be had from these records.
2. **Provides control over assets:** Accounting provides information regarding balance of cash in hand and at bank, the stock of goods in hand, the amount receivable from various parties, the amount invested in various other assets, etc. Information about these matters help owner(s) and management to make use of the assets in the best possible way.
3. **Facilitates the preparation of financial statements:** With the help of information contained in the accounting records, financial statements viz., Profit and Loss Account and Balance Sheet can be easily prepared. These statements enable the businessman to know the net result of the business during an accounting period and its financial position.
4. **Meets the information requirements:** Various interested parties such as owners, management, lenders, creditors, etc. get the necessary information at frequent intervals which help them in their decision-making.
5. **Facilitates a comparative study:** The financial Statements prepared will enable the enterprise to compare its present position with that of its past, and with that of similar organisations. This helps them to draw useful conclusions and improve their performance.
6. **Assists the management in many ways:** It is possible to identify reasons for the profit earned or loss suffered. The identification of reasons helps in taking necessary steps to increase profits further, or to avoid losses. Accounting

information will also help in planning and controlling the activities of the business.

7. **Difficult to conceal fraud or theft:** It is difficult to conceal fraud, theft, etc..as there is an automatic check in the form of periodic balancing of books of account. Further, in big organisations, the record keeping work is divided among many persons. so that chances of committing fraud are minimised.
8. **Tax matters :** The Government levies various taxes such as customs duty, excise duty, sales tax, and income tax. Properly maintained accounting records will help in the settlement of tax matters with the tax authorities.
9. **Ascertaining value of business:** In the event of sale of a business firm, the accounting records will help in ascertaining the value of business.

1.10. Limitations of Accounting

The accounting information is used by various parties who form judgments about the profitability and the financial soundness of a business on the basis of such information. It is, therefore, necessary to know about the limitations of accounting. These are as follows:

- 1 They do not record transactions and events which are not of a financial character. Hence. They do not reveal a complete picture because facts like quality of human resources, licences possessed, locational advantage, business contacts, etc. do not find any place in books of account.
- 2 The data is historical in nature. The accountants adopt historical cost as the basis in valuing and reporting all assets and liabilities. They do not reflect current values, it is quite possible that items like land and buildings may have much more value than what is stated in the balance sheet.
- 3 Facts recorded in financial statements are greatly influenced by accounting conventions and personal judgements. Hence, they do not reveal the true picture. In many cases, estimates may be used to determine the value of various items. For example, debtors are estimated in terms of collectability, inventories are based on marketability, and fixed assets are based on useful working life. All these estimates are materially affected by personal judgements.

- 4 Data provided in the financial statements is insufficient for proper analysis and decision making. It only provides information about the overall profitability of the business. No information is given about the cost and profitability of different activities.

1.11. Functions of Accounting

Functions of Accounting involves the creation of financial records of business transactions, flows of finance, the process of creating wealth in an organization, and the financial position of a business at a particular moment in time. The progress and reputation of any business big or small is build up on sound financial footing. There are a number of parties who are interested in accounting information relating to a business. Financial Accounting communicates financial information of the business concern to various parties. Financial accounting provides information regarding the status of a business and results of its operation. Here are the functions of accounting:

1. **Recording:** This is the basic function of accounting. It is essentially concerned with not only ensuring that all business transactions of financial character are in fact recorded but also that they are recorded in an orderly manner. Recording is done in the book "Journal".
2. **Classifying:** Classification is concerned with the systematic analysis of the recorded data, with a view to group transactions or entries of one nature at one place. The work of classification is done in the book termed as "Ledger".
3. **Summarizing:** This involves presenting the classified data in a manner which is understandable and useful to the internal as well as external end-users of accounting statements. This process leads to the preparation of the following statements: (1) Trial Balance, (2) Income statement (3) Balance Sheet.
4. **Analysis and Interprets:** This is the final function of accounting. The recorded financial data is analyzed and interpreted in a manner that the end-users can make a meaningful judgment about the financial condition and profitability of the business operations. The data is also used for preparing the future plan and framing of policies for executing such plans.
5. **Communicate:** The accounting information after being meaningfully analyzed and interpreted has to be communicated in a proper form and manner to the proper person. This is done through preparation and distribution of accounting reports, which

include besides the usual income statement and the balance sheet, additional information in the form of accounting ratios, graphs, diagrams, funds flow statements etc.

Let Us Sum Up

In this unit, you have learned about the following:

Business has a series of transactions. It is not possible to remember all the transactions which have taken place over a period of time, and calculate the net effect of all such transactions i.e., profit or loss. Hence, the need for accounting takes place. Information about the business enterprise is required for both internal and external use, rational decision-making. Accounting is the process of identifying, measuring, recording, classifying, summarising, analysing, interpreting and communicating the financial transactions and events.

Check Your Progress-2

1. All accounts are classified into-
 - a) Personal
 - b) Real
 - c) Nominal accounts
 - d) Any of the above
2. Accounts recording transactions with a person or group of persons are known as-
 - a) Personal accounts
 - b) Real accounts
 - c) Nominal accounts
 - d) Impersonal accounts
3. Personal accounts are of the following types:
 - a) Natural, Real, Representative
 - b) Artificial, Legal, Nominal
 - c) Natural, Artificial, Representative
 - d) Any of the above
4. An account recording transaction with an individual human being is termed as a-
 - a) Artificial or legal person account
 - b) Natural persons' personal account
 - c) Representative personal accounts
 - d) Any of the above

5. It is essential to standardize the accounting principles and policies in order to ensure
- a) Transparency
 - b) Profitability
 - c) Reputation
 - d) All of the above

Glossary

Accountancy:	The science of measurement of wealth. It is the systematic knowledge of accounting.
Accounting:	Process of identifying, measuring, recording, classifying, summarising and communicating business transactions and events in terms of money.
Accounting Year :	A period of 12 months at the end of which the financial results of the enterprise are generally ascertained.
Accrual Basis of Accounting:	A basis of accounting which takes into account all incomes, gains, expenses and losses in the year in which they are earned or incurred, and not when they are received or paid.
Book-keeping:	Systematic recording of business transactions in the books of account.
Balance Sheet:	A statement prepared for ascertaining the financial position of the business as at the end of the accounting period
Cash Basis of Accounting:	A basis of accounting in which accounts are prepared on the basis of cash received or cash paid. No accruals -are considered
Cost Accounting:	A branch of accounting concerned with measurement and control of costs.
Financial Accounting:	It is primarily concerned with record keeping directed towards preparation of financial statements and other accounting reports.

Financial Position:	Position of assets and liabilities of a business at a given point of time.
Financial Statements:	Summary of accounting information such as Profit and Loss Account and Balance Sheet.
Final Accounts :	Financial statements prepared at the end of the accounting period for ascertaining the profit or loss and the financial position of the business. They include Profit and Loss Account and the Balance Sheet.
Management:	It is used in two senses: To mean the process of management or managing the business, for example, the day-to-day management is entrusted to paid managers; and To mean the persons who are incharge of carrying out the business activity
Management Accounting:	It is concerned with the supply of information which is useful to the management in planning, controlling and decision-making.
Profit:	Excess of income over expenses.
Profit and Loss Account:	A statement showing all incomes and expenses for the accounting period. It is prepared for ascertaining the operational result of the enterprise.

Answers to Check Your Progress-1

- a-True
- b-True
- c-False
- d-True
- e-True

Answers to Check Your Progress-2

1. d) Any of the above
2. a) Personal accounts
3. c) Natural, Artificial, Representative
4. b) Natural persons' personal account
5. a) Transparency

Suggested Readings

1. Briston, R.J.,2017, Introduction to Accountancy and Finance, London: The Macmillan Press Ltd.,
2. Goel D. K., 2020-Accountancy Arya Publications, 1569/30 Naiwala, Karol Bagh, New Delhi

Unit-2

Accounting Process, Concepts and Conventions

STRUCTURE

Overview

Objectives

2.1. Introduction

2.2. Accounting Process

2.3. What is an Account?

2.4. Classification of Accounts

2.5. Principle of Double Entry

2.6. Accounting Rules

2.7. Accounting Principles

2.8. Accounting Concepts

Let Us Sum Up

Check Your Progress

Glossary

Answers to Check Your Progress

Suggested Readings

Overview

This Unit deals with the Introduction of Accounting Process, Classification of Accounts, Principle of Double Entry, Accounting Rules, Accounting Principles and Accounting Concepts.

Objectives

After studying this unit, the students should be able to:

- identify the different stages of accounting;
- classify accounts;
- analyze the dual effect of each transaction; and
- apply the rules of accounting, and determine the account to be debited and the account to be credited.

2.1. Introduction

So far you have learnt the definition of accounting, its objects, advantages, the terms commonly used in accounting, and the basic accounting concepts relevant to record keeping. You know accounting is

the art of recording, classifying and summarising the business transactions, and interpreting the results thereof. So, the accounting process starts with recording of transactions and ends with the preparation of financial statements and their analysis. In this unit, we shall first identify the different stages involved in the accounting process and then discuss different classes of accounts, the principle of double entry, and the rules of debit and credit which you are expected to master.

2.2. Accounting Process

The accounting process consists of the following four steps:

1. **Recording the Transactions:** The accounting process begins with recording of transactions in the books of the original entry. The book used for the original entries is called 'Journal'. Business transactions are recorded in the journal as and when they occur in the order of dates. You will learn the method of recording a transaction in the journal in Unit 5. Entries in the journal are made on the basis of various vouchers such as cash memos, invoices, receipts, etc.
2. **Classifying the Transactions:** The second step is to group the transactions of similar nature and post those in different accounts in another book called the 'Ledger'. For example, all transactions relating to cash are brought together and are recorded at one place in the Cash Account in the ledger. Similarly, dealings with different persons are recorded separately in the account of each person. The accounts so prepared are totalled and balanced periodically to know the net effect of related transactions. We shall discuss the process of posting into ledger and balancing of accounts in detail in Unit 5.
3. **Summarising the Transactions:** The next step is to prepare a year-end summary known as 'Final Accounts. But before final accounts are prepared, we prepare a statement called 'Trial Balance' to test the arithmetical accuracy of the work done. In other words, the trial balance is prepared to find out whether the Principle of Double Entry has been strictly followed or not, while recording the transaction. Then, with the help of the trial balance and some other relevant information we prepare the final accounts. The objectives of preparing the final accounts are: (i) to know the net result of business activities, and (ii) to know the financial position of the business. The final accounts consist of

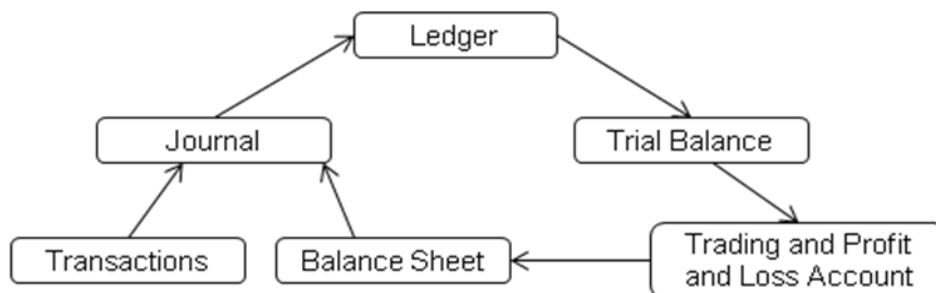
an income statement called 'Trading and Profit and Loss Account', and a position statement called 'Balance Sheet'.

The Trading and Profit and Loss Account is prepared to know whether the business unit has earned profit or incurred loss. The Balance Sheet is prepared to know the financial position of the business, i.e., what the business owns and what it owes.

4. **Interpreting the Results:** The results are then analysed and interpreted with a view to assess the performance of the business, its future profit-earning capacity and its ability to pay short-term and long-term debts. The results and conclusions thus arrived at are reported to the interested parties like investors, management, bankers, creditors, tax authorities, etc.

The balances on various accounts shown in the Balance Sheet will then be transferred to the new books of account for the next year. The process of recording transactions for the next year is again started, this continuous process of accounting is referred to as the 'Accounting Cycle' because it repeats itself regularly and in the same order.

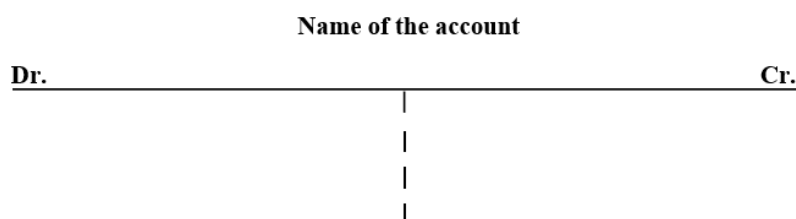
The Accounting Cycle is as follows:



2.3. What is an Account?

We have seen that an account is a summarised record of the effect of all transactions relating to a particular person or an item. Let us now learn more about this term.

An account is vertically divided into two halves and resembles the shape of the English alphabet 'T' as under:



The left hand side is called the 'debit side'. It is indicated by writing 'Dr.'(abbreviation for debit) on the left hand top corner of the account. The right hand side known as the 'credit side' is indicated by writing 'Cr.' (abbreviation for credit) on the right hand top corner of the account. The name of the account is written at the top in the centre. The word 'Account' or its abbreviation 'A/ c' is added to the name of the account. The rules of recording the transactions on the debit and credit sides shall be discussed later in this unit.

2.4. Classification of Accounts

All business transactions broadly be classified into three categories: (i) those relating to persons, (ii) those relating to property (assets), and (iii) those relating to incomes and expenses. Hence, it becomes necessary to keep an account for each person, each asset, and each item of income and expense. Thus, three classes of accounts are maintained for recording all business transactions. They are: (i) Personal Accounts, (ii) Real Accounts, and (iii) Nominal Accounts. Real and Nominal Accounts taken together are called Impersonal Accounts.

Personal Accounts

Accounts which show dealings with persons are called 'Personal Accounts'. Such dealings may relate to credit purchases of goods or credit sales of goods or loans taken, etc. A separate account is kept in the name of each person for recording the benefits received from, or given to, the person in the course of dealings with him. Examples are: Krishna's Account, Gopal's Account, Loan from Ratanlal Account, etc.

Personal accounts also include accounts in the names of institutions or companies called artificial persons) such as Indian Bank Account. Nagarjuna Finance Limited Account, the Andhra Pradesh Paper Mills Limited Account, etc.

The accounts which represent expenses payable, expenses paid in advance, incomes receivable and incomes received in advance are also personal accounts, though impersonal in name. For example, when salaries are due to the employees, but not paid before closing of the books of account for the year, an account called 'Salaries Outstanding Account' will be opened in the books. The Salaries Outstanding Account is regarded as a personal account representing the employees to whom salaries are payable by the business. Such a personal account is called 'Representative Personal Account' as it represents a particular person or a group of persons. Other examples of representative personal accounts are: Interest Outstanding Account, Prepaid Insurance Account, Rent Received in Advance Account, Commission Outstanding Account. etc.

Capital Account and Drawings Account are also treated as personal accounts as they represent dealings with the owner of the business.

Real Accounts

Accounts relating to properties or assets are known as 'Real Accounts'. Every business needs assets such as Machinery, Furniture, etc., for running its activities. In book-keeping, a separate account is maintained for each asset owned by the business. Dealings relating to purchase or sale of the asset are recorded through this account. Furniture Account, Machinery Account, Building Account, etc., are some examples of real accounts. A Cash Account which shows receipts and payments of cash is also a real account. They are known as real accounts because they represent things of value owned by the business.

Nominal Accounts

Accounts relating to expenses, losses, incomes and gains are known as 'Nominal Accounts'. Every business unit incurs certain expenses such as payment of salaries to employees, payment of wages to workers, etc., while carrying out its activities. It may also suffer losses such as loss by fire, loss by theft, etc. It may also earn certain incomes and gains such as receipt of commission, receipt of interest, profit on sale of an asset, etc. A separate account is maintained for recording each item of expense, loss, income or gain. Thus, Wages Account, Salaries Account, Commission Received Account, and Interest Received Account are all nominal accounts.

Check Your Progress-1

True/False

- a. The accounting process not begins with recording of transactions in the books of the original entry.
- b. The Trading and Profit and Loss Account is prepared to know whether the business unit has earned profit or incurred loss.
- c. Accounts relating to expenses, losses, incomes and gains are known as 'Nominal Accounts'.
- d. The 'Dr.' represents the receiving aspect and the 'Cr.' the giving aspect.
- e. Accounts which show dealings with persons are called 'Personal Accounts'.

2.5. Principle of Double Entry

You have learnt earlier that a transaction results in the transfer of money or money's worth i.e., goods or services. Hence, every business transaction involves a transfer and as such consists of two aspects: (i) the receiving aspect, and (ii) the giving aspect. It is necessary to note that these two aspects go together, as receiving necessarily implies giving and vice versa. For example, let us consider a transaction where machinery is purchased for cash. In this case, the receiving aspect is machinery (as machinery comes in) and the giving aspect is cash (as cash goes out). Similarly, in a transaction where wages are paid to workers, the receiving aspect is the service of the workers and the giving aspect is cash. The receiving and giving take place between two parties or the accounts representing those parties.

Thus, in the first example discussed above, from the point of view of the business, Machinery Account is receiving the benefit and Cash Account is giving the benefit. In the second example, Wages Account is receiving the benefit in the form of service and Cash Account is giving the benefit. These two aspects are represented in every account by the terms 'Dr.' and 'Cr.'. The 'Dr.' represents the receiving aspect and the 'Cr.' the giving aspect. The record of any business transaction will be complete only when both of these aspects are recorded. This recording of the two aspects of each transaction is known as 'Double Entry' and the system is called 'Double Entry System'.

Thus, every transaction affects two accounts and according to Double Entry system entries will be made in both of them on the debit side (left hand side) in one account and on the credit side (right hand side) in the other. In case of the first example (machinery purchased for cash), entries will be made on the debit side of Machinery Account and the credit side of Cash Account. In the case of second example (wages paid to workers), entries will be made on debit side of Wages Account and the credit side of Cash Account. Hence, for every debit there must be a corresponding credit for an equal amount and vice versa. This is known as the 'Principle of Double Entry, and all business transactions are recorded in books of account according to this principle.

Transaction	First Aspect		Second Aspect	
	Receiving Receiver	Account affected	Giving / Giver	Account affected
1. Commenced business with Rs. 50,000 as capital.	Cash	Cash A/c	Proprietor	Capital A/c

2. Bought goods for cash Rs. 5,000	Goods	Goods A/c	Cash	Cash A/c
3. Bought goods from Ramesh & Co. on credit Rs. 10,000	Goods	Goods A/c	Ramesh & Co.	Ramesh & Co. A/c
4. Sold goods for cash Rs. 12,000	Cash	Cash A/c	Goods	Goods A/c
5. Sold goods to Ajay on credit Rs. 2,500	Ajay	Ajay's A/c	Goods	Goods A/c
6. Paid cash to Ramesh & Co. Rs. 5,000	Ramesh & Co.	Ramesh & Co. A/c	Cash	Cash A/c
7. Received Cash from Ajay Rs. 1,000	Cash	Cash A/c	Ajay	Ajay's A/c
8. Paid rent Rs. 1,000	Benefit of accommodation	Rent A/c	Cash	Cash A/c
9. Purchased Typewriter Rs. 4,500	Typewriter	Typewriter A/c	Cash	Cash A/c
10. Paid interest on loan Rs. 1,200	Benefit of using the loan	Interest A/c	Cash	Cash A/c

2.6. Accounting Rules

We have already seen that every transaction affects two accounts and this effect will have to be entered in both of them, on the debit side in one account and on the credit side in the other account. It is, therefore, necessary to find out which of the two accounts is to be debited and which is to be credited. For this purpose, one has to first identify the class to which these two accounts belong i.e., personal, real or nominal; and then certain rules known as 'rules of debit and credit' are applied. These rules are as follows:

1. **For Personal Accounts:** The account of the person receiving the benefit (receiver) of the transaction (from the business) is debited and the account of the person giving the benefit (giver) of the transaction (to the business) is credited.
2. **For Real Accounts:** When an asset is coming into the business, the account of that asset is debited. When an asset is going out of the business, the account of that asset is credited.
3. **For Nominal Accounts:** When an expense is incurred or loss suffered, the account representing the expense or the loss is debited because the business receives the benefit thereof. When any income is earned or gain made, the account representing the income or the gain is credited. This is because the business gives some benefit.

Transaction	Accounts affected Accounts	Class of Credit	Debit / Credit	Reasons
1. Commenced business with Rs. 50,000 as capital	i) Cash A/c ii) Capital A/c	Real Personal	Debit Credit	Cash comes in Proprietor gives benefit
2. Bought goods for cash Rs. 5,000	i) Goods A/c ii) Cash A/c	Real Real	Debit Credit	Goods come in Cash goes Out
3. Bought goods from Sohan	i) Goods A/c ii) Sohan A/c	Real Personal	Debit Credit	Goods come in
4. Sold goods for cash Rs. 1,500	i) Cash A/c ii) Goods A/c	Real Real	Debit Credit	Cash comes in Goods go Out
5. Sold goods to Vijay on credit Rs. 2,500	i) Vijay A/c ii) Goods A/c	Personal Real	Debit Credit	Receiver Goods go out
6. Purchased furniture Rs. 4,000	i) Furniture A/c ii) Cash A/c	Real Real	Debit Credit	Furniture comes in Cash goes out
7. Sold old typewriter Rs. 500	i) Cash A/c ii) Typewriter A/c	Real Real	Debit Credit	Cash comes in Typewriter goes out
8. Purchased postage stamps Rs. 50	i) Postage A/c ii) Cash A/c	Nominal Real	Debit Credit	Postage is an expense Cash goes out
9. Paid salaries Rs. 6,000	i) Salaries A/c ii) Cash A/c	Nominal Real	Debit Credit	An expense Cash goes out
10. Received interest Rs. 200	i) Cash A/c ii) Interest A/c	Real Nominal	Debit Credit	Cash comes in an income

2.7. Accounting Principles

Accounting is a system evolved to achieve a set of objectives as stated in Unit 1.2. The objectives identify the goals and purposes of financial record keeping and reporting. In order to achieve the goals, we need a set of rules or guidelines. These guidelines are termed here as 'Basic Accounting Concepts'.

The term 'concept' means an idea or thought. Basic accounting concepts are the fundamental ideas or basic assumptions underlying the theory and practice of financial accounting. These concepts are also termed as 'Generally Accepted Accounting Principles'. These are the broad working rules of accounting activity, developed and accepted by the accounting profession.

They are evolved (and are still evolving) over a period in response to the changing business environment and the specific needs of the users of accounting information

The concepts guide the identification of events and transactions to be accounted for, their measurement and recording, and the method of summarising and reporting to interested parties. The concepts, thus, help in bringing about uniformity in the practice accounting.

An in depth understanding of these concepts will place the student in a better position to appreciate the accounting system. Of course, it may be difficult to comprehend all these concepts at a stretch. We, therefore, advise you to revisit these concepts, after giving at least one reading of this course material. These concepts may be classified into two broad groups:

1. Concepts to be observed at the recording stage i.e., while recording the transactions, and
2. Concepts to be observed at the reporting stage, i.e., at the time of preparing the final accounts.

It must, however, be remembered that some of them are overlapping and even contradictory.

2.8. Accounting Concepts

Concepts to be observed at the Recording Stage

The following concepts will guide us in identifying, measuring and recording transactions.

Business Entity Concept

Business entity means a unit of organised business activity. In that sense, a provision store, a cloth dealer, an industrial establishment or electricity supply undertaking, a bank, a school, a hospital, etc. are all business entities.

From the accounting point of view, every business enterprise is an entity separate and distinct from its proprietor(s)/owner(s). The accounting system gives information only about the business and not about its owner(s). In other words, we record those transactions in the books of account which relate only to the business. The owner's personal affairs (his expenditure on housing, food, clothing, etc.) will not appear in the books of account of his business. However, when personal expenditure of the owner is met from business funds it shall also be recorded in the business books. It will be recorded as drawings by the proprietor and not

as business expenditure.

The business entity concept is applicable to all forms of business organisations. This distinction can be easily maintained in the case of a limited company because the company has a legal entity of its own. But such distinction becomes difficult in case of a sole proprietorship or partnership because in the eyes of the law, the partner or the sole proprietor are not considered separate entities. They are personally liable for all business transactions. But, for accounting purposes, they are to be treated as separate entities. This enables them to ascertain the profit or loss of business more conveniently and accurately.

Money Measurement Concept

Usually, business deals in a variety of items having different physical units such as kilograms, quintals, tons, metres, litres, etc. If the sales and purchases of different items are recorded in terms of their physical units, adding them together will pose problems. But, if these are recorded in a common denomination, their total becomes homogeneous and meaningful. Therefore, we need a common unit of measurement. Money does this function. It is adopted as the common measuring unit for the purpose of accounting. All recording, therefore, is done in terms of the standard currency of the country where business is set up. For example, in India, it is done in terms of Rupees, in USA it is done in terms of US Dollars, and so on.

Objective Evidence Concept

The term objectivity refers to being free from bias or free from subjectivity.

Accounting measurements are to be unbiased and verifiable independently. For this purpose, all accounting transactions should be evidenced and supported by documents such as bills, invoices, receipts, cash memos, etc. These supporting documents (vouchers) form the basis for making entries in the books of account and for their verification by auditors afterwards. As for the items like depreciation and the provision for doubtful debts where no documentary evidence is available, the policy statements made by management are treated as the necessary evidence.

Historical Record Concept

You know that after identifying the transactions and measuring them in terms of money, we record them in the books of account. According to the historical record concept, we record only those transactions which have actually taken place and not those which may take place (future

transactions). It is because accounting record presupposes that the transactions are to be identified and objectively evidenced. This is possible only in the case of past (actually happened) transactions. The future transactions can hardly be identified and measured accurately. You also know that all transactions are to be recorded in chronological (date wise) order. This leads to the preparation of a historical record of all transactions. It also implies that we simply record the facts and nothing else.

Cost Concept

Business activity, in essence, is an exchange of money. The price paid (or agreed to be paid in case of a credit transaction) at the time of purchase is called cost. According to the cost concept, all assets are recorded in books at their original purchase price. This cost also forms an appropriate basis for all subsequent accounting for the assets. For example, if the business buys a machine for Rs. 80,000/- it would be recorded in books at Rs. 80,000/-. In case its market value increases later on to Rs. 1,00,000/- (or decreases to Rs. 50,000/-) it will continue to be shown at Rs. 80,000/- and not at its market value.

This does not mean, however, that the asset will always be shown at cost. You know that with passage of time, the value of an asset decreases. Hence it may systematically be reduced from year to year by charging depreciation and the asset be shown in the balance sheet at the depreciated value. The depreciation is usually charged as a fixed percentage of cost. It bears no relationship with changes in its market value. In other words, the value at which the assets are shown in the balance sheet has no relevance to its market value.

Dual Aspect Concept

This is the basic aspect of accounting. According to this concept, every business transaction has a two-fold effect. In commercial context, it is a famous dictum that "every receiver is also a giver and every giver is also a receiver". For example, if you purchase a machine for Rs. 8,000/- you receive the machine on the one hand and give Rs. 8,000/- on the other. Thus, this transaction has a twofold effect i.e., (i) increase in one asset and (ii) decrease in another. Similarly, if you buy goods worth Rs. 500/- on credit it will increase an asset (stock of goods) on the one hand and increase a liability (creditors) on the other. Thus, every business transaction involves two aspects: (i) the receiving aspect, and (ii) the giving aspect. In case of the first example you find that the receiving aspect is machinery and the giving aspect is cash. In the second example the receiving aspect is goods and the giving aspect is the

creditor. If a complete record of transactions is to be made, it would be necessary to record both the aspects in books of account. This principle is the core of double entry book-keeping and if this is strictly followed, it is called 'Double Entry System of Book-keeping' about which you will learn in detail later.

Let us understand another accounting implication of the dual aspect concept. To start with, the initial funds (capital) required by the business are contributed by the owner. If necessary, additional funds are provided by the outsiders (creditors). As per the dual aspect concept all these receipts create corresponding obligations for their repayment. In other words, a contribution to the business, either in cash or kind, not only increases its resources (assets), but also its obligations (liabilities/equities) correspondingly. Thus, at any given point of time, the total assets and the total liabilities must be equal.

This equality is called 'balance sheet equation' or 'accounting equation'. It is stated as under:

Liabilities (Equities) = Assets or

Capital + Outside Liabilities = Assets

The term 'assets' denotes the resources (property) owned by the business while the term 'equities' denotes the claims of various parties against the business assets. Equities are of two types: (1) owners' equity, and (ii) outsiders' equity. Owners' equity called capital is the claim of the owners against the assets of the business. Outsiders' equity called liabilities is the claim of outside parties like creditors, bank, etc. against the assets of the business. Thus, all assets of the business are claimed either by the owners or by the outsiders. Hence, the total assets of a business will always be equal to its liabilities.

Concepts to be observed at the Reporting Stage

The following concepts have to be kept in mind at the time of preparing the final accounts. Let us discuss them one by one:

Going Concern Concept

Normally, the business is started with the intention of continuing it indefinitely or at least for the foreseeable future. The investors lend money and the creditors supply goods and services with the expectation that the enterprise would continue for long. Unless there is a strong evidence to the contrary, the enterprise is normally viewed as a going (continuing) concern. Hence, financial statements are prepared on a going concern basis and not on liquidation (closure) basis.

Certain expenses like rent, repairs, etc., give benefits for a short period, say less than one year. But the benefit of some other expenditure like purchase of a building, machinery, etc., is spread over a longer period. The expenditure whose benefit is limited to one accounting year is fully charged to the Profit and Loss Account of the year. But the cost of the items whose benefit is available for a number of accounting years, their cost must be spread over a number of years.

Hence, only a portion of such expenditure is charged to the Profit and Loss Account every year. The balance is shown in the Balance Sheet as an asset. Let us take an example. Suppose a firm purchased a delivery van for Rs. 60,000/- and its expected life is 10 years. It means the business will use the van for a period of 10 years. So, the accountant has to spread the cost of the van over 10 years. He would charge Rs. 6,000/- (1/10 of its cost) every year to the Profit and Loss Account in the form of depreciation, and show the balance in the Balance Sheet as an asset.

This is based on the assumption that the business will continue for long and the asset will be used for its expected life. Thus, this concept is regarded as the basic assumption in accounting according to which the fixed assets are valued at historical cost less depreciation and not at its realisable value.

Accounting Period Concept

You know the going concern concept assumes that the business will continue for a long period, almost indefinitely. But the businessmen cannot postpone the preparation of financial statements indefinitely. Therefore, he prepares them periodically. This will also enable other interested parties such as owners, investors, creditors, tax-authorities to make periodic assessment of its performance. So, the life of the business enterprise is divided into what are called accounting periods'. The profit or loss and the financial position at the end of each such accounting period is regularly assessed.

Conventionally, duration of the accounting period is twelve months. It is called an 'accounting year'. Accounting year can be a calendar year i.e., January 1 to December 31 or any other period of twelve months, say, April 1 to March 31 or Dewali to Dewali.

Normally, the final accounts are prepared at the end of each accounting year. The Profit and Loss Account is prepared for the year so as to ascertain the profit earned or loss incurred during that year, and the balance sheet is prepared as at the end of the year, so as to show the financial position as on that date. However, for internal management

purposes, accounts can be prepared even for shorter periods, say monthly, quarterly or half yearly.

Matching Concept

This is also called 'Matching of Costs against Revenues Concept'. To work out profit or loss of an accounting year, it is necessary to bring together all revenues and costs pertaining to that accounting year. In other words, expenses incurred in an accounting year should be matched with the revenues earned during that year. The crux of the problem, therefore, is that appropriate costs must be matched against appropriate revenues. For this purpose, first we have to recognise the inflows (revenues) during an accounting period and the costs incurred in securing those inflows. Then, the sum of the costs should be deducted from the sum of the revenues to arrive at the net result of that period. Let us now understand how to recognise the revenues and costs in relation to an accounting period. For this purpose, the following rules are followed:

Conservatism Concept

This is also known as Prudence Concept understatement of assets or revenues, and overstatement of liabilities or costs. This is in accordance with the traditional view which states 'anticipate no profits but anticipate all losses'. In other words, you should account for profits only when they are actually realised. But in case of losses, you should take into account even those losses which may be a remote possibility. This is why closing stock is valued at cost price or market price whichever is lower. Provision for doubtful debts and provision for discounts on debtors are also made according to this concept.

Consistency Concept

The principle of consistency means 'conformity from period to period with unchanging policies and procedures'. It means that accounting method adopted should not be changed from year to year. For example, the principle of valuing closing stock 'at cost price or market price whichever is lower' should be followed year after year. Similarly, if depreciation on fixed assets is provided on straight line basis, it should be followed consistently year after year. Consistency eliminates personal bias and helps in achieving comparable results.

If this principle of consistency is not followed, the accounting information about an enterprise cannot be usefully compared with similar information about other enterprises and so also within the same enterprise for some other period. Consistent use of the same methods and bases from one

period to another, enhances the utility of the financial statement.

However, consistency does not prohibit change. Desirable changes are always welcome. But such changes should be completely disclosed while presenting the financial statements.

Full Disclosure Concept

You know the financial statements are the basic means of communicating financial information to all interested parties. These statements are the only source for assessing the performance of the enterprise for investors, lenders, suppliers, and others. Therefore, financial statements and their accompanying foot-notes should completely disclose all relevant information of a material nature which relate to the profit and loss and the financial position of the business. This enables the users of the financial statements to make correct assessment about the profitability and financial soundness of the enterprise. It is therefore, necessary that the disclosure should be full, fair and adequate.

Materiality Concept

This concept is closely related to the Full Disclosure Concept. Full disclosure does not mean that everything should be disclosed. It only means that all relevant and material information must be disclosed. Materiality primarily relates to the relevance and reliability of information. An item is considered material if there is a reasonable expectation that the knowledge of it would influence the decision of the users of the financial statements. All such material information should be disclosed through the financial statements and the accompanying notes. For example, commission paid to sole selling agents, if any, should be disclosed separately in the Profit and Loss Account. Similarly, if there is a change in the method or rate of depreciation, this fact must be duly reported in the financial statements.

Let Us Sum Up

In this unit, you have learned about the following:

In practice the accounting process starts with recording of transactions in the journal. From the journal, they are posted to ledger accounts. Then, a trial balance is prepared to verify the accuracy of the work done and the final accounts are prepared to know the profit or loss made and the financial position of the business. Finally, the results are analysed and reported to the interested parties.

Check Your Progress-2

1. Accounting principles are divided into:
 - a) Accounting Concepts
 - b) Accounting Conventions
 - c) Fundamental Accounting Assumptions
 - d) All of the above
2. According to which of the following accounting principles, the owners of business are considered as creditors?
 - a) Money Measurement.
 - b) Cost.
 - c) Dual Aspect.
 - d) Separate Legal Entity (Business and owners are two separate entities)
3. Which accounting principle differentiates between owners and management?
 - a) Going Concern
 - b) Dual Aspect
 - c) Separate Entity
 - d) Conservatism
4. According to going concern, a business is assumed as having:
 - a) a limited life
 - b) a indefinite life
 - c) a very long life
 - d) None of the above
5. Accounting concepts are based on:
 - a) Certain assumptions
 - b) Certain facts and figures
 - c) Certain accounting records
 - d) Government guidelines

Glossary

Account: A summarised record which shows the effect of the transactions relating to a particular person or thing.

Credit:	Credit represents the giving aspect of a transaction.
Debit:	Debit represents the receiving aspect of a transaction.
Double Entry Principle:	Principle of recording both the receiving and the giving aspects of each transaction.
Nominal Accounts:	Accounts relating to expenses, losses, incomes and gains.
Personal Accounts:	Accounts which relate to persons.
Real Accounts:	Accounts which relate to assets.
Account:	A classified statement of transactions relating to a person or a thing or any other subject.
Assets:	Anything which has economic value.
Business Entity:	A business enterprise.
Capital:	Owner's investment or equity in a firm.
Cash Discount:	An allowance given by the creditor to the debtor on the amount due for prompt payment.
Creditor:	One to whom the business owes some amount.
Debtor:	One who owes some amount to the business.
Drawings:	Amount withdrawn by the owner from the business for personal use.
Equity:	The claim or right over the assets of the firm. It includes both the owner's and the creditor's claims.
Expenditure:	Spending of money or incurring a liability for some benefit or service received by the business.
Gain:	Profit arising from peripheral or incidental transactions.

Answers to Check Your Progress-1

a-False

b-True

c-True

d-True

e-True

Answers to Check Your Progress-2

1. d) All of the above
2. d) Separate Legal Entity (Business and owners are two separate entities)
3. c) Separate Entity.
4. b) a indefinite life
5. a) Certain assumptions

Suggested Readings

1. Grewal T.S.2018, Double Entry Book-Keeping ,Sultan Chand & Sons.
2. Maheshwari, S.N., 2018, Principles and Practice of Book-Keeping (New Delhi: Arya Book Publications.

Unit-3

Accounting Standards

Structure

Overview

Objectives

3.1. Concept of Accounting Standards

3.2. Benefits of Accounting Standards

3.3. Procedure for Issuing AS in India

3.4. Salient Features of First Time Adoption of Indian Accounting Standards (Ind-AS):101

3.5. Currently Prevailing Accounting Standards in India

3.6. International Financial Reporting Standards

3.7. Need and Procedure of IFRS

3.8. Convergence to IFRS

3.9. Distinction between Indian AS and International AS

3.10. Measurement of Business Income

Let Us Sum Up

Check Your Progress

Glossary

Answers to Check Your Progress

Suggested Readings

Overview

In this Unit the Concept of an Accounting Standard, Benefits of Accounting Standards, Procedure for Issuing as in India, Salient Features of First Time Adoption of Indian Accounting Standards (Ind-AS):101 Currently Prevailing Accounting Standards in India, International Financial Reporting Standards, Need and Procedure of IFRS, Convergence to IFRS, Distinction between Indian AS and International AS and Measurement of Business Income has been clearly explained.

Objectives

After studying this unit, the students should be able to:

- Explain the concept of the accounting standards;
- Discuss the benefits of accounting standards;
- Discuss the procedures of issuing accounting Standards in India;

- Describe International Financial Reporting Standards, GAAP, IAS etc;
- Develop the insights about the need and procedure of issuing IFRS;
- Understand how Indian economy is converging towards implementing IFRS.
- Make comparison between Indian AS and International AS;
- Describe the procedure for measuring business income;
- Explain the accounting concepts that are relevant to measurement of business income; and
- State the objectives of measurement of business income of business income.

3.1. Concept of Accounting Standards

Accounting is the language of business. All financial information (i.e. nature of financial activities, financial position, financial results, present trend and further prospects etc.) are available through accounting. The so-called financial information is communicated to the users (both internal as well as external) of accounting information by preparing and presenting the financial statements. As such, it becomes necessary to develop some Generally Accepted Accounting Principles (GAAP) while preparing the financial statements by which the language of the business can be communicated to the users.

As per section 129 of Companies Act, 2013 the financial statements of a company must present a true and fair view of the income and financial position of the company. However, it does not define what constitutes a true and fair view of a company. Since the beginning of accounting, a number of Generally Accepted Accounting Principles have been developed consisting of accounting concepts and conventions so as to bring comparability and uniformity in the financial statements of various business organizations.

However, even these GAAP allow many alternatives for the treatment of same item that can be followed by the business organizations while preparing financial statements which leads to lack of consistency, uniformity and comparability among the financial statements of different originations. In addition, there must not be any ambiguity and uncertainty relating to the facts, figures and terms which are contained in the financial statements and will be presented to the users of accounting information.

Hence, there is a need to develop some standards which must be followed by all the organizations so as to achieve uniformity in the financial statements. For this purpose, International Accounting Standards Committee (IASC) was established on 29th June, 1973. The Institute of Chartered Accountants of India and Institute of Cost Accountants of India are members of IASC. ICAI is also developing its own accounting standards patterned on International Accounting Standards modified to the requirements of Indian accounting community.

Definition

In the words of Kohler, an accounting standard may be defined as 'a code of conduct imposed on accountants by custom, law or professional body.'

Thus, accounting standards may be defined as the accounting principles and rules which are to be followed for various accounting treatments while preparing financial statements on uniform basis and which will reveal the same meaning to all the interested groups who will use the same. Thus, the Standards are considered as a guide for maintaining and preparing accounts.

Nature of Accounting Standards

On the basis of forgoing discussion, we can say that accounting standards are guide, dictator, service provider and harmonizer in the field of accounting process.

Serve as a guide to the accountants: Accounting standards serve the accountants as a guide in the accounting process. They provide basis on which accounts are prepared. For example, they provide the method of valuation of inventories.

Act as a dictator: Accounting standards act as a dictator in the field of accounting. Like a dictator, in some areas accountants have no choice of their own but to opt for practices other than those stated in the accounting standards. For example, Cash Flow Statement should be prepared in the format prescribed by accounting standard.

Serve as a service provider: Accounting standards comprise the scope of accounting by defining certain terms, presenting the accounting issues, specifying standards, explaining numerous disclosures and implementation date. Thus, accounting standards are descriptive in nature and serve as a service provider.

3.2. Benefits of Accounting Standards

There are many benefits of accounting standards. Let us discuss the main benefits of Accounting Standards one by one.

1. **Standardized Accounting:** Perhaps the most important advantage of the FASB standard setting for businesses is the uniform set of accounting principles it promotes. The FASB clearly states the generally-accepted accounting principles that businesses must follow to avoid confusion. For example, the FASB prevents businesses from using one method for calculating inventory at the beginning of a fiscal year and finishing the year with another method. Without the accounting standards set forth by the FASB, businesses could use accounting methods that portray financial data inaccurately to investors.
2. **Problem Identification:** The FASB standard setting provides a framework upon which potential accounting problems are identified and corrected. Because all businesses in the US use the same accounting principles, any problems or inadequacies in the accounting process are quickly identified and reported to the FASB. The FASB then investigates the problem and, if needed, modifies or writes a new accounting rule for the accounting process. For example, if businesses find that reporting a certain type of liability on their income statement unfairly lowers their net income, they can appeal to the FASB so that it can identify problems with the standard setting.
3. **Private Regulation:** The FASB is a private entity with no affiliation to the US government. Despite this, the Securities and Exchange Commission relies on the FASB to set the accounting rules that all companies in the US must follow. The SEC can technically create an accounting oversight board or government agency to set accounting rules. However, using the FASB eases the burden on the US government and lets the private sector dictate accounting rules.
4. **International Accounting Standard:** The FASB is advantageous because it actively promotes an internationally recognized set of accounting rules. Globalization has deeply connected foreign financial markets; a standard set of accounting rules would make financial reporting more accurate and fair between countries. One of the goals of the FASB is to make

financial reporting more uniform globally with the cooperation of the International Accounting Standards Board (IASB).

3.3. Procedure for Issuing as In India

There is a set procedure for issuing AS in India. Let us discuss this procedure in detail.

- 1. Determination of the need of an as:** First, the Accounting Standard Board determines the broad areas in which accounting standards needs to be formulated.
- 2. Constituting Study Group:** Study Group will be constituted consisting the members of the Institute of Chartered Accountants of India. The motive behind constitution of this group is to assist the accounting Standard Board in its activities.
- 3. Drafting the Standard:** The Study Group Prepares draft of the proposed Standard. The proposed draft enlists the following areas:
 - a) Objective of the standard.
 - b) Scope of the Standard.
 - c) Definitions of the terms used in the standard
- 4. Analyzing the Draft:** ASB in this stage considers the Preliminary draft prepared by the Study Group. In case anything needs to be revised than Accounting Standard Board takes the following steps.
 - a) ASB makes the revision
 - b) ASB refers the same to the study Group
- 5. Circulation of the Draft:** In this step, the ASB circulates the AS draft to the council members of the Institute of Chartered Accountants of India
- 6. Holding Discussion and Finalizing Exposure Draft:** ASB holds meeting with the representatives of above mentioned bodies for the purpose of determining their views on the Draft Accounting Standard. Based on analyses of the discussion, ASB finalizes the exposure draft of proposed accounting standards.
- 7. Circulation of Exposure Draft:** The exposure Draft of the proposed standards is issued for comments the members of the ICAI and the public.

8. Finalizing the Exposure Draft: Based on the comments received, the ASB finalizes the draft of the proposed standards. Finally ASB submits the same to the council of the ICAI.

9. Modifying & Issuing the Accounting Standard: The council of the ICAI then considers the finalized draft standard and if necessary modifies the same in consultation with the ASB. The ICAI then issues the Accounting Standard after modification if any on the relevant subject.

Check Your Progress-1

True/False

- a. Accounting standards serve the accountants as a guide in the accounting process.
- b. Accounting is not the language of business.
- c. The FASB is not a private entity with no affiliation to the US government.
- d. ASB in this stage considers the Preliminary draft prepared by the Study Group.
- e. Ind-AS 101 lays out the accounting principles for first-time adoption of Ind-AS.

3.4. Salient Features of first time Adoption of Indian Accounting Standards (Ind-As):101

Ind-AS 101 lays out the accounting principles for first-time adoption of Ind-AS. It prescribes the various requirements to be fulfilled during the transition period when a company adopts Ind-AS for the first time, i.e., when it moves from making the financial statements in accordance with Accounting Standards (Indian GAAP) to make them in accordance with Ind-AS.

Conceptually, the accounting under Ind-AS should be applied retrospectively at the time of transition of companies from applying Accounting Standards (Indian GAAP) to Ind-AS. However, for an easy transition, Ind-AS 101 has provided some exemptions for retrospective application of Ind-AS. The exemptions are clearly categorised into those which are mandatory in nature (i.e., cases where the company is prohibited to apply Ind-AS retrospectively) and those which are voluntary in nature (i.e., it is upto the company to apply or not to apply certain requirements of Ind-AS retrospectively).

Ind-AS 101 also lists out presentation and disclosure requirements to

explain the transition to the users of financial statements. It also requires a company to explain how the transition will affect its reported balance sheet, financial performance and cash flows. It does not provide any exemption from the disclosure requirements in other Ind-AS.

Objective of Ind-AS 101

The objective of Ind-AS 101 is to ensure that the entity's first Ind-AS Financial

Statements, and its interim financial reports for the period covered by those financial statements, contain high quality information that:

- 1) Is transparent for users and comparable over all periods presented,
- 2) Provide a suitable starting point for accounting in accordance with the Indian Accounting Standards (Ind-AS), and
- 3) Can be generated at a cost that does not exceed benefits.

Scope of Ind-AS 101

An entity shall apply the Indian Accounting Standard-101 (first time adoption of Indian Accounting Standards) in:

- a) First Financial Statements after implementing Ind-AS.
- b) Each Interim Financial Report in accordance with Ind-AS 34 *Interim Financial Reporting* for the part of the period covered by its first IndAS financial Statements.

3.5. Currently Prevailing Accounting Standards in India

Section 133 of Companies Act, 2013 requires the companies to comply with the prevailing accounting standards. As on 1st April, 2016 there are 32 accounting standards specified by ICAI, all of which are mandatory to be complied by the companies.

3.6. International Financial Reporting Standards

Accounting provides companies, investors, regulators and others with a standardized way to describe the financial performance of an entity. Accounting standards present and prepares of financial statements with a set of rules to abide by when preparing an entity's accounts, ensuring this standardization across the market. Companies listed on public stock exchanges are legally required to publish financial statements in accordance with the relevant accounting standards

3.7. Need and Procedure of IFRS

With the increasing globalization of financial markets and of companies,

the use of a single set of financial reporting standards across countries is viewed as having increased the comparability of financial statements across borders. It also reduces the cost of preparing the consolidated financial statements of groups made up of companies conducting business all around the world.

Financial reporting standards have been in the spotlight since the banking crisis, more specifically those requiring the measurement of financial assets and liabilities at fair value. In September 2009, G20 leaders in Pittsburgh asked the accounting standard setters IASB and, its US counterpart, the FASB to work towards a single set of high quality global accounting standards by June 2011. Convergence, however, is proving challenging and is likely to be pushed back.

Initially, IFRS began as an academic project aimed at creating a single set of global standards, their actual use was kick-started by the European Union.

An EU regulation requires listed companies in Europe to adhere to International Financial Reporting Standards (IFRS) from financial years commencing on or after 1 January 2005 when preparing their consolidated accounts. In implementing this in UK legislation, the Government has not yet made the use of IFRS compulsory for any further categories of accounts, but the legislation permits all companies to use them for individual and consolidated accounts if they wish.

Changes have been made to UK tax legislation to accommodate these new rules for tax purposes.

The due process comprises six stages, with the Trustees of the IFRS Foundation having the opportunity to ensure compliance at various points throughout:

1. Setting the agenda
2. Planning the project
3. Developing and publishing the Discussion Paper, including public consultation
4. Developing and publishing the Exposure Draft, including public consultation
5. Developing and publishing the Standard. 6. Procedures after a Standard are issued.

3.8. Convergence to IFRS

For a country, there are two alternatives available for compliance and

implementation of the IFRS, which are (i) Adoption, (ii) Convergence

Adoption: It means acceptance of IFRS in its original form. If a country adopts IFRS in its original form, then it is not allowed to make any change in the language or format of the IFRS formed by IASB.

Convergence: It means implementing IFRS with modification wherever necessary so as to suit the requirements of a particular country.

India has decided to converge its existing accounting standards to IFRS. In India, the converged accounting standards are called Ind-AS

3.9. Distinction between Indian AS and International AS

Basic of Distinction	Accounting Standards(AS)	Ind-AS
Need	When businesses were not that complicated and accounting was done at local level, then accounting standards based on local GAAP were enough.	Today, businesses have become complicated and a globalised world is in the need of a comprehensive accounting standards that can be consistently applied globally and facilitate compatibility. Introduction of Ind-AS is the need of the hour for India to compete in this globalised world
Objective	The basic objective of Accounting standards is to remove variation in the treatment of several accounting aspects and to bring about standardization in presentation. They intend to harmonize the diverse accounting policies in the preparation and presentation of financial statements by different reporting enterprises so as to facilitate intra- firm and inter-firm comparison.	Ind-AS are Indian version of IFRS because it will be impractical to just adopt the IFRS blindly without taking into consideration the current Indian scenario. International Financial Reporting Standards are principles based standards, interpretation and the framework adopted by the International Accounting Standards Board (IASB). Since India is a member country so it has to adopt these standards. However, any changes in these IFRS would have an impact on books of Indian companies to adopt these IFRS as and when amended. So to fill the difference, Ind AS have been

		introduced which is nothing but IFRS. These standards have been made applicable to Indian companies through a road map i.e., in a systematic manner. The benefit of these standards is that any change in IFRS would not impact Ind- AS directly. The Ministry of corporate affairs can analysis such changes and incorporate the same in Ind-AS if it thinks it is suitable.
Pervasiveness	AS are not so pervasive or widespread.	Ind-AS are pervasive and cover every area comprising reported revenues, expenses, assets, liabilities and equity.
Basis	AS are driven by 'legal' form in a number of areas and are rule based.	Ind-AS focus on 'substance' rather than the legal form. They are principal based, Ind-AS will also result in accounting which more closely reflects the underlying business rationale and true economics of transaction.
Disclosure requirements	Disclosurerequirementsarecomparatively less detailed.	Disclosure requirements are more comprehensive and multifold under Ind-AS to enhance the transparency and accountability of financial statements.

3.10. Measurement of Business Income

Realization concept in accounting, also known as revenue recognition principle, refers to the application of accruals concept towards the recognition of revenue (income). Under this principle, revenue is recognized by the seller when it is earned irrespective of whether cash from the transaction has been received or not.

In case of sale of goods, revenue must be recognized when the seller transfers the risks and rewards associated with the ownership of the goods to the buyer. This is generally deemed to occur when the goods are actually transferred to the buyer. Where goods are sold on credit

terms, revenue is recognized along with a corresponding receivable which is subsequently settled upon the receipt of the due amount from the customer.

In case of the rendering of services, revenue is recognized on the basis of stage of completion of the services specified in the contract. Any receipts from the customer in excess or short of the revenue recognized in accordance with the stage of completion are accounted for as prepaid income or accrued income as appropriate.

Let Us Sum Up

In this unit, you have learned about the following:

1. Accounting Standards are defined as written statements of accounting rules and guidelines or practices for preparing the uniform and consistent financial statements.
2. Objectives of issuing accounting standards are to provide information, to harmonise different accounting processes and to facilitate uniformity, consistency and comparability.
3. Benefits of accounting standards – (i) True and fair financial position, (ii) Easy comparability, (iii) Enhances the value of accounting information, (iv) Efficiency of management, (v) Useful to accountants and auditors and (vi) Enhances credibility and reliability.
4. The authority to make accounting standards in India is Accounting Standard Board. It follows the prescribed procedure to issue an accounting standard.
5. Procedure for issuing accounting standards-ASB assisted by study group exposure draft- circulation- ASB after incorporating suggestions submit to ICAI. After that ICAI will issue standard.
6. Ind-AS 101 lays out the accounting principles for first-time adoption of Ind-AS. It prescribes the various requirements to be fulfilled during the transition period in moving from Accounting Standards (Indian GAAP) to Ind-AS.
7. Section 133 of Companies Act, 2013 requires the companies to comply with the prevailing accounting standards. As on 1st April, 2016 there are 32 accounting standards specified by ICAI, all of which are mandatory to be complied by the companies.
8. International Financial Reporting Standards is a single set of accounting standards, developed and maintained by the

International Accounting Standards Board with the intention of those standards being capable of being applied on a globally consistent basis.

9. With the increasing globalisation of financial markets and of companies, the use of a single set of financial reporting standards across countries is viewed as having increased the comparability of financial statements across borders.
10. India has decided to converge its existing accounting standards to IFRS. In India, the converged accounting standards are called Ind-AS.

Check Your Progress-2

1. The process of recording financial data up to trial balance is
 - a) Book keeping
 - b) Classifying
 - c) Summarizing
 - d) Analyzing
2. In which of the following cases, accounting estimates are needed?
 - a) Employs benefit schemes
 - b) Impairment of losses
 - c) Inventory obsolescence
 - d) All of the above
3. The long term assets that have no physical existence but, possess a value is known as,
 - a) Current assets
 - b) Fixed assets
 - c) Intangible assets
 - d) Investments
4. The assets that can be easily converted into cash within a short period (i.e.. 1 year or less is known as,
 - a) Current assets
 - b) Fixed assets
 - c) Intangible assets
 - d) Investments
5. Which of the following statement is correct?
 - a) The amount of Goodwill or Capital Reserve is found out in the books of purchasing company only

- b) The amount of Goodwill or Capital Reserve is found out in the books of vendor company only.
- c) Goodwill Net Assets - Purchase price
- d) The face value of shares of purchasing company will be taken in to account while calculating purchase consideration

Glossary

Accounting Standards: Accounting Standards are defined as written statements of accounting rules and guidelines or practices for preparing the uniform and consistent financial statements.

ASB: The board constituted by ICAI to conceive, formulate, examine and review the accounting standards.

GAAP: Generally Accepted Accounting Principles consist of accounting concepts and conventions so as to bring comparability and uniformity in the financial statements of various business organizations.

International Financial

Reporting Standards: IFRS is a single set of accounting standards, developed and maintained by the International Accounting Standards Board with the intention of those standards being capable of being applied on a globally consistent basis.

ICAI: Institute of Chartered Accountants of India- the apex body of accounting professionals of India.

Ind-AS: In India, the converged accounting standards are called Ind-AS.

Ind-AS 101: Ind-AS 101 lays out the accounting principles for first-time adoption of Ind-AS.

Answers to Check Your Progress-1

- a-True
- b-False
- c-False
- d-True
- e-True

Answers to Check Your Progress-2

1. a) Book keeping
2. d) All of the above
3. c) Intangible assets
4. d) Current assets discuss
5. c) Goodwill Net Assets - Purchase price

Suggested Readings

1. Maheshwari, S.N., 2018, Principles and Practice of Book-Keeping (New Delhi: Arya Book Publications.
2. Matulich, S. &Heitger, L.E.,2010- Financial Accounting (New York: McGraw Hill Book Company.

Unit-4

Journal and Ledger

STRUCTURE

Overview

Objectives

4.1. Introduction

4.2. What is Journal?

4.3. Form of the Journal

4.4. Steps in Journalising

4.5. Transactions of Different Types

4.6. Casting and Carry Forward

4.7. What is Ledger ?

4.8. Form of a Ledger Account

4.9. Posting in to Ledger

4.10. Balancing Ledger Accounts

4.11. Significance of Balance

4.12. Posting an Opening Entry

Let Us Sum Up

Check Your Progress

Glossary

Answers to Check Your Progress

Suggested Readings

Overview

In this Unit, the Introduction of Journal ,Meaning of Journal, Form of the Journal, Steps in Journalising the transactions of Different Types, Casting and Carry Forward, Meaning of Ledger, Form of a Ledger Account, Posting in to Ledger, Balancing Ledger Accounts, Significance of Balance and Posting an Opening Entry has been clearly explained.

Objectives

After going through this unit, you will be able to:

- Explain what journal is;
- Analyse a business transaction and identify the accounts affected;
- Apply rules of debit and credit, and formulate journal entries;

- Prepare journal;
- Post the journal entries in the respective ledger accounts;
- Balance a ledger account and explain the significance of balance in an account

4.1. Introduction

You are aware that every business transaction involves transfer of money or money's worth between two accounts. Recording of transaction is considered as complete only when both the receiving and the giving aspects are recorded in the books of account. This recording takes place in two stages. In the first stage, the transactions are recorded through a book called 'Journal' and in the second stage they are entered in the other book called 'Ledger'.

You have learnt about the different stages of accounting, different classes of accounts, and the rules of debit and credit. With this background, you will now be able to analyse the transactions and record them in the book of original entry i.e., Journal. In this unit, we intend to explain how exactly the entries are made in the journal. All business transactions are recorded in the books of account in two stages: (1) Journalising, and (2) Posting into Ledger. In this unit, you will learn about recording in the ledger. This involves posting journal entries into various accounts in the ledger, balancing the accounts periodically, and preparing a Trial Balance to check the arithmetical accuracy of all accounting entries.

4.2. What is Journal?

A Journal is called a book of prime entry (also called book of original entry) because all business transactions are entered first in this book. The word 'Journal' means a daily record. The transactions are recorded in this book in the order in which they occur i.e., they are entered in a chronological order. In this book, both aspects i.e., the receiving aspect and the giving aspect of the transaction, are recorded. The process of recording a transaction in the journal is called Journalising. The entries made in the journal are called 'journal entries'.

4.3. Form of the Journal

Date (1)	Particulars (2)	L.F. (3)	Dr. Amount (4)	Cr. Amount (5)
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Let us take an example: **Sold goods for cash, Rs. 500 on May 2, 2018.** In this transaction, the two accounts are Cash Account and Goods Account. You know, as per rules, Cash Account is to be debited and

Goods Account is to be credited. This transaction will be shown in the journal as follows:

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
2018 May 2	Cash Account Dr.		Rs. 500	Rs.500
	To Goods Account (Being cash Sale of goods)			

4.4. Steps in Journalising

In recording various business transactions in the journal, the most important aspect is the entry in the 'Particulars' column. Any mistake in this regard would lead to incorrect accounting. Hence, you should analyse the transaction carefully before making such entries. The following steps shall help you to do such analysis:

1. Take up the transaction, one by one. Read and analyse the transaction carefully from the business entity point of view, and identify the two accounts that are being affected by the transaction.
2. You are aware that accounts have been classified as personal, real and nominal accounts. Hence, after identifying the two accounts that are affected by the transaction, you must determine, in respect of each account, whether it is a personal account or a real account or a nominal account.
3. Each class of account has its own rule of debit and credit, which you have already learnt. Now, apply the relevant rules and decide which account is to be debited and which is to be credited.

The three steps explained above will have to be repeated in respect of every transaction. We have simply reinforced the point here to help you to journalise correctly.

Besides identifying the accounts to be debited and credited, you should be equally careful about the date of the transaction and the amounts with which each account is to be debited or credited. Now let us take a transaction, analyse it and see how a complete journal entry will be made.

Sold goods to Saran Brothers on credit for Rs. 500 on January 3, 2018

Step 1: From the business point of view, it is sale of goods on credit. In this case, the receiving aspect is Saran Brothers (as they

receive the goods) and the giving aspect is Goods (as goods go out). So, the two accounts affected are 'Saran Brothers' Account' and 'Goods Account'.

Step 2: The next step is to classify the accounts identified in Step 1. You are **Journal and Ledger** aware that Saran Brothers' Account is a personal account because it relates to persons, and Goods Account is a real account as it relates to property of the business.

Step 3: The rule for personal accounts is 'debit the receiver and credit the giver'. Saran Brothers receive the goods. So, Saran Brothers' Account will be 'debited'. The rule for real accounts is 'debit what comes in and credit what goes out'. Goods go out of business. So, Goods Account will be credited.

Having identified that Saran Brothers' Account is to be debited and Goods Account is to be credited, the entry will be recorded in the journal as follows:

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
2018 Jan. 3	Saran Brothers Dr.		Rs.500	Rs.500
	To Goods Account (Being goods sold on credit)			

4.5. Transactions of Different Types

Illustration 1

Enter the following transactions in the journal.

2018 Jan. 1.	Bought goods for cash	38,000
	2. Sold goods for cash	2,500
	3. Purchased goods for cash from Ajeet	8,000
	4. Sold goods to Kishan for cash	3,500

Solution:

Date	Particulars	L.F.	Dr. Amount Rs.	Cr. Amount Rs.
2018 Jan 1	Goods Account Dr.		38,000	38,000
	To Cash Account (Being cash purchase of goods)			
Jan 2	Cash Account Dr.		2,500	2,500
	To Goods Account (Being cash sale of goods)			

Jan 3	Goods Account Dr. To Cash Account (Being cash purchase of goods)		8,000	8,000
Jan 4	Cash Account Dr. To Goods Account (Being cash sale of goods)		3,500	3,500

Illustration 2

Journalise the following transactions:

2018		Rs.
March 1	Sold goods to Anand on credit	18,000
March 4	Bought goods on account from Ram	48,000
March 6	Purchased goods from Shyam	13,000

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. Amount Rs.	Cr. Amount Rs.
2018	Anand's Account Dr.		18,000	
March 1	To Goods Account (Being goods sold on credit)			18,000
March 4	Goods Account Dr. To Ram's Account (Being goods purchased on credit)		48,000	48,000
March 6	Goods Account Dr. To Shyam's Account (Being goods purchased on credit)		13,000	13,000

4.6. Casting and Carry Forward

Journal is totalled periodically (daily or weekly), depending upon the volume of business and the number of transactions. Totalling is called 'casting'. You have to total both the debit amount column and the credit amount column. Since every debit has an equal and corresponding credit, the totals of the two columns should always be equal. If, however, they do not tally, it implies that there is some error. In that case, you must go through the entire work and locate the error and get the correct total.

When the transactions during a particular period are many and cannot be journalised in the same page, then it would be necessary to total the

two amount columns on that page and carry forward the total to the next page. This is done by writing 'Total c/f' against the totals in the particulars column and entering the amount in both amount columns. These totals are then brought forward on the next .

Check Your Progress-1

True/False

- a. The process of recording a transaction in the journal is called Journalising.
- b. Totalling is not called 'casting'.
- c. The word 'Journal' means a daily record.
- d. In recording various business transactions in the journal, the most important aspect is the entry in the 'Particulars' column.
- e. Ledger is a book which contains all accounts affected by various transactions in a business.

4.7. What is Ledger?

Ledger is a book which contains all accounts affected by various transactions in a business. Ledger can be termed as a classified and summarised record of business transactions relating to all personal, real and nominal accounts.

All transactions which are first recorded in the journal, must invariably be posted into the concerned accounts in the ledger. This is necessary because Journal is just a chronological record of transactions, identifying the accounts to be debited and credited. It does not help us to know the net effect of various transactions affecting a particular account. This can only be achieved by recording the effect of all transactions on each account at one place.

Let us illustrate this. Suppose, Mohan Brothers have been selling goods on credit to Suresh. Suresh is allowed to make part payments and make further purchases even before the old balance is cleared. No doubt, all transactions relating to the goods sold to him and the amounts received from him would be duly recorded in the journal (or its subdivisions). But the journal, by itself, will not be in a position to readily provide information as to whether Suresh, at a given point of time, owes them any money and if so, how much. This is because the entries for transactions with him have been made at different places in the journal and you will have to go through all entries to obtain the required information.

The ledger is a bound volume with the pages numbered consecutively. Alphabetical index is also shown at the beginning so that the page in which an account appears can be easily ascertained. In certain modern business, loose-leaf ledgers are maintained, instead of one bound volume. Banks maintain loose-leaf ledgers for customer's deposit accounts.

4.8 . Form of a Ledger Account

As stated earlier, an account is the summarised record of all the transactions relating to a particular person or an item. The form of an account is given below:

Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
			Rs.				Rs.

4.9. Posting in to Ledger

The journal entries form the basis for recording in the ledger accounts, and the process of entering transaction in the ledger is called 'Posting'. When a journal entry has to be posted in the concerned ledger accounts, the following procedure is adopted.

1. Every journal entry will have to be posted into all those accounts which have been debited and credited in the journal entry. For example, for cash sales, Cash Account is debited and Sales Account is credited in the journal. When this entry is posted in the ledger, it must be posted in Cash Account as well as in Sales Account.
2. Posting will be made on the debit side of the account which has been debited in the journal, and the credit side of the account which has been credited in the journal. In case of above example of the cash sales, posting will be made on the debit side of Cash Account, as it has been debited in journal and the credit side of Sales Account, as it had been credited in the journal.
3. Whether the posting is made on the debit side or the credit side, first of all the date of the transaction (as given in the journal) will be entered in the date column. The method of recording the date in the ledger account is the same as in journal.
4. While posting on the debit side of an account, in the particulars column, we shall write the name of the account which had been credited in the journal and add the word 'To' before the name. Similarly while posting on the credit side of an account, we shall

write the name of the account which has been debited in the journal and add the word 'By' before the name. In case of the above example, we shall write 'To Sales A/c' in particulars column on the debit side of Cash Account and 'By Cash A/c' in particulars column on the credit side of the Sales Account.

5. The journal entries contain 'narration'. But it is not required in the ledger accounts. Similarly, there is no need to draw a line between the two entries in an account as is done in the journal. Note that posting in the ledger account is considered complete only when both the debit and the credit aspects of all journal entries have been posted
6. In the folio column, we shall mention the page number of the journal where the concerned journal entry appears. At the same time, the page number of the ledger accounts will be entered in the 'L.F.' column in the journal so as to complete the cross reference.
7. The amount involved in the journal entry shall be entered in amount column of both the accounts.

4.10. Balancing Ledger Accounts

In the above illustration, you have seen that many transactions are likely to involve a particular account, and there are a number of entries on both sides of an account. At the end of a day, a week or a month, it would be necessary to know the net effect of various transactions entered in an account. For example, it would be important and useful to know as to what is still due from a customer. We can get this information by working out the difference between the total of debit entries and the total of credit entries in customer's account. This process is termed as 'balancing of an account. For example, look at the Pankaj's Account in illustration 14. You find that there are two transactions, one on each side. Pankaj has been debited with Rs. 10,000 for credit sales to him, and credited by Rs. 4,000 for the amount paid by him. The difference between the amount debited and the amount credited is Rs. 6,000. This amount of Rs. 6,000 is the 'balance' in his account which he still owes to the business.

Where the debit side total is more than the credit side total, as in this case, it is called a debit balance. It is shown, in particulars column, on the credit side by writing 'By Balance c/d' and totals on both sides made equal. After totalling the two sides of the account, the same balance is shown on the debit side, on the next date, by writing 'To Balance b/d' in particulars column. The term c/d is an abbreviation for carried down and

b/d is for brought down. Such balancing of accounts is done periodically, say, daily (as in the case of cash account), weekly, monthly or at any other convenient time, as and when needed.

Total both the amount columns (debit and credit) and ascertain the difference in two totals (use a separate rough sheet for this purpose). If there is no difference between the totals of the two sides, it means there is nil balance on this account. This means, the account is closed. However, if there is some difference in the two totals, such difference is called the 'balance'. If the debit side total is more than the credit side total (as in Pankaj's Account), the difference is called debit balance. If, on the other hand, the total of the items on the credit side is greater than the total of the debit side, the difference is called credit balance.

1. Put the difference between the two sides on the side showing a smaller total.
2. Enter the date on which balancing is being done, in the date column. Note that balancing is not a transaction, as this does not involve any transfer between two accounts.
3. If the balance is entered on the debit side, then write in particulars column 'To Balance c/d'. In case, the balance is entered on the credit side, write in particulars column 'By Balance c/d' (c/d stands for carried down).
4. Now total both the amount column. There might be more entries on one side, as compared to the other. Even then, the totals must be written on the same horizontal line. Draw one line across both the amount columns, on the same horizontal line. Draw one line across both the amount columns, on the same horizontal line. Put the totals on both the sides, which will now be identical and then draw line immediately beneath the totals.
5. The closing balance (which was carried down) has now to be brought down on the side which was showing the bigger total. In other words, at the beginning of the next period, the debit balance is shown on the debit side and credit balance on the credit side of the account. It is called opening balance, The balance brought down is usually given the date following the balance date. After entering the date in the date column, if the balance brought down is on the debit side, write 'To Balance b/d' in particulars column. Similarly, if the balance brought down is on the credit side, write 'By Balance b/d' (b/d stands for brought down), particulars column. Suppose an account was balanced on

June 30, and the closing balance was entered on the credit side as 'By Balance c/d'. On July 1, this balance would be entered on the debit side as 'To Balance b/d' below the total.

You have now understood the method of balancing an account. Usually a page is allotted to an account and all transactions affecting that account are posted there. Sometimes, when transactions are numerous, more number of pages can be set apart for such an account. When the balance is proposed to be brought down on the same page, then the abbreviations, c/d and b/d are used. However, when there is not much space in the same page, and the balance has to be carried forward either to the next page, or some other page, the abbreviations 'c/f' (carried forward) and 'b/f' (brought forward) are used in place of 'c/d' and 'b/d'. The page numbers are entered in the Folio columns to show as to where the balance has been carried forward and from where it has been brought forward.

Sometimes, there may be no difference between the totals of the two sides. In such cases, there will be no closing balance and no opening balance. However, to signify that the balancing has been done, totals are entered on both the sides and the account is closed.

Now let us take up comprehensive illustration and reinforce what you have learnt so far regarding journalising, posting into ledger and balancing the accounts.

Illustration

Journalise the following transactions, post them into ledger and balance the accounts:

2018		Rs.
March 1	Ashok commenced business with cash	1,20,000
March 2	Purchased furniture for cash	24,000
March 2	Purchased goods from Vijay	36,000
March 3	Sold goods	4,800
March 4	Paid rent	3,000
March 6	Sold goods to Arun	9,000
March 7	Arun returned goods	450
March 10	Bought goods from Dinesh	24,000
March 11	Returned goods to Dinesh	600
March 14	Paid for advertising	1,500
March 15	Paid for stationery	300

March 17	Drew for personal use	2,400
March 20	Cash Sales	9,600
March 21	Received from Arun	2,550
March 23	Paid to Vijay	12,000
March 24	Sold goods to Sanjay	15,000
March 28	Cash sales	6,000
March 31	Paid salaries	6,000
March 31	Paid municipal taxes	1,200
March 31	Paid printing charges	1,500

Date	Particulars	L.F.	Dr. Amount Rs.	Cr. Amount Rs.
2018				
March 1	Cash Account	Dr	1,20,000	
	To Capital Account (being Capital brought in)			1,20,000
March 2	Furniture Account	Dr.	24,000	
	To Cash Account (Being furniture purchased)			24,000
March 2	Purchases Account	Dr.	36,000	
	To Vijay's Account (Being credit purchases)			36,000
March 3	Cash Account	Dr.	4,800	
	To Sales Account (Being cash sales)			4,800
March 4	Rent Account	Dr.	3,000	
	To Cash Account (Being rent paid)			3,000
March 6	Arun's Account	Dr.	9,000	
	To Sales Account (Being credit sales)			9,000
March 7	Returns Inwards Account	Dr.	450	
	To Arun's Account (Being goods returned by Arun)			450
March 10	Purchases Account	Dr.	24,000	
	To Dinesh's Account (Being credit purchases)			24,000
March 11	Dinesh's Account	Dr.	600	
	To Returns Outwards Account (Being goods returned to Dinesh)			600
March 14	Advertising Account	Dr.	1,500	

	To Cash Account			1,500
	(Being the amount paid for Advertising)			
March 15	Stationary Account	Dr.	300	
	To Cash Account			300
	(Being the payment for stationery)			
March 17	Drawings Account	Dr.	2,400	
	To Cash Account			2,400
	(Being cash withdrawn for Personal use)			
March 20	Cash Account	Dr.	9,600	
	To Sales Account			9,600
	(Being cash sales)			
March 21	Cash Account	Dr.	2,550	
	To Arun's Account			2,550
	(Being the amount received from Arun)			
March 23	Vijay's Account	Dr.	12,000	
	To Cash Account			12,000
	(Being the amount paid to Vijay)			
March 24	Sanjay's Account	Dr.	15,000	
	To Sales Account			15,000
	(Being credit sales)			
March 28	Cash Account	Dr.	6,000	
	To Sales Account			6,000
	(Being Cash sales)			
March 31	Salaries Account	Dr.	6,000	
	To Cash Account			6,000
	(Being salaries paid)			
March 31	Municipal Taxes Account	Dr.	1,200	
	To Cash Account			1,200
	(Being municipal taxes paid)			
March 31	Printing Charges Account	Dr.	1,500	
	To Cash Account			1,500
	(Being Printing charges paid)			

Cash Account

Mar.3	To Sales A/c	4,800	Mar.4	By Rent A/c	3,000
Mar.20	To Sales A/c	9,600	Mar.14	By Advertising A/c	1,500
Mar.21	To Arun A/c	2,550	Mar.15	By Stationery A/c	300
Mar.28	To Sales A/c	6,000	Mar.17	By Drawings A/c	2,400
			Mar.23	By Vijay A/c	12,000
			Mar.31	By Salaries A/c	6,000
			Mar.31	By Municipal Tax A/c	1,200
			Mar.31	By Printing Charges A/c	1,500
			Mar.31	By Balance C/d	91,050

		1,42,950		1,42,950
Apr.1	To Balance b/d	91,050		

Sales Account

2018		Rs.	2018	Rs.	
Mar.31	To Balance c/d	44,400	Mar.3	By Cash A/c	4,800
			Mar.20	By Arun A/c	9,000
			Mar.24	By Cash A/c	9,600
			Mar.28	By Sanjay A/c	15,000
			Apr.1	By Cash A/c	6,000
		<u>44,400</u>		To Balance b/d	<u>44,400</u>

Arun's Account

2018		Rs.	2018	Rs.	
Mar.6	To Sales A/c	9,000	Mar.7	By Returns Inwards	450
			Mar.21	By Case A/c	2,550
			Mar.31	By Balance c/d	6,000
		<u>9,000</u>			<u>9,000</u>
Apr.1	To Balance b/d	9,000			

Return Inward Account

2018		Rs.	2018	Rs.	
Mar.7	To Arun A/c	450	Mar.31	By Balance c/d	450
Apr.1	To Balance b/d	450			

2018		Rs.	2018	Rs.	
Mar.11	To Return Outward	600	Mar.10	By Purchase A/c	24,000
Mar.31	A/c to Balance c/d	23,400		By Balance c/d	24,000
		24,000	Apr.1		23,400

Return Outward Account

2018		Rs.	2018	Rs.	
Mar.31	To Balance c/d	600	Mar.11	By Dinesh's	600
			Apr.1	By Balance b/d	600

Advertising Account

2018		Rs.	2018	Rs.	
Mar.14	To Cash by A/c	1,500	Mar.31	By Balance c/d	1,500
Apr.1	Balance c/d	1,500			

Capital Account

2018		Rs.	2018		Rs.
Mar.31	To Balance c/d	1,20,000	Mar.1	By Cash A/c	<u>1,20,000</u>
			Apr.1	By Balance b/d	1,20,000

Furniture Account

2018		Rs.	2018		Rs.
Mar.2	To Cash A/c	24,000	Mar.31	By Balance c/d	<u>24,000</u>
Apr.1	To Balance b/d	24,000,			

Purchase Account

2018		Rs.	2018		Rs.
Mar.2	To Vijay's A/c	36,000	Mar.31	By Balance c/d	60,000
Mar.10	To Dinesh's c/d	<u>24,000</u>			
		60,000			
Apr.1	To Balance b/d	60,000			

2018		Rs.	2018		Rs.
Mar.23	To Cash A/c	12,000	Mar.2	By Purchase A/c	36,000
Mar.31	To Dinesh's c/d	<u>24,000</u>			
		36,000	Apr.1	To Balance b/d	<u>24,000</u>

2018		Rs.	2018		Rs.
Mar.4	To Cash A/c	<u>3,000</u>	Mar.31	By Balance c/d	<u>3,000</u>
Apr.1	To Balance b/d	3,000			

Stationery Account

2018		Rs.	2018		Rs.
Mar.15	To Cash A/c	<u>300</u>	Mar.31	By Balance c/d	<u>300</u>
Apr.1	To Balance b/d	300			

Drawings Account

2018		Rs.	2018		Rs.
Mar.17	To Cash A/c	<u>2,400</u>	Mar.31	By Balance c/d	<u>2,400</u>
Apr.1	To Balance b/d	2,400			

Sanjay's Account

2018		Rs.	2018		Rs.
Mar.24	To Sales A/c	<u>15,000</u>	Mar.31	By Balance c/d	<u>15,000</u>
Apr.1	To Balance b/d	15,000			

Salaries Account

2018		Rs.	2018		Rs.
Mar.31	To Cash A/c	<u>6,000</u>	Mar.31	By Balance c/d	<u>6,000</u>
Apr.1	To Balance b/d	6,000			

Municipal Taxes Account

2018		Rs.	2018	Rs.	
Mar.31	To Cash A/c	1,200	Mar.31	By Balance c/d	1,200
Apr.1	To Balance b/d	1,200			

4.11. Significance of Balance

You have learnt that the 'balance in an account signifies the net effect of all transactions related to it during a given period. It may be a debit balance or a credit balance or a nil balance depending upon whether the debit or the credit total is higher. Let us now understand the significance of a balance in respect of the various types of accounts in the ledger.

Personal Accounts

Personal accounts are more frequently balanced as compared to any other class of accounts. Balance in a personal account indicates whether the party concerned owes to the business or the other way round. When it shows a debit balance, it means that the party owes that amount to the business. In other words, he is a debtor to the business. Similarly, when it shows a credit balance, it would mean that the business owes that amount to him i.e., he is creditor of the business if however, the account shows a nil balance, it means that the account has been cleared, nothing is due to him or due from him.

Real Accounts

Real accounts are normally balanced at the end of the accounting period primarily for the purpose of preparing the final accounts. The cash account, however, is balanced everyday because the actual cash is to be verified and confirmed with the closing balance shown by Cash Account. All real accounts show a debit balance as there are assets (property) accounts.

Nominal Accounts

Nominal accounts are not usually balanced, but closed by transfer to Profit and Loss Account, at the time of preparing the final accounts (at the end of the accounting period). However, to start with, for the purpose of understanding the procedure involved, nominal accounts have also been balanced. Even otherwise, the difference between the debit side and credit side totals have to be worked out for preparing the trial balance (you will learn about the trial balance later).

The accounts which relate to expenses or losses will show a debit balance; whereas those relating to incomes and gains will have a credit balance. This is because all expenses and losses are debited and all incomes and gains are credited.

4.12. Posting an Opening Entry

So far, you have learnt about the opening entry which is passed in the journal for all assets and liabilities brought from the previous year. The posting of the opening entry is very different from the posting of other journal entries. We open the concerned accounts in the new ledger for all items that appear in the opening entry. Then, in the accounts which have been debited in the opening entry we shall write 'To Balance b/f in the Particulars column on the debit side of those accounts and show the respective amount in the Amount column. Similarly, in the accounts that have credited in the opening entry, we shall write 'By Balance b/f in the particulars column on the credit side of those accounts and show the respective amount in the Amount column. Thus, the posting is complete.

As a matter of fact, the account which have been debited or credited in the opening entry merely represent the closing balances of various personal and real accounts from the previous year. These are now entered in the ledger accounts of the current year as opening balances through the opening entry.

Let Us Sum Up

In this unit, you have learned about the following:

The journal is the book of prime entry in which all business transactions must be carried first. Each transaction is analysed so that the two-fold aspect of each transaction is clearly presented in the form of a 'Journal Entry. While journalising the transaction, it is necessary to remember the difference between the treatment of cash and credit transaction, as it is necessary to decide whether the personal account of the party concerned is to be involved or not. Entries relating to Goods Account are made in five separate accounts depending upon the nature of the transactions. These accounts are: (i) Purchase Account, (ii) Sales Account, (iii) Purchase Returns Account, (iv) Sales Returns Account, and (v) Stock Account.

Check Your Progress-2

1. Which of the terms given below will be regarded as the book of original entry?
 - a) The trial balances
 - b) The general journal
 - c) The general ledger
 - d) The payment and receipt account

2. All the transactions of an organisation should be first recorded into which book or account?
 - a) T accounts
 - b) The equation of accounting
 - c) The book of original entry
 - d) The book of final entry
3. Which of the following is a ledger account?
 - a) Events
 - b) Journal
 - c) Transactions
 - d) None of the Above
4. A ledger column that connects the entry to the journal is called as
 - a) Credit column
 - b) L.F column
 - c) J.F column
 - d) Debit column
5. Refer to the left side of the ledger account as.
 - a) Debit side
 - b) Credit side
 - c) Footing
 - d) Balance

Glossary

Balance:	The difference between the total of debits and total of credits appearing in an account. It signifies the net effect of the transactions posted to that account.
Compound Entry:	A journal entry involving more than two accounts.
Journal:	A book of original entry where a chronological record of transactions is first made.
Journal Entry:	An entry made in the journal.
Journalising:	The process of recording the business in the journal.
Ledger:	A book which contain all accounts affected by various transactions in business.
Opening Entry:	A journal entry passed at the beginning of the year

to bring forward the previous year's assets and liabilities.

Posting: A process of entering transactions into ledger accounts.

Answers to Check Your Progress-1

- a-True
 - b-False
 - c-True
 - d-True
 - e-True
-

Answers to Check Your Progress-2

1. c) The general journal
 2. c) The book of original entry
 3. b) Journal
 4. c) J.F column
 5. a) Debit side
-

Suggested Readings

1. Matulich, S. &Heitger, L.E.,2010- Financial Accounting (New York: McGraw Hill Book Company..
2. Mr Barry Elliott, Jamie Elliott,2017- Financial Accounting and Reporting- ,Pearson Publications.

Block-2: Introduction

The Block-2: **Subsidiary Books** has been divided in to three Units (Unit-5 to Unit-8).

Unit-5: Subsidiary Books – Cash Book: This unit will be really helpful to describe the alternative use of Subsidiary books and can also explain how it is different from Journal book. These Students will also come to know about the advantages and disadvantages of Cash Books.

Unit-6: Purchase and Sales Journals Book: This Unit is important to describe the alternative use of Subsidiary books as compare to Journal and also know how to maintain different subsidiary books with authorized format of different Subsidiary books. They also can understand the Importance of Subsidiary Books.

Unit-7 : Petty Cash Book: This unit will be really helpful to describe the alternative use of Subsidiary books and can also explain how it is different from Journal book. These Students will also come to know about the advantages and disadvantages of Petty Cash Book.

In all the units of Block -2: **Subsidiary Books**, the Check your progress, Glossary, Answers to Check your progress and Suggested Reading has been provided and the Learners are expected to attempt all the Check your progress as part of study.

Unit-5

Subsidiary Books – Cash Book

STRUCTURE

Overview

Objectives

5.1. Introduction

5.2. Subsidiary Books

5.3. Advantages of Subsidiary Books

5.4. Cash Book

5.5. Single Column Cash Book

5.6. Two Column Cash Book

5.7. Petty Cash Book

5.7.1. Imprest System

5.7.2. Recording, Posting and Balancing the Petty Cash Book

5.8. Three Column Cash Book

5.8.1. Recording in Three Column Cash Book

5.8.2. Posting the Three Column Cash Book

5.8.3. Balancing the Three Column Cash Book

Let Us Sum Up

Check Your Progress

Glossary

Answers to Check Your Progress

Suggested Readings

Overview

In this Unit, the Introduction to subsidiary book, Advantages of Subsidiary Books, Cash Book, Single Column Cash Book, Two Column Cash Book, Petty Cash Book and Three Column Cash Book has been clearly explained.

Objectives

After studying this unit, the students should be able to:

- prepare simple cash book and balance it;
- post cash book entries into ledger;
- prepare cash book with discount column;
- post discount column entries into ledger;

- describe imprest system;
- prepare petty cash book and post it into ledger;
- describe the functions of a bank;
- explain the advantages of opening a bank account;
- describe how to open bank account;
- explain the functions of pay-in-slip book, cheque book and the pass book;
- appreciate the importance of crossing and endorsement;
- record banking transactions in a three column cash book;
- post three column cash book into ledger;
- state various transactions recorded in journal proper.

5.1. Introduction

You learnt how to record the business transactions in journal and then post them into ledger. You know that journal is a book of prime entry in which all transactions are to be recorded first. But, in practice, the number of transactions happens to be so large that it becomes difficult to record them in one book.

Hence, the journal is subdivided into a number of special journals, called subsidiary books. In this unit, you will learn about the most important subsidiary book called Cash Book. We shall discuss various types of cash books, study how transactions are recorded in the Single Column Cash Book, Two Column Cash Book and Three Column Cash Book and how they are posted into ledger. You shall also learn about the Imprest System and the preparation, posting and balancing of Petty Cash Book.

Further, you will learn how to record cash transactions in Single Column Cash Book, Two Column Cash Book and Three Column Cash Book and post them into ledger. In three column cash book, we have an additional column for banking transactions.

As a prelude, we shall first discuss how to open an account in a bank, the advantages of opening a bank account, the functions of pay-in-slip, cheque book and pass book, and the importance of crossing and endorsement of cheques. Then, we shall learn how various transactions with a bank are recorded in the Three Cash Book and posted into ledger.

In this unit, we also intend to take up the books like: (i) Purchases Journal, (ii) Purchases Returns Journal, (iii) Sales Journal (iv) Sales Returns Journal, (v) Journal Proper. You will also learn how

transactions are recorded in each of these books and how they are posted into ledger.

5.2. Subsidiary Books

Before we list various books into which the journal is subdivided, let us understand the basis for its sub-division. You may adopt any basis. But, the principle generally followed is that transactions of the same nature are to be recorded at one place.

For example, the cash receipts and cash payments may be grouped into one category and recorded in a separate book. Similarly, all credit purchases of goods may be grouped into one category, all credit sales of goods into another category and recorded in separate books.

In practice, the journal is subdivided in such a way that a separate book is used for each category of transactions which are repetitive in nature and are sufficiently large in number. In any large business, the following subsidiary books are generally used.

1. **Cash Book:** It is used for recording all receipts and payments of cash, including cash purchases and cash sales of goods.
2. **Purchases Journal:** It is used for recording credit purchases of goods only.
3. **Purchases Returns Journal:** It is used for recording goods returned to suppliers.
4. **Sales Journal:** It is used for recording credit sales of goods only.
5. **Sales Returns Journal:** It is used for recording goods returned by the customers.
6. **Bills Receivable Journal:** It is used for recording bills of exchange and promissory notes received from the debtors.
7. **Bills Payable Journal:** It is used for recording bills of exchange and promissory notes accepted by the business in favour of creditors.
8. **Journal Proper:** This book is used for recording all such transactions which are not covered by any of the above mentioned special journals, for example, credit purchases of fixed assets, opening entry, rectification entries, etc.
9. It must, however, be noted that there is no rigidity as to the number of special journals. Depending on the necessity, the number of journals may be increased or decreased.

5.3. Advantages of Subsidiary Books

The following are the advantages of having a number of subsidiary books:

- i) **Classification of transactions becomes automatic:** As there is a separate book for each type of transactions, the transactions of same nature are automatically brought at one place. For example all credit purchase of goods are recorded in the purchases book.
- ii) **Reference becomes easy:** If any reference is required, it can be traced easily by referring to the appropriate subsidiary book. You do not have to go through all the transactions recorded in the journal.
- iii) **Facilitates division of work:** The division of journals into various subsidiary books facilitates division of work among many persons. This, in turn, facilitates prompt recording of transactions and saves a lot of time.
- iv) **More particulars:** More details about the transactions can be given in subsidiary books than would be possible in one book.
- v) **Responsibility can be fixed:** The work of maintaining a particular book can be entrusted to a particular person. He will be responsible for keeping it up-to-date and in order.
- vi) **Facilitates checking:** When the Trial Balance does not agree, the location of errors will be relatively easy.

5.4. Cash Book

Having outlined various subsidiary books, we shall now discuss the most important subsidiary book called 'Cash Book'. In any business there would be numerous cash transactions which involve either receipts or payments of cash. Cash sales, receipt of cash from debtors, cash purchases, payments to creditors, payment of various expenses such as salaries, wages, rent, taxes, etc., are some examples of transactions involving cash. All these are recorded in cash book, receipts on one side and payments on the other.

Every business unit, small or big, maintains a cash book. It enables the businessman to know and verify the amount of cash in hand from time to time. As a matter of fact, cash book plays a dual role. It is a book of prime entry and also serves the purpose of a Cash Account. It is designed in the form of a ledger account and records cash receipts on

the debit side and payments on credit side. It is also balanced in the same way. Hence, when cash book is maintained, there is no need to have a Cash Account in the ledger.

There are different types of cash books maintained by the business. These are:

1. Simple or Single Column Cash Book
2. Two or Double Column Cash Book
3. Three or Triple Column Cash Book

We shall now consider them one by one and learn how they are prepared and posted into the ledger.

Check Your Progress-1

True/False

- a. In three column cash book, we have an additional column for banking transactions.
- b. Sales Journal is not used for recording credit sales of goods only.
- c. Purchases Journal is not used for recording credit purchases of goods only.
- d. Every business unit, small or big, maintains a cash book.
- e. There are different types of cash books maintained by the business

5.5. Single Column Cash Book

Look at the proforma of a Single Column Cash Book shown in Figure 5.1. Doesn't it look like a ledger account? Yes, it does. In fact a Single Column Cash Book is nothing but a Cash Account. It is used for recording all cash receipts and cash payments and serves the purpose of Cash Account as well. It is called Single Column Cash Book just because it has only one amount column on each side.

Single Column Cash Book

Date	Particulars	₹	Amount Rs.	Date	Particular	₹	Amount Rs.
	To (write the name of the account				To (write the name of the account		

Figure – 5.1

Illustration 1

From the following particulars of M/s Naveen & Co., prepare a Simple Cash Book and balance the same. Also show postings into the ledger accounts.

2018		Rs.
July 1	Naveen started business with a capital of	25,000
" 2	Opened a bank account and deposited	20,000
" 5	Purchased goods for cash	3,000
" 6	Sold goods for cash	4,000
" 8	Purchased furniture	1,000
" 10	Purchased goods from Ramlal on credit	2,500
" 12	Sold goods to Chhotelal on credit	3,000
" 16	Sold goods for cash	1,000
" 17	Paid to Ramlal on account	2,500
" 19	Received from Chhotelal	2,000
" 22	Withdrawn cash from bank	3,000
" 25	Paid electricity bill	50
" 28	Paid rent to the landlord	350
" 31	Paid salary to the clerk	500

Solution:

Cash Book of Naveen & Co.

Dr.				Cr.			
Date	Particulars	L.F.	Amount Rs.	Date	Particular	L.F.	Amount Rs.
2018 July, 1	To Capital A/c		25,000	2018 July, 2	By Bank A/c		20,000
" 16	To Sales A/c		4,000	" 5	To Cash A/c		3,000
" 19	To Sales A/c		1,000	" 8	By Furniture		1,000
" 22	To Chhotelal		2,000	" 17	By Ramlal		2,500
Aug.1	To Bank A/c		35,000	" 25	By Electricity Charges A/c		50
	By Balance b/d		7,600	" 28	By Rent		350
				" 31	By Salaries A/c		500
				"31	By Balance c/d		7,600
			35,000				35,000
	To Balance b/d		7,600				

Note: Transactions of July 10 and 12 are credit transactions. So they are not recorded in the cash book.

LEDGER

Capital Account

Dr.		Rs.	Cr		Rs.
			2018 July 1	By Cash A/c	25,000

Sales Account

Dr.		Rs.	Cr		Rs.
			2018 July 6	By Cash A/c	4,000
			July 16	By Cash A/c	1,000

Chhotelal's Account

Dr.		Rs.	Cr		Rs.
			2018 July 19	By Cash A/c	2,000

Bank Account

Dr.		Rs.	Cr		Rs.
2018 July, 2	To Cash A/c	20,000	2018 July 22	By Cash A/c	3,000

Bank Account

Dr.		Rs.	Cr		Rs.
2018 July, 2	To Cash A/c	20,000	2018 July 22	By Cash A/c	3,000

Purchase Account

Dr.		Rs.	Cr		Rs.
2018 July, 5	To Cash A/c	3,000			

Furniture Account

Dr.		Rs.	Cr		Rs.
2018 July, 8	To Cash A/c	1,000			

Ramlal's Account

Dr.		Rs.	Cr		Rs.
2018 July, 17	To Cash A/c	2,500			

Electricity Charges Account

Dr.		Rs.	Cr		Rs.
2018 July, 17	To Cash A/c	50			

Rent Account

Dr.		Rs.	Cr		Rs.
2018 July, 17	To Cash A/c	530			

Salaries Account

Dr.		Rs.	Cr		Rs.
2018 July, 17	To Cash A/c	500			

5.6. Two Column Cash Book

Previously you learnt about the cash discount. When cash is received from a debtor, some discount may be allowed to him.

Similarly, when payment is made to a creditor, some discount may be allowed by him. This is termed as Cash Discount and it has to be recorded in the books of account. While making compound journal entries for such transactions, you learnt that cash and discount go together.

You know that receipts from debtors and payments to creditors are to be recorded in the cash book. Now the question arises as to how to record the cash discount. One method is to record the discount aspect separately in the journal.

But this would be cumbersome, and the possibility of failing to record can also happen. Hence, accountants have developed a practice of recording the discount aspect in the cash book itself. For this, an extra amount column is added on both sides of the cash book.

Look at the proforma shown in Figure 5.2. The discount allowed to debtors is recorded on the debit side and the discount received from creditors is recorded on the credit side.

Thus, now there are two amount columns on both sides of the cash book, one for discount and the other for cash. It is called 'Two Column Cash Book'.

Two Column Cash Book

Dr.					Cr.				
Date	Particulars	₹	Discount Allowed	Cash	Date	Particulars	₹	Discount Received	Cash
			Rs.	Rs.				Rs.	Rs.

Figure 5.2.

Study illustration 2 carefully. You will understand how transactions are recorded in the Two Column Cash Book and posted to the ledger accounts.

Illustration 2

From the following transactions of M/s. Joshi & Sons, prepare Cash Book and show the ledger postings:

		Rs.
2018		
Aug.1	Cash in hand	4,270
“ 5	Purchased an old typewriter for	1,500
“ 7	Received cash from Singh & Co. Rs. 1,980 and allowed discount of	20
“ 10	Cash Sales	5,500
“ 12	Paid to Ram Narain Rs. 2,970 and he allowed a discount of	30
“ 14	Sold old newspapers for Rs.	60
“ 16	Received from Prasad Rs. 985 in full settlement of his account for	1,000
“ 18	Purchased goods worth from Sanjeev Bros. at a trade discount of 10% and paid cash.	
“ 20	Sold goods worth for cash at a trade discount of 5%. 1,000	1,000
“ 24	Settled the account of Tiwari of by paying the necessary amount after deducting a discount of 3%. 500	500
“ 30	Paid rent	500
“ 30	Deposited in the bank the cash in excess of	1,490

Cash Book (With Discount and Cash Columns)

Rs.					Rs.				
Date	Particular	L.F.	Discount Allowed	Cash	Date	Particular	L.F.	Discount Received	Cash
2018			Rs.	Rs.	2018			Rs.	Rs.
Aug.1	To Balance b/d			4,270	Aug. 5	By Typewriter A/c			1,500
" 7	To Singh & Co.		20	1,980	" 12	By Rain Narain		30	2,970
" 10	To Sales A/c			5,500	" 18	By Purchases A/c			1,800
" 14	To Old News-papers A/c			60	" 24	By Tiwari		15	485
" 16	To Prasad		15	985	" 30	By Rent A/c			500
" 20	To Sales A/c			950	" 30	By Bank A/c			5,000
Sep.1	To Balance b/d			950	" 31	By Balance c/d			1,490
			35	13,745				45	13,745
				1,490					

- The cash in hand on August 1, 2018 is not a transaction but the balance brought down from the previous month. It has been shown on the debit side of the cash column as 'To Balance b/d'. No posting to any account is necessary for the balance.
- The transactions of August 18 and 20 are recorded at net amounts i.e., after adjusting trade discount. Earlier you learnt that trade discount is not to be shown in the books.
- Cash in excess of Rs 1,490 is deposited in the bank. It means the closing balance of cash is Rs 1,490. The actual difference between the debit and credit cash columns would work out at Rs 6,490. Hence, the amount deposited in the bank is Rs 5,000 (6,490-1,490).

LEDGER

Singh & Co. Account

Dr.				Cr.	
			2018		Rs.
			Aug. 7	By Cash A/c	1,980
			" 7	By Discount Allowed	20

Sales Account

			2018		Rs.
			Aug 10	By Cash A/c	5,500
			Aug. 20	By Cash A/c	950

Old Newspapers Account

			2018 Aug. 14	By Cash A/c	Rs. 60
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Prasad's Account

			2018 Aug. 16	By Cash A/c	Rs. 985
			Aug. 16	By Discount Allowed	15

Typewriter Account

2018 Aug. 5	To Cash A/c	Rs. 1,500			
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Ram Narain's Account

2018 Aug. 12	To Cash A/c	Rs. 2,970			
Aug. 12	To Discount Received A/c	30			

Purchases Account

2018 Aug. 18	To Cash A/c	Rs. 1,800			
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Tiwari's Account

2018 Aug. 24	To Cash A/c	Rs. 485			
Aug. 24	To Discount Received	15			

Rent Account

2018 Aug. 30	To Cash A/c	Rs. 500			
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Bank Account

2018 Aug. 30	To Cash A/c	Rs. 5,000			
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Discount Allowed Account

2018		Rs.			
Aug. 31	To Sundries A/c	35			

Discount Received Account

			2018		Rs.
			Aug. 31	By Sundries A/c	45

5.7. Petty Cash Book

In every business, there will be numerous small payments in cash such as payments for postage, telegrams, stationery, cartage, conveyance, entertaining the customers, minor repairs, etc. If all these petty payments are recorded in the cash book along with other payments, the cash book will be overloaded. Hence, a separate book called 'Petty Cash Book' is maintained for recording all such small (petty) payments.

A person called petty cashier is entrusted with the work of making the small payments and maintaining the Petty Cash Book. The sum of money given to the petty cashier for making small payments is called petty cash.

5.7.1. Imprest System

Generally, Petty Cash Book is maintained on Imprest System. Under this system, an estimate is made of the amount required for petty payments for a certain period, say a week or a month. This amount is handed over to the petty cashier in advance. The petty cashier is required to obtain vouchers for all expenses he incurs. At the end of the period, the petty cashier presents the Petty Cash Book together with the vouchers to the chief cashier. The chief cashier verifies the entries in the Petty Cash Book and pays to the petty cashier a sum equal to the amount spent by him. The original amount of the petty cash with which the petty cashier had started is thus restored. This system of advance at the beginning and reimbursing the amount spent from time to time is called 'Imprest System'. For example, on June 1, Rs. 200 is given as advance for petty payments to the petty cashier. He spent Rs. 185 on various items during the month. The chief cashier, after verifying the expenses with the vouchers, would pay Rs 185 to him. Thus on July 1, the petty cashier would again have Rs. 200 (Rs. 185 paid by the chief cashier plus the old balance of Rs. 15), the imprest amount. This system provides an adequate check on petty payments.

5.7.2. Recording, Posting and Balancing the Petty Cash Book

Look at illustration 3. You will find only one column each for receipts, cash book folio, date, particulars, and voucher no. But, it provides a number of amount columns for recording the payments of various petty expenses. This facilitates the analysis of payments under different heads and their posting to appropriate expense account. The headings under which petty expenses are generally categorised are: (i) printing and stationery, (ii) postage and telegrams, (iii) cartage, (iv) conveyance (v) entertainment, and (vi) miscellaneous.

When the head cashier advances money to the petty cashier, either in cash or by cheque, an entry is made in the cash or bank column of the main cash book on the credit side by writing 'By Petty Cash A/c'. The petty cashier, on receiving the cash, records it in the particulars column of the Petty Cash Book by writing 'To Cash A/c' (if cash is received) or 'To Bank A/c' (if cheque is received) and enters the amount in receipts column. When he makes payments, each payment is entered in the particulars column by writing the name of expense incurred. The amount is first entered in the total payments column and then in the column specified for the concerned expense.

The Petty Cash book is balanced periodically, say weekly or monthly. The various expense accounts in the ledger are individually debited with the periodic totals (as per Petty Cash Book) by writing 'To Petty Cash A/c'. The Petty Cash Account in the ledger is credited with the total expenditure incurred during the period by writing 'By Sundries as per Petty Cash Book'. The Petty Cash Account is then balanced. It will normally have a debit balance which will be equal to the actual cash with the petty cashier. Illustration 3 shows recording in Petty Cash Book and its posting into the ledger.

Illustration 3

2018

Aug

" 1	Received a cheque from head cashier	250.00
" 2	Paid to printing of letter heads	40.00
" 4	Purchased postal stamps	15.00
" 5	Paid for cartage on goods purchased	9.00
" 7	Paid auto fare	5.00
" 9	Tea expenses for customers	4.75

“ 12	Sent telegram to Calcutta	8.50
“ 14	Paid for stationery	15.25
“ 15	Paid taxi fare	12.75
“ 17	Paid for postage	42.50
“ 19	Paid tips to office boys	8.00
“ 20	Paid for cartage	14.50
“ 22	Paid for cold drinks offered to customers	5.00
“ 25	Payments made to coolies	9.75
“ 27	Purchase of postal envelopes	3.60
“ 28	Rickshaw charges	3.00
“ 30	Cartage on goods purchased	10.00

Balance the Petty Cash Book at the end of August and show the amount of the cheque to be issued to the petty cashier on September 1, 2018. Also show the ledger postings.

Solution

Petty Cash Book

Receipts	Cash Book Folio No.	Date	Particulars	Voucher No.	Payments	Printing & Stationery	Postage & Telegram	Cartage	Conveyance	Entertainment	Miscellaneous	Remarks
Rs.		2018				Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
250.00		Aug. 1	To Bank A/c									
		" 2	By Letter heads		40.00	40.00						
		" 4	By Postal stamps		15.00		15.00					
		" 5	By Cartage		9.00			9.00				
		" 7	By Auto fare		5.00				5.00			
		" 9	By Tea expenses		4.75					4.75		
		" 12	By Telegram		8.50		8.50					
		" 14	By Stationery		15.25	15.25						
		" 15	By Taxi fare		12.75				12.75			
		" 17	By Postage		42.50		42.50					
		" 19	By Tips to office boy		8.00						8.00	
		" 20	By Cartage		14.50			14.50				
		" 22	By Cold drinks		5.00					5.00		
		" 25	By Coolies		9.75			9.75				
		" 27	By Envelopes		3.60		3.60					
		" 28	By Rickshaw		3.00				3.00			
		" 30	By Cartage		10.00			10.00				
			Total Payments		209.60	55.25	69.60	43.25	21.75	10.75	8.00	
250.00		" 31 Sept 1	By Balance b/d		40.40							
40.40			Total		250.00	L.F.	L.F.	L.F.	L.F.	L.F.	L.F.	
			To Balance b/d									
209.60		" 1	To Bank A/c									

LEDGER

Petty Cash Account

Dr.					Cr.
2018		Rs.	2018		Rs.
Aug. 1	To Bank A/c	250.00	Aug. 31	By Sundries as per Petty Cash Book	209.60
			" 31	By Balance c/d	40.40
		250.00			250.00
Sept 1	To Balance b/d	40.40			
" 1	To Bank A/c	209.60			

Bank Account

2018		Rs.	2018		Rs.
Aug. 1			Aug. 1	By Petty Cash A/c	250.00
			Sept. 1	By Petty Cash A/c	209.60

Printing and Stationery Account

2018		Rs.			
Aug. 31	To Petty Cash A/c	55.25			

Postage and Telegram Account

2018		Rs.			
Aug. 31	To Petty Cash A/c	69.60			

Cartage Account

2018		Rs.			
Aug. 31	To Petty Cash A/c	43.25			

Conveyance Account

2018		Rs.			
Aug. 31	To Petty Cash A/c	21.75			

Entertainment Account

2018		Rs.			
Aug. 31	To Petty Cash A/c	10.75			

Miscellaneous Expenses Account

2018		Rs.			
Aug. 31	To Petty Cash A/c	8.00			

5.8. Three Column Cash Book

Generally, business firms deposit the day's collections in a bank, retaining only a small amount for immediate use. They prefer to make payment by cheque as it is more safe and convenient. So, bank transactions are more numerous than cash transactions.

The bank transactions can also be recorded in the cash book along with cash transactions. It is done by providing an additional column for bank on both sides of the cash book. Look at the proforma of a Three Column Cash Book in Figure 5.8. A bank column in the cash book, also serves the purpose of a bank account and avoids the need to have a 'Bank Account' in the ledger. The bank column on the debit side records all deposits made in the bank and the bank column on the credit side records all withdrawals from the bank. We shall now have three amount columns, one each for discount, cash and bank. Hence, it is called a Three Column or Triple Column Cash Book.

Three Column Cash Book

Dr.

Cr.

Date	Particulars	L.F.	Discount Allowed	Cash	Bank	Date	Particulars	L.F.	Discount Received	Cash	Bank
------	-------------	------	------------------	------	------	------	-------------	------	-------------------	------	------

5.8.1. Recording in Three Column Cash Book

All receipts of cash or cheques are to be recorded on the debit side: When payment is received in cash, the amount is recorded in the cash column. If it is by cheque, it is recorded in the bank column. The date on which it is received, and the name of the person from whom it is received, are recorded in the date and particulars columns respectively.

If any discount is allowed to a party on receipt of cash or cheque, it is recorded on the debit side in the discount allowed column as usual.

All cash and cheque payments are to be recorded on the credit side: When payment is made by cash, the amount is recorded in the cash column. If it is made by cheque, it is recorded in the bank column. The date on which payment is made, and the name of the person to whom payment is made, are recorded in the date and particulars columns respectively,

Discount received, if any, at the time of making payment is to be recorded on the credit side in the discount received column as usual.

Contra Entry: The word 'contra' means 'the other side'. If the double entry of a transaction is complete in the cash book itself such entry is called 'contra entry'.

Contra entry arises only when cash account and bank account are simultaneously involved in a transaction. It happens only when either cash is deposited in the bank or cash is withdrawn from it. In both cases, entries have to be made in cash as well as bank columns. When cash is deposited in the bank, it is recorded (i) in bank column on the debit side of the cash book, and (ii) in cash column on the credit side of the cash book. Similarly, when cash is withdrawn from the bank, it is recorded on the (i) debit side in cash column, and (ii) on the credit side in bank column. It must, however, be noted that if cash is withdrawn from bank for personal use of the owner, it is recorded only on the credit side of cash book in bank column as drawings. In order to denote contra entries, the capital letter 'C' is written in the L.F. column on both sides of the cash book. It means that the corresponding aspect of the transaction is entered on the other side (contra) of the same page of the cash book. The letter 'C' also indicates that the relevant entry need not be posted into the ledger, as the double entry is complete in the cash book itself.

5.8.2. Posting the Three Column Cash Book

All the entries recorded in the Three Column Cash Book are to be posted to their respective ledger accounts, except the contra entries. For posting the entries recorded on the debit side of the cashbook, credit the accounts concerned in the ledger by writing 'By Cash A/c' if the entry is in cash column, and 'By Bank A/c' if the entry is in bank column. If discount is also involved, credit the concerned personal account by writing 'By Discount Allowed A/c'. Totals of the discount allowed and discount received columns shall be posted to the respective discount accounts the same way as for Two Column Cash Book.

5.8.3. Balancing the Three Column Cash Book

The cash and bank columns are balanced separately like any other ledger account. As stated earlier, the Cash Account always shows a debit balance. The bank account also normally shows a debit balance. But, sometimes it may show a credit balance which indicates a bank overdraft. It reflects the amount withdrawn from the bank in excess of what is deposited in the bank.

The procedure of recording the closing and opening balances is the same as in Two Column Cash Book. Note that the discount columns will not be balanced. They are simply totalled.

Study illustration 4 carefully. You will follow the recording, posting and balancing of a Three Column Cash Book.

Illustration 4

Enter the following transactions in the Three Column Cash Book of Galaxy Enterprises and show the ledger postings:

2018

July	15	Cash in hand	800
"	15	Balance in bank account	4,500
"	16	Purchased goods and issued cheque	3,000
"	17	Cash sales	4,000
"	18	Received from Saniad in full settlement of his account Rs.4,000 cheque	2,000
		Cash	1,950
"	20	Cash deposited into bank	5,000
"	21	Paid Rama Krishna by cheque	2,970
		Received discount	30
"	22	Received from Bose	1,680
		Discount allowed	20
"	24	Cash withdrawn for office purpose	2,000
"	25	Paid Mahantha in cash	3,000
		Discount allowed by him	40
"	26	Paid for stationery	100
"	28	Deposited cash into bank	2,000
"	30	Cash withdrawn from bank for personal use of proprietor	500

Solution :

Joshi & Sons

Cash Book (With Discount and Cash Columns)

Rs.					Rs.						
Date	Particular	I.F.	Discount Allowed	Cash		Date	Particula	I.F.	Discount Received	Cash	Bank
2018				Rs.	Rs.	2018			Rs.	Rs.	
July.15	To Balance c/d			800	4,500	July 16	By Purchase A/c				3,000
" 17	To Sales A/c			4,000		" 20	By Bank A/c	C		5,000	
" 18	To Samad		50	1,950	2,000	" 21	By Rama Krishna		30		2,970
" 20	To Cash A/c	C			5,000	" 24	By Cash A/c	C			2,000
" 22	To Bose		20	1680		" 25	By Mahanta		40	3000	
" 24	To Bank A/c	C		2,000		" 26	By Stationery A/c			100	
" 28	To Cash A/c	C			2,000	" 28	By Bank A/c	C		2,000	
						" 30	By Drawings A/c				500
						" 31	By Balance c/d			330	5,030
			70	10,430	13,500				70	10,430	13,500
Aug. 1	To Balance b/d			330	5030						

LEDGER

Sales Account

			2018		Rs.
			July 17	By Sales A/C	4,000

Sanad's Account

			2018		Rs.
			July 18	By Discount Allowed	50
			" 18	By Cash A/c	1,950
			" 18	By Bank A/c	2,000

Bank Account

			2018 July 22	By Discount Allowed	Rs. 20
			“ 22	By Cash A/c	1,680

Purchase Account

2018 July 16	To Bank A/c	Rs. 3,000			
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Rama Krishna's Account

2018 July 21	To Discount Allowed A/c	Rs. 30			
“ 21	To Bank A/c	2,970			

Mahendra's Account

2018 July 21	To Discount Received A/c	Rs. 40			
“ 21	To Bank A/c	3,000			

Stationery Account

2018 July 26	To Cash A/c	Rs. 100			
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Drawings Account

2018 July 30	To Bank A/c	Rs. 500			
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Discount Allowed Account

2018 July 31	By Sundries as per Cash book	Rs. 70			
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Discount Received Account

			2018 July 31	By Sundries as per Cash book	Rs. 70
--	--	--	-----------------	------------------------------	-----------

In illustration 4, you will notice that the total of bank column on the debit side is more than the total of bank column on the credit side of the cash book. This indicates that there is money in the bank. If, however, the total of bank column on the debit side is less than the total on the credit side, it will reflect an overdraft in the bank.

Let Us Sum Up

In this unit, you have learned about the following:

In business many transactions are of repetitive nature. The journal is therefore sub-divided in such a way that a separate book is used for each category of transactions which are repetitive in nature and are sufficiently large in number. 3. Depending on the requirements of business, the special journals used are:(i) Cash book (ii) Purchases Journal, (iii) Sales Journal, (iv) Purchase Returns Journal (v) Sales Returns Journal (vi) Journal Proper. cash transactions are recorded in cash book. There are different types of cash books. The most commonly used are: (i) Single Column Cash Book, (ii) Two Column Cash Book, and (iii) Three Column Cash Book.

Check Your Progress -2

1. How are the cash discount transactions normally recorded in the Cash Book?

.....
.....
.....

2. _____ is sent to a customer when he returns goods

- a) Debit note
- b) Credit note
- c) Proforma Invoice
- d) None of the above

3. Which of the following are subsidiary books

- a) Sales Book
- b) Cash Book
- c) Purchase Book
- d) All of the above

Glossary

Adjustment Entry : An entry passed to bring into account certain unrecorded items like closing stock, outstanding expenses and incomes, at the time of preparing final accounts.

Bearer Cheque : A cheque payable at the counter of the bank without identification.

Cash Book :	A special journal used for recording all cash receipts and cash payments.
Cash Discount :	An allowance given by the creditor to the debtor for prompt payment.
Closing Entries :	Entries passed at the end of each accounting year to close the nominal accounts by transferring them to Trading and Profit and Loss Account.
Credit Note :	A statement sent by the seller to his customer informing that his account is credited to the extent of the goods returned by him or allowance granted to him.
Cheque :	An instrument used for withdrawing money from the bank.
Crossed Cheque :	A cheque on which two parallel lines have been drawn. It is not payable at the counter.
Contra Entry :	When both the debit and credit aspects of a transaction are recorded in the cash book itself.

Answers to Check Your Progress-1

- a-True
- b-False
- c-False
- d-True
- e-True

Answers to Check Your Progress-2

1. At the time of receiving the payment, discount allowed is recorded in the 'Discount' column on the debit side (or receipts side) of the Double Column Cash Book (with cash and discount columns).
2. b) Credit Note
3. c) All of the above

Suggested Readings

1. Paul V.A. & Korlahalli, J.S.,2018- Principle and Practice of Accountancy. New Delhi : S. Chand & Co., 2018
2. S.P.Jain, K.L.Narang,2019; Advanced Accountancy-Volume:1, Twenty Second Edition, Kalyani Publishers, Ludhiana.

Unit-6

Purchases and Sales Journal Books

STRUCTURE

Overview

Objectives

6.1. Purchases Journal

6.1.1. Invoice

6.1.2. Posting the Purchases Journal

6.2. Purchases Returns Journal

6.2.1. Debit Note

6.3. Sales Journal

6.3.1. Recording in the Sales Journal

6.3.2. Posting the Sales Journal

6.4. Sales Returns Journal

6.4.1. Credit Note

Let Us Sum Up

Check Your Progress

Glossary

Answers to Check Your Progress

Suggested Readings

Overview

In this Unit, the Purchases Journal such as Invoice and posting the Purchase Journal, Purchases Returns Journal including Debit Note, Sales Journal and Sales Returns Journal has been clearly explained.

Objectives

By the end of this unit, you would be able to:

- appreciate the need for special journals;
- sub-divide the journal into various special journals;
- identify the type of transactions recorded in special journal
- prepare purchases and purchases returns journals and post them into ledger;
- prepare sales and sales returns journals and post them into ledger; and
- prepare bills books and post them into ledger.

6.1. Purchase Book

While studying subdivision of journal, you learnt that Purchases Journal is used for recording credit purchases of goods and raw materials. The goods or raw materials can be purchased either on cash basis or on credit basis. When they are purchased on cash basis, the entry is made in the cash book. But when they are purchased on credit, they are recorded in the Purchases Journal. Note that the credit purchases of fixed assets like typewriter, vehicle, etc., are not recorded in this book. They are recorded in Journal Proper about which you will learn later. The Purchases Journal is also called 'Purchases Book', 'Purchases Day Book', and 'Invoice Book'.

6.1.1. Invoice

When you purchase something from a shop, you receive a bill such bill is called 'invoice'. It contains the details pertaining to the quantity, description, price, total amount, and trade discount, if any. Thus, an invoice is a business document giving full details of the goods purchased. It is a 'Purchase Invoice' or 'Inward invoice' for the purchaser and a 'Sales Invoice' or 'Outward Invoice' for the seller. Entries in the

Purchases Journal are made on the basis of the purchase invoices received (inward invoices). Look at Figure 6.8 for a specimen of an invoice.

Invoice			
Book Lovers Private Limited, Hyderabad			
No.3891		Date: 15-7-2018	
To			
M/s. Book Paradise, Nagpur			
Quantity	Particulars	Rate per unit	Total
10 Copies	Principles and Practice of Accountancy by R. Srirani Less: Discount 10% (Rupees two hundred and twenty five only)	Rs.	Rs.
		25.00	250.00
			25.00
			225.00
			xxxxx
For Book Lovers Private Limited			

The Purchases Journal has six columns.

Column 1: It is meant for writing the date of purchase.

Column 2: In this column, you write the name and address of the supplier.

Column 3: The inward invoice number is recorded in this column. As stated earlier, when you purchase goods on credit, you get an invoice from the supplier. Although it bears a number, you have to accord your own serial numbers to all inward invoices for easy reference. It is this serial number which will be entered in the inward invoice column of the Purchase Journal.

Column 4: In this column, you will write the page number of the account in ledger where posting is done.

Column 5: In this column, the amount payable to the supplier is recorded. You must note that the amount payable is arrived at after deducting the trade discount, if any. For example, see the invoice given in Figure 6.8. The amount payable is Rs. 225. If, some sales tax is also involved, the amount payable should include that also.

Column 6: Any other relevant information is to be recorded in this column. Information such as the date on which the amount of the bill is payable and the date on which it is actually paid may be noted in this column.

6.1.2. Posting the Purchases Journal

The transactions recorded in the Purchases Journal are to be posted to their respective personal accounts in the ledger. When a purchase is made on credit, the supplier becomes the creditor for the firm. Hence, every credit purchase recorded in the Purchases Journal is posted on the credit side of the personal account of the supplier by writing 'By Purchases A/c' in particulars column. The Purchases Journal is totalled periodically, say, weekly or monthly. This total is posted to the debit side of Purchases Account in the ledger by writing 'To Sundries—as per Purchases Journal'.

Thus, you observe that posting of Purchases Journal involves two steps: (i) posting each purchase to the credit of the respective personal accounts of suppliers, and (ii) posting the total purchases to the debit of the Purchases Account. With this, double entry for credit purchases is

complete. Look at illustration 6 for recording in the Purchases Journal and its posting into ledger.

Illustration 6

Record the following transactions in the Purchases Journal of M/s. Dharam Chand & Co., and show the ledger postings.

2018	Rs.	
July 1	Bought goods from Shreedhar	5,000
“ 2	Purchased goods from Shreekant	4,000
“ 3	Purchased from Shreenivas goods worth	2,500
“ 4	Shreedhar sold us goods	1,500
“ 5	Purchased goods from Shreenivas subject to a trade discount of 10%	3,000
“ 6	Bought from Shreekant goods worth with discount of 20%	3,500

Dharam Chand & Co.

PURCHASES JOURNAL

Date	Name of the supplier	Inward invoice number	L.F.	Amount Rs.	Remarks
2018	Shreedhar	25		5,000	
July 1	Shreekant	26		4,000	
“ 2	Shreenivas	27		2,500	
“ 3	Shreedhar	28		1,500	
“ 4	Shreenivas	29		2,700	
“ 5	Shreekant	30		2,800	
“ 6	Total			18,500	

Note: i) The inward invoice numbers are imaginary.

ii) Sometimes, the particulars of items purchased can also be given with each entry.

But it is considered unnecessary because the details are available in the invoice, the serial numbers of which are duly given in the Purchases Journal.

LEDGER

Shreedhar's Account

Dr.					Cr.
			2018		Rs.
			July 1	By Purchases A/c	5,000
			" 4	By Purchases A/c	1,500

Shreekant's Account

			2018		Rs.
			July 2	By Purchases A/c	4,000
			" 6	By Purchases A/c	2,800

Shreenivas's Account

			2018		Rs.
			July 3	By Purchases A/c	2,500
			" 5	By Purchases A/c	2,700

Purchases Account

	To Sundries - as perPurchase Journal	Rs. 18,500			
2018 July, 31					

6.2. Purchases Returns Journal

In any business, sometimes goods purchased may have to be returned to the supplier either partly or fully. This may become necessary when they are found to be defective, damaged in transit, inferior quality, short weight, received too late (off season), or not in conformity with the order given. If the number of such returns is small, they can be recorded in the journal itself. But, if it is large, a separate book called 'Purchases Returns Journal' should be used for recording these transactions. This book is also called 'Returns Outwards Journal'.

6.2.1. Debit Note

When you return goods to supplier, a statement called 'Debit Note' is sent to the supplier. It informs the supplier that his account has been debited to the extent of the value of goods returned. You know that when goods were purchased, the supplier's account was credited. Debiting his account now means that the amount payable to him has been reduced

by the value of goods returned. The debit note also contains other particulars such as the name and address of the supplier, the description of the goods returned, etc. The specimen of a debit note is shown in Figure 6.10.

Debit Note

Book Paradise Nagpur		Date: 20-7-18		
Debit Note No. 587				
To				
M/s. Book Lovers Pvt. Ltd. Hyderabad.				
We Have Debited your Account for Goods Returned as Follows				
	Rs.	Ps.	Rs.	Ps.
2 Copies of 'Principles and Practice of Accountancy' by Sriram @ Rs, 25 each			50.00	
Less: Trade discount allowed by you @ 10% (Rupees forty five only)			5.00	
				45.00
xxxxx For Book Paradise				

Fig. 6.10

illustration 7 (Continuation of illustration 6)

Enter the following transactions in the Purchases Returns Journal of M/s. Dharam Chánd and Co. and show the ledger postings.

2018		Rs.
July 5	Returned goods to Shreekant (vide invoice No. 26)	200
" 10	Returned goods to Shreenivas (vide invoice No. 29)	90
" 12	Returned goods to Shreekant (vide invoice No. 30)	120

Dharam Chand & Co.
PURCHASES RETURNS JOURNAL

Date	Name of the supplier	Debit note number	L.F.	Amount Rs.	Remarks
2018					
July 5	Shreekant	16		200	
July 10	Shreenivas	17		90	
July 12	Shreekant	18		120	
July 31	Total			410	

Note : Debit Note numbers are imaginary.

LEDGER

Shreekant's Account

2018		Rs.	2018		Rs.
July 5	To Purchases Return A/c	200	July 2	By Purchases A/c	4,000
" 12	To Purchases Return A/c	120	" 6	By Purchases A/c	2,800

Shreenivas's Account

2018		Rs.	2018		Rs.
July 10	To Purchases Return A/c	90	July 3	By Purchases A/c	2,500
			" 5	By Purchases A/c	2,700

Purchase Returns Account

			2018	By Sundries –	Rs.
			July 31	as per Purchase Returns Journal	410

6.3. Sales Journal

This book is used for recording only the credit sales of goods. Note that the cash sale of goods or sale of fixed assets (cash or credit) are not recorded in this book. The Sales Journal is also called 'Sales Day Book', or 'Sales Book'.

6.3.1. Recording in the Sales Journal

The ruling of the Sales Journal is similar to that of Purchases Journal. The difference is only with regard to the second column. In Purchases Journal, the second column is used for recording the name of the supplier. But, in case of Sales Journal, it is used for writing the name of the customer.

When goods are sold on credit, an invoice is given to the buyer. The seller generally has a bound invoice book. It contains consecutively numbered invoices in duplicate. While the original copy is given to the buyer, the duplicate remains in the book itself. The entries in the Sales Journal are made with the help of the duplicate copies which are duly numbered. The procedure for recording in the Sales Journal is similar to that of the Purchases Journal.

6.3.2. Posting the Sales Journal

All entries made in the Sales Journal are posted to the respective personal accounts in the ledger. In a credit sale, the customer becomes a debtor to the firm. Hence, every credit sale recorded in the Sales Journal is posted on the debit side of the personal account of individual customers by writing 'To Sales A/c' in particulars column. Then, the total of the Sales Journal is posted on the credit side of the Sales Account by writing 'By Sundries—as per Sales Journal'.

Look at illustration 8 and study how credit sales of goods are recorded in the Sales Journal and how they are posted into ledger.

Illustration 8

Prepare the Sales Journal of M/s. Bharat Furniture Works, Delhi from the following transactions:

2018

Aug. 1 Sold to Douloth Furniture House, Delhi

50 Chairs @ Rs. 150 each

10 Tables @ Rs. 500 each

At a trade discount of 10%

Aug. 4 Supplied the following furniture, as per the order, to Keshav Memorial School, Mehraulli

100 Chairs @ Rs. 135 each

40 Tables @ Rs. 450 each

- 2 Almirahs @Rs. 750 each
 5 Black boards @ Rs. 800 each
 “ 10 Supplied on credit to Pyarelal Furniture Palace, Okhla
 10 Sofa sets @ Rs. 800 each
 10 Dining tables @ Rs. 500 each
 5 Cots @ Rs. 600 each
 5 Dining tables @ Rs. 800 each Trade discount 10%

Solution :

Bharat Furniture Works Sales Journal

Date	Name of the supplier	Debit note number	L.F.	Amount	Remarks
2018				Rs.	
Aug. 1	Doulath Furniture House, Delhi	107		11,250	
“ 4	Keshav Memorial School, Mehrauli	108		37,000	
“ 10	Pyarelal Furniture Palace, Okhla	109		18,000	
“ 31	Total			66,250	

Note: i) Invoice numbers are imaginary,

ii) Sometimes, the particulars of items sold can also be given with each entry, but it is considered unnecessary because the details are available in the invoices and the serial numbers of which are duly given in the Sales Journal.

LEDGER

Daulath Furniture House Account

Dr.	Cr.				
2018		Rs.			
Aug 1	To Sales A/c	1,250			

Keshav Memorial School, Mehrauli

2018		Rs.			
Aug 4	To Sales A/c	37,000			

Pyarelal Furniture Palace

2018		Rs.			
Aug 10	To Sales A/c	18,000			

Sales Account

			2018 Aug. 31	By Sundries – as per Sales Journal	Rs. 66,250
--	--	--	-----------------	---------------------------------------	---------------

Check Your Progress-1

True/False

- In any business, sometimes goods purchased may have to be returned to the supplier either partly or fully.
- The Purchases Journal is also called 'Purchases Book', 'Purchases Day Book', and 'Invoice Book'.
- The ruling of the Sales Journal is similar to that of Purchases Journal.
- In a credit sale, the customer becomes a debtor to the firm.
- When customers return the goods to the business, it will not be recorded in a separate book called 'Sales Returns Journal'.

6.4. Sales Returns Journal

When customers return the goods to the business, it will be recorded in a separate book called 'Sales Returns Journal'. Normally, if the number of such returns is small, they can be recorded in the journal itself. But if their number is large, it is better to maintain a separate book called Sales Returns Journal. This book is also called 'Returns Inwards Journal'.

6.4.1. Credit Note

When a customer returns goods, a statement called 'Credit Note' is sent to him. The credit note informs the customer that his account has been credited to the extent of the value of goods returned.

You know that when goods were sold, the customer's account was debited. Now crediting his account means the amount payable by him stands reduced by the value of goods returned.

The credit note also contains other information such as the name and address of the customer, description of the goods returned, etc.

The credit notes are consecutively numbered and are prepared in duplicate.

The original is sent to the customer and the duplicate is carefully filed. The specimen of a credit note is shown in Figure 6.12.

Credit Note

Book Lovers Private Limited Hyderabad	
No.698	Date: 25-7-2018
M/s. Book Paradise Nagpur	
We Have Credited your Account for Goods Returned as Follows	
2 Copies of 'Principles and Practice of Accountancy' by Shriram @Rs. 25 each Less: Trade discount allowed @ 10% (Rupees forty five only).	Rs. Ps. 50.00 5.00 45.00
xxx For Book Lovers Pvt. Ltd	

Fig. 6.12

Look at illustration 9 and study how sales returns have been recorded in the Sales Returns Journal and posted into ledger.

Illustration 9 (Continuation of illustration 8)

2018 Aug. 5 Received a debit note along with one chair and a table from Doualath Furniture House, Delhi, saying that the legs of the chair and table are broken (remember, each chair was sold at Rs. 150/- and each table at Rs. 500/- with a trade discount of 10%).

10 Received 2 chairs and 2 tables along with a letter from Keshav Memorial School, Mehrauli, saying that they were damaged (chairs were sold at Rs. 135/- each and tables at Rs. 450/- each).

16 Received a debit note from M/s. Pyarelal Furniture Palace, Okhla, stating that the mirrors of two dressing tables were found defective and so returned.

Enter the above transactions in the Sales Return Journal of M/s Bharat Furniture Works, Delhi, and show the ledger postings.

Bharat Furniture Works

SALES RETURNS JOURNAL

Date	Name of the supplier	Credit note number	L.F.	Amount Rs.	Remarks
2018 Aug.5	Doualath Furniture House, Delhi	56		585	

" 10	Keshav Memorial School, Mehrauli	57		1,170
" 16	Pyarelal Furniture Palace, Okhla	58		200
" 31	Total			1,955

Note : Credit Note numbers are imaginary.

LEDGER

Doulath Furniture House Account

Dr.			Cr.		
2018		Rs.	2018		Rs.
Aug 1	To Sales A/c	11,250	Aug 5	By Sales Returns A/c	585

Keshav Memorial School Account

2018		Rs.	2018		Rs.
Aug 4	To Sales A/c	37,000	Aug 10	By Sales Returns A/c	1,170

Pyarelal Furniture Palace Account

2018		Rs.	2018		Rs.
Aug 10	To Sales A/c	18,000	Aug 16	By Sales Returns A/c (Allowance granted)	200

Sales Returns Account

2018		Rs.			
Aug 31	To Sundries - as per Sales Returns Journal	1,955			

These postings were made from Sales Journal, when goods were sold (refer illustration 9).

Let Us Sum Up

In this unit, you have learned about the following:

Purchases Journal is meant for recording all credit purchase of goods. Inward invoice is the basis for recording in the Purchases Journal. Purchases Returns Journal is used for recording goods returned

to the suppliers. Debit note is the basis for recording in Purchases Returns Journal. Sales Journal is meant for recording all credit sales of goods. Outward invoice is the basis for recording in the Sales Journal. Sales Returns Journal is used for recording goods returned by the customers. Credit note is the basis for recording in it. All transactions which cannot be recorded in any of the special journals will be recorded in the journal itself, which is now called Journal Proper.

Check Your Progress-2

1. How does Debit Note differ from Credit Note? Discuss the utility of these notes.
2. Write short notes on the following:
 - a) Returns Inward Journal
 - b) Returns Outward Journal
3. What is a Journal Proper?

Glossary

Debit Note :	A statement sent by the purchaser to his supplier informing that his account is debited to the extent of the goods returned or allowance claimed.
Dishonour :	Refusal to pay the cheque by the bank
Endorsement :	A written statement signed by the payee at the back of the cheque for its transfer.
Imprest System :	A system of advancing a fixed amount to the petty cashier periodically.
Invoice :	A bill or a statement issued by the seller to the purchaser giving details of goods sold.
Opening Entry :	An entry passed to open a new set of accounts.
Order Cheque :	A cheque in respect of which identification of the payee is necessary.
Pass Book :	A book or a statement supplied by the bank to its customer showing his transactions with the bank.
Pay-in-slip :	A slip or a challan used for depositing cash or cheques in the bank.
Petty Cash Book :	A cash book prepared for recording small payments of cash.

Subsidiary Book : Any special journal used for recording a particular category of transactions.

Transfer Entry : An entry passed to transfer an amount from one account to another account.

Answers to Check Your Progress-1

a-True

b-True

c-True

d-True

e-False

Answers to Check Your Progress-2

1. A debit note is exchanged for a credit note. A credit note is exchanged for a debit note. On issuance of a debit note, it would reflect a positive amount. On issuance of a credit note, it would reflect a negative amount. In most cases, whenever a debit note is issued, it further increases the tax liabilities.
2. a) The return inwards journal records the transactions made when the goods are returned. The seller prepares this journal by using the outgoing debit note. When the buyer complains about the discrepancy in the goods, the seller prepares the debit note and sends it to him.

b) Returns Outward: Explanation If goods are returned to a supplier, or if an invoice received from the supplier has an overcharge, a credit note would be sought to rectify the situation. All credit notes received from the supplier are entered in the returns outward book.
3. Journal proper is book of original entry (simple journal) in which miscellaneous credit transactions which do not fit in any other books are recorded. It is also called miscellaneous journal.

Suggested Readings

1. Thomas Edmonds, Christopher, Edmonds,2018-Introductory Financial Accounting for Business, McGraw Hill Publications.
2. Thomas, Wendy M. Tietz&TheminSuwardy Walter T. Harrison,2018-Financial Accounting, Global Publications, 12th Edition

Unit -7

Petty Cash Book

STRUCTURE

Overview

Objectives

7.1. Introduction

7.2. Imprest System

7.3. Recording, Posting and Balancing the Petty Cash Book

7.4. Journal Proper

Let Us Sum Up

Check Your Progress

Glossary

Answers to Check Your Progress

Suggested Readings

Overview

This Unit deals with Imprest System, Recording, Posting and Balancing the Petty Cash Book and Journal Proper has been clearly explained.

Objectives

By the end of this unit, you would be able to

- appreciate the need for special journals;
- sub-divide the journal into various special journals;
- identify the type of transactions recorded in special journal
- prepare purchases and purchases returns journals and post them into ledger;
- prepare sales and sales returns journals and post them into ledger; and
- prepare bills books and post them into ledger.

7.1. Introduction

In every business, there will be numerous small payments in cash such as payments for postage, telegrams, stationery, cartage, conveyance, entertaining the customers, minor repairs, etc. If all these petty payments are recorded in the cash book along with other payments, the

cash book will be overloaded. Hence, a separate book called 'Petty Cash Book' is maintained for recording all such small (petty) payments.

A person called petty cashier is entrusted with the work of making the small payments and maintaining the Petty Cash Book. The sum of money given to the petty cashier for making small payments is called petty cash.

7.2. Imprest System

Generally, Petty Cash Book is maintained on Imprest System. Under this system, an estimate is made of the amount required for petty payments for a certain period, say a week or a month. This amount is handed over to the petty cashier in advance. The petty cashier is required to obtain vouchers for all expenses he incurs. At the end of the period, the petty cashier presents the Petty Cash Book together with the vouchers to the chief cashier. The chief cashier verifies the entries in the Petty Cash Book and pays to the petty cashier a sum equal to the amount spent by him. The original amount of the petty cash with which the petty cashier had started is thus restored. This system of advance at the beginning and reimbursing the amount spent from time to time is called 'Imprest System'. For example, on June 1, Rs. 200 is given as advance for petty payments to the petty cashier. He spent Rs. 185 on various items during the month. The chief cashier, after verifying the expenses with the vouchers, would pay Rs 185 to him. Thus on July 1, the petty cashier would again have Rs. 200 (Rs. 185 paid by the chief cashier plus the old balance of Rs. 15), the imprest amount. This system provides an adequate check on petty payments.

7.3. Recording, Posting and Balancing the Petty Cash Book

Look at illustration 3. You will find only one column each for receipts, cash book folio, date, particulars, and voucher no. But, it provides a number of amount columns for recording the payments of various petty expenses. This facilitates the analysis of payments under different heads and their posting to appropriate expense account. The headings under which petty expenses are generally categorised are: (i) printing and stationery, (ii) postage and telegrams, (iii) cartage, (iv) conveyance (v) entertainment, and (vi) miscellaneous.

When the head cashier advances money to the petty cashier, either in cash or by cheque, an entry is made in the cash or bank column of the main cash book on the credit side by writing 'By Petty Cash A/c'. The petty cashier, on receiving the cash, records it in the particulars column of the Petty Cash Book by writing 'To Cash A/ c' (if cash is received) or

'To Bank A/c' (if cheque is received) and enters the amount in receipts column. When he makes payments, each payment is entered in the particulars column by writing the name of expense incurred. The amount is first entered in the total payments column and then in the column specified for the concerned expense.

The Petty Cash book is balanced periodically, say weekly or monthly. The various expense accounts in the ledger are individually debited with the periodic totals (as per Petty Cash Book) by writing 'To Petty Cash A/c'. The Petty Cash Account in the ledger is credited with the total expenditure incurred during the period by writing By Sundries as per Petty Cash Book'. The Petty Cash Account is then balanced. It will normally have a debit balance which will be equal to the actual cash with the petty cashier. Illustration 1 shows recording in Petty Cash Book and its posting into the ledger.

Illustration 1

2018	Rs.
Aug	
" 1 Received a cheque from head cashier	250.00
" 2 Paid to printing of letter heads	40.00
" 4 Purchased postal stamps	15.00
" 5 Paid for cartage on goods purchased	9.00
" 7 Paid auto fare	6.00
" 9 Tea expenses for customers	4.75
" 12 Sent telegram to Calcutta	8.50
" 14 Paid for stationery	16.25
" 15 Paid taxi fare	12.75
" 17 Paid for postage	42.50
" 19 Paid tips to office boys	8.00
" 20 Paid for cartage	14.50
" 22 Paid for cold drinks offered to customers	6.00
" 25 Payments made to coolies	9.75
" 27 Purchase of postal envelopes	3.60
" 28 Rickshaw charges	3.00
" 30 Cartage on goods purchased	10.00

Balance the Petty Cash Book at the end of August and show the amount of the cheque to be issued to the petty cashier on September 1, 2018. Also show the

Solution

Petty Cash Book

Receipts	Cash Book Folio No.	Date	Particulars	Voucher No.	Payments	Printing & Stationery	Postage & Telegram	Cartage	Conveyance	Entertainment	Miscellaneous	Remarks
						Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Rs. 250.00		2018 Aug. 1	To Bank A/c									
		" 2	By Letter heads		40.00	40.00						
		" 4	By Postal stamps		15.00		15.00					
		" 5	By Cartage		9.00			9.00				
		" 7	By Auto fare		6.00				6.00			
		" 9	By Tea expenses		4.75					4.75		
		" 12	By Telegram		8.50		8.50					
		" 14	By Stationery		16.25	16.25						
		" 15	By Taxi fare		12.75				12.75			
		" 17	By Postage		42.50		42.50					
		" 19	By Tips to office boy		8.00						8.00	
		" 20	By Cartage		14.50			14.50				
		" 22	By Cold drinks		6.00					6.00		
		" 25	By Coolies		9.75			9.75				
		" 27	By Envelopes		3.60		3.60					
		" 28	By Rickshaw		3.00				3.00			
		" 30	By Cartage		10.00			10.00				
			Total Payments		209.60	56.25	69.60	43.25	21.75	10.75	8.00	
		" 31	By Balance b/d		40.40							
250.00		Sept 1	Total		250.00	L.F.	L.F.	L.F.	L.F.	L.F.	L.F.	
40.40			To Balance b/d									
209.60		" 1	To Bank A/c									

LEDGER
Petty Cash Account

Dr.					Cr.
2018		Rs.	2018		Rs.
Aug. 1	To Bank A/c	250.00	Aug. 31	By Sundries as per Petty Cash Book	209.60
			" 31	By Balance c/d	40.40
		250.00			250.00
Sept 1	To Balance b/d	40.40			
" 1	To Bank A/c	209.60			

Bank Account

2018			2018		
Aug. 1			Aug. 1	By Petty Cash A/c	250.00
			Sept. 1	By Petty Cash A/c	209.60

Printing and Stationery Account

2018		Rs.	
Aug. 31	To Petty Cash A/c	56.25	

Postage and Telegram Account

2018		Rs.	
Aug. 31	To Petty Cash A/c	69.60	

Cartage Account

2018		Rs.	
Aug. 31	To Petty Cash A/c	43.25	

Conveyance Account

2018		Rs.	
Aug. 31	To Petty Cash A/c	21.75	

Entertainment Account

2018		Rs.	
Aug. 31	To Petty Cash A/c	10.75	

Miscellaneous Expenses Account

2018		Rs.	
Aug. 31	To Petty Cash A/c	8.00	

Check Your Progress-1

True/False

- a. The petty cashier is not required to obtain vouchers for all expenses he incurs.
- b. The chief cashier verifies the entries in the Petty Cash Book and pays to the petty cashier a sum equal to the amount spent by him.
- c. The Petty Cash book is balanced periodically, say weekly or monthly.
- d. All events and transactions which cannot be recorded in any of the special journals maintained by the firm, shall be recorded in the Journal Proper.
- e. The sum of money given to the petty cashier for making small payments is called petty cash.

7.4. Journal Proper

By now, you know what a journal is and what its subdivisions are. You also know that the special journals discussed earlier take care of certain types of transactions which are repetitive and numerous. However, there are a number of transactions which do not occur frequently and hence do not warrant preparation of special journals. But they have to be recorded somewhere. For them, the proper place is the original journal itself, which is now called 'Journal Proper'. Thus all events and transactions which cannot be recorded in any of the special journals maintained by the firm, shall be recorded in the Journal Proper. Examples of such transactions are:

- a) Opening Entry
- b) Closing Entries

- c) Transfer Entries
 - d) Adjustment Entries
 - e) Rectification Entries
 - f) Miscellaneous Entries
- a) **Opening Entry:** An opening entry is passed in the journal for opening a new set of accounts. This may be needed at the time of the commencement of business or at the commencement of new accounting year.

If a person commences business only with cash, there is no need to pass a journal entry. The cash brought in is just entered in the cash book. But, if he also brings some other assets, then an opening entry is passed in Journal Proper, debiting the concerned assets accounts and crediting the Capital Account.

In case of a running business, an opening entry is passed at the commencement of a new accounting year to incorporate various balances of assets and liabilities brought forward from the previous year into current year's books.

- b) **Closing Entries:** At the end of the accounting year, when final accounts are prepared, the nominal accounts are closed by transferring them to Trading Account or Profit and Loss Account. The journal entries passed for this purpose are called 'Closing Entries'.
- c) **Transfer Entries:** When an amount is to be transferred from one account to another, you have to pass an entry in the Journal Proper in order to effect the transfer. Such entries are called 'Transfer Entries'. Suppose, you want to transfer proprietor's total drawings made during the year to his Capital Account. The proprietor's total drawings appear in Drawings Account which shows a debit balance. You will transfer the balance of Drawings Account to Capital Account by passing the following entry in the Journal Proper.
- Capital AccountDr. To Drawings Account (Transfer entry)
- d) **Adjustment Entries:** At the time of preparing the final accounts, it is necessary to bring into the books of account certain unrecorded items like closing stock, depreciation on fixed assets, interest on capital, expenses incurred but not yet paid, income earned but not yet received, etc. Entries passed in the Journal Proper to record

such items are called 'Adjustment Entries'. These entries are explained in detail later.

- e) **Rectification Entries:** You may commit errors while recording transactions in various books, and while posting, totalling, balancing, etc. Such errors are generally corrected through entries in Journal Proper and are known as 'Rectification Entries'.
- f) **Miscellaneous Entries:** In addition to the entries mentioned above, if there is any transaction which cannot be recorded in any of the special journals, it will be entered in the Journal Proper. Example of such transactions are:
 - i) Credit purchases of fixed assets, investments, etc.
 - ii) Credit sales of fixed assets, investments etc.
 - iii) Withdrawal of goods from the business by the owner for his personal use.
 - iv) Loss of goods by theft, accident, fire, etc.
 - v) Special allowances received from suppliers or given to customers.
 - vi) Endorsement or dishonour of bills.
 - vii) Writing off bad debts.

Look at illustration 2 for entries of such transactions in the Journal Proper.

Illustration 2

Enter the following in the Journal Proper of Rajani Enterprises.

2018

- Aug. 3 Sold office van on credit for Rs. 15,000 to Ahmed Ali.
- Aug. 8 The owner has taken away goods worth Rs. 1,000 for his domestic use.
- Aug.15 Fire broke out in the premises and goods worth Rs. 5,000 were destroyed.
- “ 21 Bill drawn on Singh returned dishonoured when presented for payment, Rs. 2,000.
- “ 25 Amount due Rs. 500 from Bahadur is irrecoverable, as he has been declared insolvent.

Aug. 28 Misra, a customer, informed that some goods were damaged in transit. An allowance of Rs. 50 was granted to him for repairs.

Solution :

JOURNAL PROPER

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2018 Aug. 3	Ahmed Ali Dr. To Office Van A/c (Being the credit sale of office van to Ali)		15,000	15,000
Aug. 8	Drawing A/c Dr. To Purchases A/c (Being the withdrawal of goods By the owner for domestic use)		1,000	1,000
Aug.15	Loss by Fire A/c Dr. To Purchases A/c (Being loss of goods by fire accident)		5,000	5,000
Aug. 21	Singh Dr. To Bills Receivable A/c (Being the dishonour of bill by Singh)		2,000	2,000
Aug. 25	Bad Debts A/c Dr. To Bahadur (Being the amount irrecoverable from Bahadur)		500	500
Aug.28	Allowances A/c Dr. To Misra (Being an allowance granted for repair of goods damaged in transit)		50	50

Let Us Sum Up

In this unit, you have learned about the following:

'Petty Cash Book' is maintained for recording all such small (petty) payments. Petty Cash Book is maintained on Imprest System. The Petty Cash book is balanced periodically, say weekly or monthly. All events and transactions which cannot be recorded in any of the special journals maintained by the firm, shall be recorded in the Journal Proper.

Check Your Progress-2

1. Define Petty Cash Book
2. what is meant by Adjustment Entries?
3. What is Imprest system?

Glossary

Petty Cash Book: The Book Maintained for recording petty payments

Petty Cashier:	the one who maintains a petty cash book
Journal Proper:	A book maintained to enter transactions other than subsidiary book transactions
Opening Entry:	Entry given at the beginning of a year
Closing Entry:	Entry given at the closing of a year

Answers to Check Your Progress-1

- a-False
- b-True
- c-True
- d-True
- e-True

Answers to Check Your Progress-2

1. The petty cash book is a recordation of petty cash expenditures, sorted by date. In most cases, the petty cash book is an actual ledger book, rather than a computer record. Thus, the book is part of a manual record-keeping system. The petty cash book has declined in importance, as companies are gradually eliminating all use of petty cash, in favour of using company credit cards.
2. At the time of preparing the final accounts, it is necessary to bring into the books of account certain unrecorded items like closing stock, depreciation on fixed assets, interest on capital, expenses incurred but not yet paid, income earned but not yet received, etc. Entries passed in the Journal Proper to record such items are called 'Adjustment Entries'. These entries are explained in detail later.
3. The word "imprest" means – A fund that a business uses for small expenditures and usually restores to a fixed amount after a period of time. **Imprest system** refers to paying an advance at the start and reimbursing the amount spent from time to time.

Suggested Readings

1. Thomas Edmonds, Christopher, Edmonds, 2018-Introductory Financial Accounting for Business, McGraw Hill Publications.
2. Thomas, Wendy M. Tietz & Themin Suwardy Walter T. Harrison, 2018- Financial Accounting, Global Publications, 12th Edition.

Block-3: Introduction

The Block-3: Trial Balance, Rectification of Errors and Final Accounts has been divided into three Units (Unit-8 to Unit-10).

Unit-8: Trial Balance: This unit will be really helpful to describe the trial balance and helps to come to know to derive from Journal book and ledger book directly. These Students will also come to know about the advantages and disadvantages of preparing Trial Balance.

Unit-9: Rectification of Errors: This Unit is important to describe the Types of Errors and their examples and give proper knowledge to Rectify the Errors. These Students will also come to know about the Two sided i.e. Errors not affecting Trial Balance one sided i.e. Errors which affect Trial Balance and to maintain suspense account.

Unit -10: Final Accounts: This unit will be really helpful to Prepare Final Accounts For Sole-Traders, Partnerships And Limited Companies in Accordance With Appropriate Principles, Conventions and Standards.

In all the units of Block -3: **Trial Balance, Rectification of Errors and Final Accounts**, the Check your progress, Glossary, Answers to Check your progress and Suggested Reading has been provided and the Learners are expected to attempt all the Check your progress as part of study.

Unit-8

Trial Balance

STRUCTURE

Overview

Objectives

8.1. Introduction

8.2. What is a Trial Balance?

8.3. Preparation of a Trial Balance

8.4. Preparation of Trial Balance from a given list of Balances

8.5. Advantages of a Trial Balance

8.6. Limitations of a Trial Balance

Let Us Sum Up

Check Your Progress

Glossary

Answers to Check Your Progress

Suggested Readings

Overview

In this Unit, the concept of Trial Balance, Preparation of Trial Balance from a given list of Balances, Advantages of Trial Balance and Limitations of a Trial Balance has been clearly explained to the learners.

Objectives

After studying this unit, the students should be able to:

- define trial balance,
- prepare trial balance from a given set of balances;
- explain the causes of disagreement of a trial balance;
- describe the procedure for locating the errors;
- describe the types of errors which remain undisclosed by the trial balance;
- explain the advantages and limitations of trial balance;
- rectify errors before preparing the final accounts;
- explain the use of suspense account;
- prepare the suspense account;
- rectify errors located during subsequent accounting years; and
- compute the effect of rectifying errors on profit

8.1. Introduction

You have learnt the method of recording transactions in journal and its subdivisions. You have also learnt their posting to various accounts in the ledger. This process of recording and posting continues throughout the year. At the end of the year it becomes necessary to check the arithmetical accuracy of the books of account before the final accounts can be prepared. For this purpose, we prepare a statement called Trial Balance.

In this unit, you will study about the preparation of Trial Balance and the extent upto which it can be relied upon for testing the accuracy of accounts. You will also learn about the errors that will be disclosed by Trial Balance and the method of locating such errors.

You know that Trial Balance is prepared to verify the arithmetical accuracy of accounting records. When the Trial Balance does not tally, it means there are errors in the books of account and you will also learn about the errors that affect the Trial Balance and also study the procedure for locating such errors. In the process of rechecking, a number of errors are detected.

These errors must be rectified before preparing the final accounts. In this unit, you will also learn about the method of rectifying various errors and study the effect of the rectification on the profit of the business. You are advised to go through this unit once again and note the errors that are usually committed in the process of recording various transactions in subsidiary books and their postings.

8.2. What is a Trial Balance ?

Numerous transactions take place in business everyday. They are first recorded in some books of original entry i.e., Journal Proper or one of its subdivisions. Then they are posted to the appropriate accounts in the ledger. Each ledger account is balanced periodically so as to ascertain the net effect of various transactions posted therein. In the process, some accounts may get closed, while the others may show a debit or a credit balance. Based on these balances, the final accounts are prepared for ascertaining the profit or loss and the financial position of the business.

The quality and reliability of the results obtained depend largely on the correctness of the entries made in various books of account. Hence, it is necessary to ascertain the accuracy of these entries before we proceed with the preparation of final accounts. For this purpose, we prepare a

statement called 'Trial Balance', which shows balance of all ledger accounts. The ruling of trial balance is similar to that of journal. We write the name of each account in the particulars column. If the account shows a debit balance, its amount is entered in the debit balances column and if it shows a credit balance the amount is entered in the credit balances column.

You know that the total of the debit balances column must tally with the total of the credit balances column, because for every debit there is a corresponding credit and vice versa. When the two totals tally, it is considered as a preliminary proof of the arithmetical accuracy of entries in the books of accounts. It is an assurance that posting into ledger has been correctly done and that equality between debits and credits has been maintained throughout. If, however, the two totals do not tally it implies that there are errors in the books of account.

Trial Balance can thus be defined as a statement (or a schedule) listing, in separate columns, the debit and credit balances of all ledger accounts on a particular date. It indicates whether or not the books of account have been written in accordance with the rules of double entry and ensures, to a great extent, the arithmetical accuracy of accounting entries.

8.3. Preparation of a Trial Balance

At the outset, it is necessary to note that Trial Balance is a statement of balances. Its preparation does not involve passing of any journal entries. We simply balance various accounts in the ledger and list all accounts which show some balance, whether it is debit or credit. You are aware that when cash book is maintained, the ledger does not contain cash and bank accounts. Hence, cash and bank balances are taken from the cash book. If the number of personal accounts is large, you may prepare separate statements of balances for all debtors and creditors and show only the total debtors and total creditors in the trial balance.

Check Your Progress-1

True/False

- a. The quality and reliability of the results obtained depend largely on the correctness of the entries made in various books of account.
- b. Numerous transactions take place in business everyday.
- c. In the process of rechecking, a number of errors are detected.

- d. All accounts of expenses (including purchases) and losses will be debit balances.
- e. Trial Balance is not a statement of balances.

8.4. Preparation of Trial Balance from a given list of Balances

Normally when a trial balance is to be prepared, you have full details of ledger accounts with you. You can, therefore, easily ascertain whether a particular account has a debit balance or credit balance, and prepare the Trial Balance without any difficulty. But, sometimes, you are given only a list of balance. The nature of each balance is not mentioned. In other words, it is not clearly indicated whether the account is showing a debit balance or credit balance. Can you prepare a Trial Balance in such a situation? No you can't unless you know the nature of each balance. You will not know whether to show a particular balance in the debit column or in the credit column of the Trial Balance.

Hence, when you are asked to prepare a Trial Balance from a given list of balances and it is not clearly indicated whether a particular account has a debit balance or credit balance, you will first have to determine the nature of each balance. In this exercise, your knowledge of rules of debit and credit should help you. For example, you are aware that in case of nominal accounts all expenses and losses are debited and all incomes and gains are credited. Hence, accounts like salaries, wages, etc., will show debit balances and the accounts like interest received, discount received, etc., will show credit balances. Similarly, you know the rules for real and personal accounts. The accounts of assets like cash in hand, machinery, etc., will show debit balances and accounts like capital, creditors, etc., will show credit balances. For convenience, however, a few guidelines may help you to determine quickly the nature of each balance. These are:

- a. All accounts of expenses (including purchases) and losses will be debit balances.
- b. All accounts of incomes (including sales) and gains will be credit balances.
- c. All accounts of assets will be debit balances.
- d. All accounts of liabilities will be credit balances.
- e. Capital Account will normally be a credit balance.
- f. Drawings Account will be a debit balance.

The difficulty may arise with regard to items like commission, discount, rent and interest, because these can take the form of expenses as well as incomes. In such cases, the nature of balance is usually indicated by mentioning (Dr.) or (Cr.) against each item, or the word 'received' or 'paid' is usually added. So you can treat them correctly without much difficulty. If, however, there is one item for which no such indication is given and you find it difficult to identify the nature of its balance, you just proceed with the preparation of Trial Balance. At the time of totalling the amount columns in the trial balance, you will find that the total of one column is less than the other. This implies that the unindicated balance pertains to the column which is short. For example, there is an item of commission Rs. 300. But it is not indicated whether it is paid or received. When you prepare the trial balance, you find that the debit total is short by Rs. 300. This means that Commission Account has a debit balance. Now, if you show it as such in the Trial Balance, it will tally.

Look at illustration 1. The Trial Balance has been prepared from a given list of balances where the nature of each balance is not indicated. Study illustration carefully and note how each item has been shown in the Trial Balance.

Illustration 1

Prepare a Trial Balance from the following balances taken from the books of Sudhakar on March 31, 2018.

	Rs.		Rs.
Capital	1,80,000	Discount Received	360
Stock (1-4-2017)	49,200	Bills Payable	12,270
Sales	2,43,600	Sundry Creditors	31,110
Gas & Water	2,520	Returns Outwards	19,200
Land & Buildings	60,000	Bank Charges	3,000
Machinery	55,470	Drawings	14,550
Debtors	1,07,400	Trade Expenses	2,970
Commission (Dr.)	4,410	Cash	2,400
Plant	30,810	Bank	15,780
Carriage	3,370	Purchases	96,480
Rent Received	1,290	Rates & Taxes	2,520
Insurance	3,180	Furniture	3,750
Returns Inwards	5,970	Bills Receivable	4,410
Salaries	19,640		

Solution :**Trial Balance as on March 31, 2018**

Name of Account	L.F.	Dr. Balances	Cr. Balances
		Rs.	Rs.
Capital		—	1,80,000
Stock (1-4-2017)		49,200	—
Sales		—	2,43,600
Gas and Water		2,520	—
Land & Buildings		60,000	—
Machinery		55,470	—
Debtors		1,07,400	—
Commission (Dr.)		4,410	—
Plant		30,810	—
Carriage		3,370	—
Rent Received		—	1,290
Salaries		19,640	—
Insurance		3,180	—
Returns Inwards		5,970	—
Discount Received		—	360
Bills Payable		—	12,270
Sundry Creditors		—	31,110
Returns Outwards		—	19,200
Bank Charges		3,000	—
Drawings		14,550	—
Trade Expenses		2,970	—
Cash		2,400	—
Bank		15,780	—
Purchases		96,480	—
Rates & Taxes		2,520	—
Furniture		3,750	—
Bills Receivable		4,410	—
Total		4,87,830	4,87,830

In illustration 1, the Trial Balance has tallied i.e., the total of debit balances is equal to the total of credit balances. This implies that each balance has been entered in the appropriate amount column.

However, you require constant practice to determine the correct nature of items. Hence, another illustration is given where the accountant has not been able to correctly place the balances and, consequently, the Trial Balance does not tally. Look at illustration 3. The total of debit balances (Rs. 10,83,600) is different from the total of credit balances (Rs. 7,16,400). It is because a number of balances have been entered in the wrong amount columns. To cite one example, stock (an asset) is a debit balance but it has been wrongly entered in the credit column. Now, go through all items and identify those which have not been correctly shown in the given Trial Balance. Then, study the Revised Trial Balance and note how they are actually shown. This should help you gain clarity about the nature of various balances.

8.5. Advantages of a Trial Balance

The following advantages accrue from a Trial Balance:

1. It is a reasonable proof of the arithmetical accuracy of accounting entries. If the two sides of a Trial Balance tally, it is an indication that the books of account are arithmetically correct. Of course, there may still be some errors left.
2. It contains the balances of all ledger accounts on a particular date. Thus it serves as a summary of the results of all transactions during the period. The position of each account can be judged simply by looking at the Trial Balance. The ledger may be referred only if some further details are required in respect of a particular account.
3. It acts as a basis for preparing the final accounts i.e., Profit & Loss Account and the Balance Sheet. Of course, one can prepare these statements even by taking each balance directly from the ledger. But, that will be too cumbersome.
4. Regular preparation of a trial balance ensures that the accounting staff will work carefully. They will keep the accounts up to date and strive hard to avoid mistakes.

8.6. Limitations of a Trial Balance

The following can be considered as the limitations of Trial Balance:

1. Trial balance does not disclose all types of errors. Certain types of errors remain undetected even when the Trial Balance tallies. Hence, it is not a conclusive proof of the accuracy of the books of account.
2. A Trial Balance does not provide any additional information. You can not have any idea about the net result of the trading activity or about the financial position directly from the Trial Balance. Thus, the Trial Balance serves a limited purpose only.

Notwithstanding the limitations expressed above, the Trial Balance serves a useful purpose as a preparatory step in the preparation of final accounts.

Let Us Sum Up

Trial Balance is also used by banks and lending agencies to understand the borrowing capacity of the business and credibility. Looking at all the pros and cons, it is very clear that preparation of Trial Balance has a lot

of benefits and hence its preparation has become mandatory for closure of books of accounts. Even today the Trial Balance provides an excellent base for preparation of financial statements and analysis of business.

Check Your Progress

1. What is a Trial Balance?

2. How do you prepare a Trial Balance?

3. State the advantage of preparing a Trial Balance.

Glossary

Trial Balance: A trial balance is a sheet recording all the ledger balances categorized into debit and credit. A typical trial balance will have the name of ledger and the balances.

Credibility: Trial Balance is used by banks and lending agencies to understand the borrowing capacity of the business

ERP System: With software being used for preparation of accounts, today the trial balance from ERP system has automated a lot of processes.

Answers to Check Your Progress-1

a-True

b-True

c-True

d-True

e-False

Answers to Check Your Progress-2

1. A trial balance is a bookkeeping worksheet in which the balances of all ledgers are compiled into debit and credit account column totals that are equal. A company prepares a trial balance periodically, usually at the end of every reporting period.
2. It is necessary to note that Trial Balance is a statement of balances. Its preparation does not involve passing of any journal entries. We simply balance various accounts in the ledger and list all accounts which show some balance, whether it is debit or credit.
3. (1) It is a reasonable proof of the arithmetical accuracy of accounting entries. If the two sides of a Trial Balance tally, it is an indication that the books of account are arithmetically correct. Of course, there may still be some errors left.

(2) It contains the balances of all ledger accounts on a particular date. Thus it serves as a summary of the results of all transactions during the period. The position of each account can be judged simply by looking at the Trial Balance. The ledger may be referred only if some further details are required in respect of a particular account.

(3) It acts as a basis for preparing the final accounts i.e., Profit & Loss Account and the Balance Sheet. Of course, one can prepare these statements even by taking each balance directly from the ledger. But, that will be too cumbersome.

(4) Regular preparation of a trial balance ensures that the accounting staff will work carefully. They will keep the accounts up to date and strive hard to avoid mistakes.

Suggested Readings

1. Mr Barry Elliott, Jamie Elliott, 2017- Financial Accounting and Reporting- , Pearson Publications.
2. Paul V.A. & Korlahalli, J.S., 2018- Principle and Practice of Accountancy. New Delhi : S. Chand & Co., 2018

Unit-9

Rectification of Errors

STRUCTURE

Overview

Objectives

9.1. Introduction

9.2. Causes for the disagreement of a Trial Balance

9.3. Locating errors when the Trial Balance Disagrees

9.4. Errors not Disclosed by Trial Balance

9.5. Rectification of Errors

9.5.1. Rectification of One-sided Errors

9.5.2. Rectification of Two-sided Errors

9.6. Suspense account and Rectification

Let Us Sum Up

Check Your Progress

Glossary

Answers to Check Your Progress

Suggested Readings

Overview

In this Unit, the Causes for the disagreement of a Trial Balance, Locating errors When the Trial Balance Disagrees, Errors not Disclosed by Trial Balance, Rectification of Errors, Rectification of One-sided Errors, Rectification of Two-sided Errors and Suspense account and Rectification has been clearly explained.

Objectives

After completion of this Unit, you will be able to:

- Present the Causes for the disagreement of a Trial Balance, Locating errors When the Trial Balance Disagrees.
- Ascertain the Errors not Disclosed by Trial Balance, Rectification of Errors and
- Presenting the Rectification of One-sided Errors, Rectification of Two-sided Errors and Suspense account and Rectification.

9.1. Introduction

As mentioned earlier, when the Trial Balance does not tally, it means that there are errors in the books of account. Let us now analyse the errors which usually affect the Trial Balance and lead to its disagreement.

9.2. Causes for the Disagreement of a Trial Balance

1. **Omission of posting in one account:** You are aware that both the debit and credit aspects of a transaction have to be posted in the ledger accounts. If you post it to the debit of one account and forget its posting to the credit of the other concerned account, it is bound to affect the Trial Balance. For example, an amount of Rs. 200/- received from Ali, correctly entered on the debit side of the cash book but is not posted to the credit side of Ali's Account. This error shall result in the lower credit and hence the Trial Balance will not tally.
2. **Double posting in one account:** If by mistake you post an entry two times to the debit or to the credit of an account it would result in extra debit or credit and as such cause disagreement in the Trial Balance. If, however, the whole entry is posted twice i.e., both the debit and the credit aspects are posted twice, it won't affect the Trial Balance. It is because both the debit and the credit sides will be equally affected.
3. **Posting on the wrong side of an account:** When an entry is posted on the wrong side of an account i.e., instead of debit side it is posted on the credit side, it would also cause disagreement in the Trial Balance. In such a situation, the difference will be for double the amount. For example, Rs. 300/- received from Khan which is correctly entered on the debit side of the Cash Book, but while posting it to Khan's Account, it is wrongly posted to the debit side instead of the credit side. This would mean that a debit of Rs. 600/- (Rs. 300/- in Cash Account and Rs. 300/- in Khan's Account) has no corresponding credit. So, in the Trial Balance, the credit side will be lower by Rs. 600/-.
4. **Posting wrong amount in an account:** If you post an entry to the correct side of an account but commit an error in writing the amount, this would affect the Trial Balance. Suppose, in the above example you post the entry correctly on the credit side of Khan's Account but the amount is wrongly put as Rs. 200/-. It

would cause a difference of Rs. 100/-. In the Trial Balance, the credit side will be lower by Rs. 100/-.

5. **Wrong totalling of the subsidiary book:** If any subsidiary book is overcast or undercast, it affects the concerned account in ledger. Suppose the correct total of Sales Journal is Rs. 5,600/-, but it is actually totalled as Rs. 5,300/-. You know that the total of Sales Journal is posted to the credit side of the Sales Account. So, the Sales Account will be short by Rs. 300/-, and the Trial Balance will not tally.
6. **Omitting to post the total of a subsidiary book:** If the total of a subsidiary book is not posted to the concerned account, it would affect the Trial Balance. Such mistake relates only to the account where posting was to be done and as such affects only one account. Take for example, the Sales Journal. If its total of Rs. 18,900/- is not posted to the credit of Sales Account, the credit side on the Trial Balance will be lower by Rs. 18,900/-.
7. **Wrong totalling or balancing of an account:** When an account is wrongly totalled or wrongly balanced, this would affect the Trial Balance. Suppose the debit side of Shyam's Account is totalled as Rs. 1,300/- instead of Rs. 1,100/-. It would lead to wrong balance in Shyam's Account. Consequently, the debit total in the Trial Balance will be higher by Rs. 200/-. Similarly, if the totalling is correctly done but a mistake is committed in balancing the account, it would also cause a difference in the Trial Balance.
8. **Omission of an account from Trial Balance:** You know that all accounts which show some balance must be included in the Trial Balance. If you forget to write the balance of any account in the Trial Balance, it will not tally. In practice, cash book balances are often omitted from Trial Balance.
9. **Writing the balance of an account on the wrong side of the Trial Balance:** If the balance of an account which is to be shown in the debit column of the Trial Balance is actually shown in the credit column, the Trial Balances will not tally. It will be affected by double the amount. You noticed such error in respect of many items in illustration 3.
10. **Wrong totaling of the Trial Balance :** If a mistake is committed in totalling the Trial Balance amount columns of the Trial Balance itself, the Trial Balance will not tally. Thus, you learn about various errors which may cause differences in the Trial Balance.

Note that these errors affect only one aspect (debit or credit). This upsets the debit-credit correspondence leading to the disagreement of the Trial Balance.

9.3. Locating Errors When the Trial Balance Disagrees

When a Trial Balance disagrees, an attempt must be made to locate the errors and rectify them. If all errors are rectified and the Trial Balance is revised, it will tally.

The following routine procedure is usually adopted for locating the errors.

- a) Check the totals of both the debit and the credit columns of the Trial Balance.
- b) If the difference still persists, ascertain the exact amount of difference; and then
 - i) See whether an account having that balance has been omitted from the Trial Balance. Suppose the debit column in Trial Balance is short by Rs. 630/-, it is just possible that an account with a debit balance of Rs. 630/- has not been entered in the Trial Balance.
 - ii) Check whether an account with a balance equal to that difference has been entered twice in the Trial Balance.
 - iii) Take the half amount of difference, see whether there is any account with such balance in the Trial Balance and, if so, check whether it is entered in the correct column or not. If an account with a debit balance of Rs. 315/- has been entered in the credit column, the debit column becomes short by Rs. 630/-.
- c) Verify whether (i) the balances of all the accounts are included in the Trial Balance, (ii) they are entered in the correct column, and (iii) their amounts have been correctly written. If no errors are found upto this stage, or the errors located have been duly corrected, but still the Trial Balance does not tally, there is need to take further action. You may take the following steps:
- d) Check the totals of the lists of sundry debtors and sundry creditors.
- e) Check the totals and balances of all accounts in the ledger.
- f) Check the totals and the postings of all subsidiary books.

- g) Check the postings of all amounts equal to the difference in Trial Balance. It is possible that a posting has been omitted. Similarly, check the postings of all amounts equal to half the difference. It is possible that the amount has been posted on the wrong side of the concerned account.
- h) See that correct amounts have been brought forward from the previous pages.
- i) Verify that all opening balances have been correctly entered in various accounts.
- j) Compare the current year's Trial Balance with that of the previous year. Any variation noticed should be carefully checked.

The procedure outlined above, if carefully followed, should normally reveal all the errors. The errors are then rectified and a Revised Trial Balance is prepared. If no other errors exist, the Revised Trial Balance is likely to tally. However, if the Revised Trial Balance also does not tally, there is no alternative but to recheck the entire accounting work done during the year. Sometimes, all these efforts fail to reveal the errors. In such a situation, the difference may be placed to the debit or credit of a Suspense Account (as the case may be) and you may proceed with the preparation of the final accounts. Later on, as and when the errors come to light, they will be corrected through proper rectifying entries in the journal.

Check Your Progress-1

True/False

- a. It is possible that a posting has been omitted.
- b. When a transaction is completely or partially omitted to be recorded in books of account, it is called an 'Error of Omission'.
- c. When the Trial Balance does not tally, it means that there are errors in the books of account.
- d. When a Trial Balance disagrees, an attempt must be made to locate the errors and rectify them.
- e. When an entry is posted on the wrong side of an account i.e., instead of debit side it is posted on the credit side, it would also cause agreement in the Trial Balance.

9.4. Errors not Disclosed by Trial Balance

As stated earlier, the Trial Balance is only a reasonable proof (not a conclusive proof) of the arithmetical accuracy of accounting entries. There is no guarantee that when the Trial Balance has tallied, there will be no errors left. As a matter of fact, there are a number of errors which do not affect the Trial Balance at all. They are:

1. **Errors of Principle:** When a transaction has not been recorded as per the rules of debit and credit, or some other accounting principle has been ignored, the errors so arising are called 'Errors of Principle'. Example of such errors are:
 - i) A credit purchase of a fixed asset recorded in the Purchases Journal instead of the Journal Proper: This results in debiting the Purchases Account instead of the concerned fixed asset account. It means that a capital expenditure has been treated as a revenue expenditure. This is an error of principle. This does not disturb the debit-credit correspondence. Hence, the Trial Balance will not be affected.
 - ii) An expenditure incurred on repairs of machinery debited to Machinery Account: As per rules it should have been debited to Machinery Repair Account, as it is a revenue expenditure. Debiting to Machinery Account amounts to treating it as a capital expenditure. It is therefore an error of principle. This also does not affect the Trial Balance because the debit has been duly recorded, though in the wrong account.
 - iii) Salary paid to Shyam recorded in the Cash Book as a payment to Shyam: This results in debiting Shyam's personal account instead of the Salaries Account. This is also an error of principle and does not affect the Trial Balance.
2. **Errors of Omission:** When a transaction is completely or partially omitted to be recorded in books of account, it is called an 'Error of Omission'. If the transaction is omitted to be recorded in the subsidiary books or its posting is completely omitted, it is called an 'Error of Complete Omission'.

If, however, the posting is done in one account, but omitted to be done in the other, it is called an 'Error of Partial Omission'. For example, if a credit purchase of goods from Shyam is not recorded in the Purchases Journal or a credit purchase of furniture from Ram is duly recorded in the Journal Proper but no posting is done

in any of the two accounts involved, then these will be termed as errors of complete omission. If the purchase of goods from Shyam is recorded in the Purchases Journal but is omitted to be posted in Shyam's Account, it will be called an error of partial omission.

Other examples of partial omission are: omission in carrying forward the total from one page to the other, omission to balance an account, and so on.

The errors of complete omission do not, affect the Trial Balance. But the errors of partial omission would certainly cause disagreement of the Trial Balance because they would lead to either short debit or short credit.

3. **Some Errors of Commission:** When an error is committed in recording a transaction in the subsidiary book with a wrong amount, or is committed in posting it to a wrong account or to the wrong side of an account, it is called an 'Error of Commission'. Errors like double posting, wrong totalling of an account, wrong carry forward, wrong balancing, etc., are also regarded as errors of commission. Such errors will generally affect the Trial Balance. But, if an error of commission is committed while recording a transaction in any of the subsidiary books, it shall not affect the Trial Balance because both the debit and the credit are equally affected. Suppose, a machine of Rs. 5,000/- purchased on credit from Gautam is recorded in the journal for Rs. 5,500/-. It means both the debit and the credit have been recorded for Rs. 5,500/-. Hence, the Trial Balance remains unaffected.
4. **Compensating Errors:** Those errors which nullify the effect of each other are called 'Compensating Errors'. In other words, compensating errors refer to such a group of errors wherein the effect of one error is compensated by the effect of another error or errors. Such errors do not affect the Trial Balance. For example, while posting an entry of Rs. 200/- to the debit of Ram's personal account, we wrongly wrote Rs.400/-. Then, while posting an entry of Rs. 500/- to the debit of some other account we wrote Rs. 300/-. The first error will result in a higher debit of Rs. 200/- whereas the second error will result in a lower debit of Rs. 200/-. Thus, the effect of the first error is nullified by the effect of the second error. So the Trial Balance will not be affected. Take another example. The Purchases Journal is overcast by Rs. 1,000/- which means the Purchases Account will be debited in excess by Rs. 1,000/-. The sales journal also, by mistake, is

overcast by Rs. 1000/- which means the sales account will be credited in excess by Rs. 1000/-. These two mistakes together result in excess debit of Rs. 1,000/- as well as an excess credit of Rs. 1,000/-. Thus, they cancel out each other and the Trial Balance remains unaffected.

9.5. Rectification of Errors

Any error when located must be rectified. However, the rectification should not be made by overwriting or by striking off the wrong entry. This would destroy the authenticity of the books of account. Hence, the errors should always be corrected by making suitable entries called rectifying entries. For purposes of rectification, the errors are divided into two categories: (i) one-sided errors, and (ii) two-sided errors.

One-sided Errors: Certain errors affect only one side of an account, either the debit side or the credit side. Such errors are called 'one-sided errors'. Examples of one-sided errors are:

- i) Rs. 100/- received from Deshmukh was posted to his account as Rs. 10/-. It means Deshmukh's Account has been credited with Rs. 10/- instead of Rs.100/- and there is no mistake in the Cash Book. Thus, this error has affected only one side of an account.
- ii) The Purchase Book is overcast by Rs. 1000/-. This will affect the debit side of Purchases Account where the total of the Purchases Book is posted, and no other account is affected.

Two-sided Errors : Certain errors may affect two or more accounts. Such errors are called 'two-sided errors'. Examples of two-sided errors are:

- i) A credit sale of Rs. 1,080/- to Anand was wrongly recorded in the Sales Book for Rs. 1,800/-. This error will affect two accounts viz., Anand's Account and Sales Account. Anand's Account has been debited by Rs. 1,800/- instead of Rs. 1,080/-. The Sales Account has also been credited by an additional amount of Rs. 720/- (Rs. 1,800/- to Rs. 1,080/-), because the Sales Book shows a higher total.
- ii) A sale of Rs. 500/- made to Kamal has been posted on the debit side of Kishore's Account. This error will affect two accounts viz., Kamal's Account and Kishore's Account. An entry of Rs. 500/- does not appear on the debit side of Kamal's Account whereas Kishore's Account has been wrongly debited with that amount.

9.5.1. Rectification of One-sided Errors

Generally errors are corrected by passing suitable journal entries. You know passing a journal entry means debiting one account and crediting another. But in the case of one-sided error only one account is involved. So it cannot be corrected by passing journal entry. It is rectified by noting the correction on the appropriate side. Take the first example of one-sided error. Deshmukh's Account was credited short by Rs. 90. This will be corrected by an additional entry for Rs. 90 on the credit side of his account as follows:

Deshmukh's Account

Dr.	Cr.	
	By Difference in amount	Rs.
	received from him posted on	90

In the second example of one-sided error, the Purchases Account is debited in excess by Rs. 1,000. This will be corrected by crediting the Purchases Account with Rs. 1,000 as follows:

Purchases Account

Dr.	Cr.	
	By Overcasting of Purchases	Rs.
	Book for the month of	1,000

The wrong total in the Purchases Book will be circled with red ink and the correct total entered above or below the circle. The person doing the rectification will also put his initials.

Let us take a few more examples of one-sided errors and study how they will be rectified.

1. **The Sales Returns Book for the month of June was undercast by Rs. 10** :You know the periodical total of the Sales Returns Book is posted to the debit side of Sales Returns Account. So, a mistake in totalling the Sales Returns Book will affect only the Sales Returns Account. It has been debited short by Rs. 10. So, this error can be corrected by an additional entry for Rs. 10 on the debit side of Sales Returns Account as shown below:

Sales Returns Account

Dr.	Cr.
To Undercasting of Sales Returns Book for the month of June	Rs. 10

2. **A payment of Rs. 1,000 towards interest was posted twice to Interest Account :** You know when interest is paid it is recorded on the credit side of the Cash Book and posted On the debit side of Interest Account. The error lies in repeating the posting to interestAccount. Thus, it has affected only the Interest Account which now shows an excess debit of Rs. 1,000. This will be corrected by crediting the Interest Account with Rs. 1,000 as follows:

Interest Account

Dr.	Cr.
	By Double posting from Cash Book on now, rectified
	Rs. 1,000

3. **Receipt of Rs. 300 towards commission was omitted to be posted:** You know receipt of commission is recorded on the debit side of the Cash Book and posted on the credit side of the Commission Account. The error lies in omitting to post. Hence, it has not been credited by Rs. 300. This error can be corrected by making the posting now as shown below:

Commission Account

Dr.	Cr.
	By Omission of posting from Cash Book
	Rs. 300

4. **A credit sale for Rs. 1,000 to Tiwari was posted to the credit side of his account:** You know a credit sale is entered in the Sales Book and posted on the debit side of the customer's account from the Sales Book. This error relates to posting on wrong side of Tiwari's Account. His account should have been debited and not credited. To correct this error, we have not only to remove the wrong credit of Rs. 1,000 from his account but also give a debit of Rs. 1,000 to his account. Hence, the error can be rectified by debiting Tiwari's Account with double the amount i.e. Rs, 2,000 as shown below:

Tiwari's Account

Dr.	Cr.
To Posting of sales made to him on credit side on Now rectified	Rs. 2,000

9.5.2. Rectification of Two-sided Errors

You have learnt that one-sided errors are corrected by noting the Correction on the appropriate side of the account affected by the error. These cannot be rectified by suitable journal entries because only one account was involved. But, the two-sided errors are mostly rectified by journal entries. It is because such errors affect two or more accounts and in most cases the debit and credit are equally affected. Take the case of first example of two-sided errors given earlier. A credit sale of Rs. 1,080 to Anand was wrongly recorded in the Sales Book as Rs. 1,800. The two accounts affected are: (i) Anand's Account which shows an excess debit of Rs. 720, and (ii) Sales Account which stands credited in excess by Rs. 720. To rectify this error, we must credit Anand's Account with Rs. 720 and debit the Sales Account with Rs. 720

So, a journal entry can be passed as follows:

	Rs	Rs
Sales Account Dr.	720	
To Anand		720

(Being sales of Rs. 1,080 to Anand wrongly recorded in the Sales Book as Rs. 1,800, now rectified)

Take the second example of two-sided errors given earlier. A sale of Rs. 500 made to Kamal was posted to the debit side of Kishore's Account. The two accounts affected are: (i) Kamal's Account which has not been debited by Rs. 500, and (ii) Kishore's Account which has been wrongly debited with Rs. 500. To rectify this error we have to debit Kamal's Account with Rs, 500 and credit Kishore's Account with Rs. 500. So, journal entry for the rectification of this error

will be as follows:

	Rs	Rs
Kamal Dr.	500	
To Kishore		500

(Being rectification of wrong debit to Kishore for sale made to Kamal)

Now let us take a few more examples of two-sided errors and see how they will be rectified

1. **Sale of old machinery to Chakraborty for Rs. 600 was wrongly entered in the Sales Book.** You know the correct entry for this transaction would be as follows:

	Rs	Rs
Chakraborty Dr.	600	
To Machinery Account		600

Instead of the above entry, the transaction was recorded as

	Rs	Rs
Chakraborty Dr.	600	
To Sales Account		600

Thus, debit to Chakraborty's Account is correctly given. But it has affected two other accounts (i) Machinery account: which has not been credited, and (iii) Sales Account which has been wrongly credited. This can be rectified by debiting the Sales Account since it has been wrongly credited, and crediting the Machinery Account which has not been credited. Hence, a rectifying entry can be passed

	Rs	Rs
Sales Account Dr.	600	
To Machinery Account		600

(Being rectification of wrong credit to sales for the sale of old machinery)

2. **A credit sale of Rs. 7,600 to Sharma was recorded in the Sales Book for Rs. 6,700:** It means the entry in the Sales Book has been made with Rs. 900 (Rs. 7,600 – Rs. 6,700) short. So, this error has affected two accounts:

(i) Sharma's Account which is having a short debit of Rs. 900, and (ii) the Sales Account which is having a short credit of Rs. 900. It can be rectified by debiting Sharma's Account and crediting Sales Account. The rectifying journal entry will be as follows:

	Rs	Rs
Sharma Dr.	900	
To Sales Account		900

(Being the rectification of a credit sale for Rs. 7,600 wrongly recorded as Rs. 6,700)

3. **Repairs to machinery amounting to Rs. 400 was wrongly debited to Machinery Account :** You know when routine repairs are made, such expenditure is debited to Repairs Account and not to the concerned asset account. So, in this case the debit should have gone to Repairs Account and not to Machinery Account. To rectify this error, we should now debit the Repairs Account and credit the Machinery Account. Thus, the rectification entry will be:

	Rs	Rs
Repairs Account Dr.	400	
To Machinery Account		400

(Being the rectification of wrong debit to Machinery Account for routine repairs)

Illustration - 1

How would you rectify the following errors in the books of Kiran & Co.?

1. The Sales Returns Book has been undercast by Rs. 500.
2. The total of the Bills Receivable Book amounting Rs. 4,500 has been posted to the credit of Bills Receivable Account.
3. While posting Purchases Book to the ledger, the personal account of Kumar has been credited with Rs. 221 instead of Rs. 212.
4. Rs. 10,000 paid for the purchase of a TV set for the proprietor is debited to General Expenses Account.
5. An amount of Rs. 1,000 paid by Pran has been credited to the account of Praneet.
6. Goods sold to Inder for Rs. 1,200 have been entered in the Purchases Book.

Solution:

1. This error will be rectified by entering Rs. 500 on the debit side of Sales Returns Account by writing "To Undercasting of Sales Returns Book for the Month ofRs. 500".
2. This error will be rectified by entering an amount of Rs. 9,000 on the debit side of Bills Receivable Account by writing "To Wrong posting of the total of Bills Receivable Book on the opposite side Rs. 9,000".
3. Kumar's Account has been credited with an excess amount of Rs. 9 (Rs.221— Rs. 212). This error will be rectified by debiting his

account with Rs. 9 by writing "To Difference in amount posted from the Purchases Book onRs. 9".

4. The following journal entry is required for rectification:

		Rs	Rs
Drawings A/c	Dr.	10,000	
To General Expenses A/c			10,000

(Being rectification of purchase of TV wrongly debited to General Expenses A/c)

5. The Following Journal entry is required for rectification:

		Rs	Rs
Praneet	Dr.	1,000	
To Pran			1,000

(Being rectification of wrong credit to Praneet for the amount paid by Pran)

6. The following journal entry is required for rectification:

		Rs	Rs
Inder	Dr.	2,400	
To Purchases A/c			1,200
Tp Sales A/c			1,200

(Being rectifying entry for sale to Inder wrongly entered in the Purchases Book)

Illustration- 2

How would you rectify the following errors:

1. Rs. 3,000/- received from the sale of old machinery has been wrongly posted to Sales Account.
2. Rs. 600/-, the cost of repairing the machinery has been wrongly charged to Machinery Account.
3. Goods purchase for Rs. 500/- from Sanjay has been wrongly debited to Furniture Account.
4. A sales of Rs. 600/- has been wrongly credited to the customer's account.
5. A payment of Rs. 460/- on account of rent has been posted twice to the Rent Account.
6. An item of Rs. 197/- has been debited to a personal account as Rs. 179/-.

Solution:

1. The following journal entry is required for rectification:

		Rs	Rs
Sales A/c	Dr	3,000	
To Machinery A/c			3,000

(Being rectifying entry for sale of old machinery credited to Sales A/c)

2. The following Journal entry is required for rectification:

		Rs	Rs
Repairs	Dr	600	
To Machinery A/c			600

(Being rectification of wrong debit to Machinery A/c instead of Repairs A/c)

3. The following journal entry is required for rectification:

		Rs	Rs
Purchases A/c	Dr	500	
To Furniture A/c			500

(Being rectifying entry for purchase wrongly debited to Furniture A/c)

4. This error will be rectified by debiting the customer's account with Rs. 1,200/- (double of Rs. 600/-) by writing "To Wrong posting from Sales Book on the credit side on Rs. 1,200/-"
5. This error will be rectified by entering Rs. 460/- on the credit side of the Rent Account by writing "By Double posting from Cash Book onRs. 460/- "
6. The personal A/c has been debited Rs. 18/- short (Rs. 197/- to Rs.179/-). To rectify this error, the personal A/c will be debited with the difference by writing "To Difference in amount posted on Rs. 18/-".

9.6. Suspense Account and Rectification

You have learnt the method of rectifying the errors. This method is used for rectifying the errors located before preparing the final accounts. After the corrections have been made, a revised Trial Balance is prepared which should normally tally. But, if it does not tally, it means there are still some errors which have not been detected. As considerable time and effort have already been spent in locating and rectifying the errors, it may not be possible to wait any longer because it will delay the

preparation of final accounts. Hence, in such situation the usual practice is to place the difference to Suspense Account and tally the Trial Balance for the time being. If the total of the debit column in the Trial Balance is more than the total of its credit column, the difference is placed to the credit of Suspense Account and the Trial Balance will tally. Similarly, if the credit column total is more than the debit column total, the difference is placed to the debit of Suspense Account. The Suspense Account thus created is shown in the Balance Sheet and is carried forward to the next year.

Note that the Suspense Account is not the result of any transaction. It merely represents the net effect of errors which still remain undetected. Therefore, during the next accounting year, after the errors are located and rectified, the Suspense Account will get closed. Let us now understand how errors will be corrected during the next year. As for the two sided errors, there is no change in the method of rectification. These errors do not affect the agreement of Trial Balance and hence do not involve the Suspense Account. They are rectified by means of the journal entries as usual. This is not the case in respect of one-sided errors. When one-side errors were to be corrected before preparing the Trial Balance we did it by writing an appropriate note in the concerned account. But, when they are to be corrected during the next year i.e., after Suspense Account has been created, the rectification will be through an appropriate journal entry. The onesided error usually affects only one account. So to pass a journal entry for rectification of such error, we shall now take Suspense Account as the other account involved. For example, Rs. 580 received from Shyam were posted to his account as Rs. 850. It means Shyam's Account is to be debited with Rs. 270.

You can now pass the following journal entry to rectify this error:

	Rs.	Rs.
Shyam A/c Dr.	270	
To Suspense Account (Being rectification entry)		270

Thus all errors, whether they are two-sided or one- sided will now be rectified by means of journal entries.

Let us assume that a businessman could not tally his Trial Balance. The difference of Rs. 1 between the totals of the two columns was put against the Suspense Account on its debit side and the Trial Balance was made to tally temporarily. The Suspense Account was carried forward to the next accounting year. The following errors were then located:

1. An amount of Rs. 99/- was omitted to be posted to the credit of a customer's account from the Cash Book.
2. The Sales Book was overcast by Rs. 100/-.

The first error involved the omission of posting to the credit of customer's account. So, to rectify this error, you will have to credit customer's account with Rs. 99/-.

As the Suspense Account is in existence, the corresponding debit would be given to the Suspense Account. Thus, the journal entry will be:

		Rs.	Rs.
Suspense A/c	Dr.	99	
To Customer's A/c			99
(Being the rectification of omission in posting)			

The second error refers to Sales Book being overcast by Rs. 100. It means that the Sales Account has been credited with Rs. 100 in excess. To rectify this error, the Sales Account will have to be debited with Rs. 100. The corresponding credit would be given to Suspense Account. The rectifying entry will be:

		Rs.	Rs.
Sales A/c	Dr.	100	
To Suspense A/c			100
(Being the rectification of overcasting in Sales Book)			

The Suspense Account, after posting the two rectification entries, would appear as follows:

Suspense Account

Dr.		Cr.	
To Difference in Trial Balance	Rs. 1	By Sales A/c	Rs. 100
To Customer's A/c	99		
	100		100

With the posting of the two rectification entries the Suspense Account got closed. Note that the opening balance in Suspense Account simply shows the net effect of these errors. Sometimes, the balance of Suspense Account is not given. In that case it can be worked out after completing the posting of the rectification entries.

Suppose in the above example, the amount with which the Suspense Account was opened was not given. Leave the first line blank on both

the debit and credit sides of the Suspense Account and post the rectification entries. The difference between the totals of two sides will be considered as the balance with which the Suspense Account was opened. This is based on the assumption that there are no more errors remaining undetected.

Illustration-3

The Trial Balance of Siva did not tally. The credit side exceeded by Rs. 1,455. This amount was entered in the debit column against Suspense Account and the Trial Balance was made to tally.

Later, the following errors were discovered.

1. Goods worth Rs. 1,250/- were sold to Mahesh on credit. This was entered in the Sales Book but was not posted.
2. Goods worth Rs. 313/- were returned by Ahmed. The amount was credited to his account but was not recorded in the Returns Inwards Book.
3. Manoj paid Rs. 670/- but his account was wrongly credited with Rs. 609/-.
4. An amount of Rs. 375/- owed by Dinesh was omitted from the schedule of Sundry Debtors.
5. The Sales Book was undercast by Rs. 420/-.

Rectify the errors and show the Suspense Account.

Solution:

JOURNAL

		Rs.	Rs.
1.	Mahesh To Suspense A/c (Being sales to Mahesh not posted)	Dr. 1,250	1,250
2.	Returns Inwards A/c To Suspense A/c (Being goods returned not recorded in Returns Inwards Book though credited to personal account)	Dr. 313	313
3.	Suspense A/c To Manoj (Being Cash paid by Manoj underposted)	Dr. 63	63
4.	Sundry Debtors A/c	Dr. 375	

	To Suspense A/c (Being Dinesh's debit omitted from the list of Sundry Debtors)		375
5.	Suspense A/c	Dr	420
	To Sales A/c (Being rectification of overcasting in Sales Book)		420

Suspense Account

Dr.	Rs.	Cr.	Rs.
To Difference in Trial Balance	1,455	By Mahesh	1,250
To Manoj	63	By Returns Inwards A/c	313
To Sales A/c	420	Sundry Debtors A/c	375
	1,938		1,938

Illustration- 4

Kishan, the accountant, found certain errors in the books. He transferred the difference in the Trial Balance to the credit of a Suspense Account. Subsequently, the following errors were discovered. Pass the necessary journal entries to rectify the errors and show the Suspense Account.

- An amount of Rs. 300/- paid as Commission was not posted to Commission Account.
- Rs. 3,400/- paid towards rent was wrongly entered in the Rent A/c as Rs. 4,300/-.
- Discount Received column of the Cash Book was under cast by Rs. 100/-.
- Cash sales not posted to the Sales Account amounted to Rs. 1,000/-.

Solution:

JOURNAL

1.	Commission A/c	Dr.	300	
	To Suspense A/c			300
	(Being the omission of posting to commission A/c rectified)			
2.	Suspense A/c	Dr.	900	
	To Rent A/c			900
	(Being excess debit to Rent Account now rectified)			
3.	Suspense A/c	Dr.	100	

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		Rs.	Rs.
1.	Purchases A/c Dr. To Anthony & Co. (Being the omission of credit purchases, now rectified)	8,000	8,000
2.	Ray Dr. To Roy (Being credit given to Ray's account instead of Roy's account, now rectified)	500	500
3.	Suspense A/c Dr. To Gopal (Being excess debit given to Gopal's A/c, now rectified)	5,400	5,400
4.	Salaries A/c Dr. To Wages A/c (Being debit to Wages A/c instead of Salaries A/c, now rectified)	1,000	1,000
5.	Commission A/c Dr. To Interest A/c (Being credit given to Commission A/c instead of interest A/c, now rectified)	450	450
6.	Suspense A/c Dr. To Returns Outwards A/c (Being the omission of posting total of Returns Outwards Book, now rectified)	560	560
7.	Rakesh Dr. To Suspense A/c (Being wrong credit given to Rakesh, now rectified)	500	500
8.	Madhu Dr. To Suspense A/c (Being short amount debited to Madhu now rectified)	270	270
9.	Suspense A/c Dr. To Kailash (Being debit given to Kailash instead of credit, now rectified)	800	800
10.	Suspense A/c Dr. To Discount Allowed A/c (Being excess amount carried forward in Cash Book, now rectified)	99	99

Suspense Account

Dr.		Cr.	
To Gopal	Rs. 5,400	By Balance b/d (balancing figure)	Rs. 6,089
To Returns Outward A/c	560	By Rakesh	500
To Kailash A/c	800	By Madhu	270
To Discount Allowed A/c	99		
	6,859		6,859

Let Us Sum Up

In this unit, you have learned about the following:

It is necessary to prepare a Trial Balance before preparing the final accounts. It verifies the arithmetical accuracy of the books of account. When a Trial Balance does not tally, it means that there are errors in books of account. A series of steps are taken to locate errors. There are certain errors which affect the Trial Balance and there are some which do not. Errors of principle, errors of complete omission, certain errors of commission in subsidiary books, and the compensating errors are not disclosed by the Trial Balance.

Check Your Progress-2

1. In the books of accounts are broadly divided into
 - a) two groups
 - b) three groups
 - c) four groups
 - d) five groups
2. Errors which are made while recording transaction in the journal and posting them in the ledger are called
 - a) trial balance
 - b) bookkeeping errors
 - c) balance sheet errors
 - d) none of these
3. when a transaction is wholly or partially recorded incorrectly it is called
 - a) Error of commission
 - b) Error of principle
 - c) Error of omission
 - d) Error of posting

Glossary

- Compensating Errors :** A group of errors wherein the effect of an error is counter-balanced (or compensated) by the effect of one or more errors, as a result of which the agreement of Trial Balance remains unaffected.
- Errors of Principle** An error committed by ignoring or misapplying some principles of accounting while recording a transaction in the books of account.
- Errors of Complete Omission:** An error committed in completely omitting to record a transaction in the books of account.
- Errors of Partial Omission:** An error committed in omitting to post one aspect of an entry in the ledger.
- Errors of Commission:** A clerical error committed while recording or posting of a transaction.
- One-sided error :** An error which affects the debit or credit side of one account only.
- Profit and Loss Adjustment Account :** An account opened for avoiding the effect of rectifying entries in respect of previous year's errors on the profit or loss of the current year.
- Suspense Account :** An account opened to make the Trial Balance tally temporarily. It represents the net effect of undetected one-sided errors.
- Two-sided errors :** An error which involves two or more accounts and both the debit and credit aspects.

Answers to Check Your Progress-1

- a-True
- b-True
- c-True
- d-True
- e-False

Answers to Check Your Progress-2

1. a) Two Groups
2. b) Book Keeping errors
3. c) Error of Commission

Suggested Readings

1. Grewal T.S.2018, Double Entry Book-Keeping ,Sultan Chand & Sons
2. Maheshwari, S.N., 2018, Principles and Practice of Book-Keeping (New Delhi: Arya Book Publications.

Unit-10

Final Accounts

STRUCTURE

Overview

Objectives

10.1. Introduction

10.2. Trading Account

10.2.1. Format of Trading Account

10.3. Manufacturing Account

10.4. Profit and Loss Account

10.5. Balance Sheet

10.5.1. Assets

10.5.2. Liability

10.5.3. Grouping of Assets and Liabilities

10.6. Financial Statements with Adjustments Entries

Let Us Sum Up

Check Your Progress

Glossary

Answers to Check Your Progress

Suggested Readings

Overview

In this Unit, the concept of Trading Account including format of Trading account, Manufacturing Account, Profit and Loss Account, Balance Sheet consist of Assets, Liability, Grouping of Assets and Liability and Financial Statements with Adjustments Entries has been clearly explained .

Objectives

After studying this unit you should be able to:

- explain why adjusting entries are necessary at the time of preparing the final accounts;
- list the items in respect of which adjustments are usually made;
- pass the necessary adjustment entries; and
- prepare final accounts with adjustment

10.1. Introduction

Final Accounts are the accounts, which are prepared at the end of a fiscal year. It gives a precise idea of the financial position of the business/organization to the owners, management, or other interested parties. Financial statements are primarily recorded in a journal; then transferred to a ledger; and thereafter, the final account is prepared (*as shown in the illustration*).

Usually, a final account includes the following components –

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

Now, let us discuss each of them in detail –

10.2. Trading Account

Trading accounts represents the Gross Profit/Gross Loss of the concern out of sale and purchase for the particular accounting period.

Study of Debit side of Trading Account

- **Opening Stock** – Unsold closing stock of the last financial year is appeared in debit side of the Trading Account as “To Opening Stock” of the current financial year.
- **Purchases** – Total purchases (net of purchase return) including cash purchase and credit purchase of traded goods during the current financial year appeared as “To Purchases” in the debit side of Trading Account.
- **Direct Expenses** – Expenses incurred to bring traded goods at business premises/warehouse called direct expenses. Freight charges, cartage or carriage charges, custom and import duty in case of import, gas, electricity fuel, water, packing material, wages, and any other expenses incurred in this regards comes under the debit side of Trading Account and appeared as “To Particular Name of the Expenses”.
- **Sales Account** – Total Sale of the traded goods including cash and credit sales will appear at outer column of the credit side of Trading Account as “By Sales.” Sales should be on net releasable value excluding Central Sales Tax, Vat, Custom, and Excise Duty.

- **Closing Stock** – Total Value of unsold stock of the current financial year is called as closing stock and will appear at the credit side of Trading Account.

Closing Stock = Opening Stock + Net Purchases - Net Sale

- **Gross Profit** – Gross profit is the difference of revenue and the cost of providing services or making products. However, it is calculated **before** deducting payroll, taxation, overhead, and other interest payments. Gross Margin is used in the US English and carries same meaning as the Gross Profit.

Gross Profit = Sales - Cost of Goods Sold

- **Operating Profit** – Operating profit is the difference of revenue and the costs generated by ordinary operations. However, it is calculated **before** deducting taxes, interest payments, investment gains/losses, and many other non-recurring items.

Operating Profit = Gross Profit - Total Operating Expenses

- **Net Profit** – Net profit is the difference of total revenue and the total expenses of the company. It is also known as net income or net earnings.

Net Profit = Operating Profit - (Taxes + Interest)

10.2.1. Format of Trading Account

Trading Account of M/s ABC Limited (For the period ending 31-03-2014)			
Particulars	Amount	Particulars	Amount
To Opening Stock	XX	By Sales	XX
To Purchases	XX	By Closing Stock	XX
To Direct Expenses	XX	By Gross Loss c/d	XXX
To Gross Profit c/d	XXX		
Total	XXXX	Total	XXXX

10.3. Manufacturing Account

Manufacturing account prepared in a case where goods are manufactured by the firm itself. Manufacturing accounts represent cost of production. Cost of production then transferred to Trading account where other traded goods also treated in a same manner as Trading account.

Important Point Related to Manufacturing Account

Apart from the points discussed under the section of Trading account, there are a few additional important points that need to be discuss here

- **Raw Material** – Raw material is used to produce products and there may be opening stock, purchases, and closing stock of Raw material. Raw material is the main and basic material to produce items.
- **Work-in-Progress** – Work-in-progress means the products, which are still partially finished, but they are important parts of the opening and closing stock. To know the correct value of the cost of production, it is necessary to calculate the correct cost of it.
- **Finished Product** – Finished product is the final product, which is manufactured by the concerned business and transferred to trading account for sale.
- **Raw Material Consumed (RMC)** – It is calculated as.

$$RMC = \text{Opening Stock of Raw Material} + \text{Purchases} - \text{Closing Stock}$$

- **Cost of Production** – Cost of production is the balancing figure of Manufacturing account as per the format given below.

Manufacturing Account (For the year ending.....)			
Particulars	Amount	Particulars	Amount
To Opening Stock of Work-in-Progress	XX	By Closing Stock of Work-in-Progress	XX
To Raw Material Consumed	XX	By Scrap Sale	XX
To Wages	XXX	By Cost of Production	XXX
To Factory overhead xx		(Balancing figure)	
Power or fuel xx			
Dep. Of Plant xx			
Rent- Factory xx			
Other Factory Exp. xx	xxx		
Total	XXXX	Total	XXXX

10.4. Profit And Loss Account

Profit & Loss account represents the Gross profit as transferred from Trading Account on the credit side of it along with any other income received by the firm like interest, Commission, etc.

Debit side of profit and loss account is a summary of all the indirect expenses as incurred by the firm during that particular accounting year.

For example, Administrative Expenses, Personal Expenses, Financial Expenses, Selling, and Distribution Expenses, Depreciation, Bad Debts, Interest, Discount, etc. Balancing figure of profit and loss accounts represents the true and net profit as earned at the end of the accounting period and transferred to the Balance Sheet.

Profit & Loss Account of M/s (For the period ending)			
Particulars	Amount	Particulars	Amount
To Salaries	XX	By Gross Profit b/d	XX
To Rent	XX		
To Office Expenses	XX	By Bank Interest received	XX
To Bank charges	XX	By Discount	XX
To Bank Interest	XX	By Commission Income	XX
To Electricity Expenses	XX	By Net Loss transfer to Balance sheet	XX
To Staff Welfare Expenses	XX		
To Audit Fees	XX		
To Repair & Renewal	XX		
To Commission	XX		
To Sundry Expenses	XX		
To Depreciation	XX		
To Net Profit transfer to Balance sheet	XX		
Total	XXXX	Total	XXXX

10.5. Balance Sheet

A balance sheet reflects the financial position of a business for the specific period of time. The balance sheet is prepared by tabulating the assets (fixed assets + current assets) and the liabilities (long term liability + current liability) on a specific date.

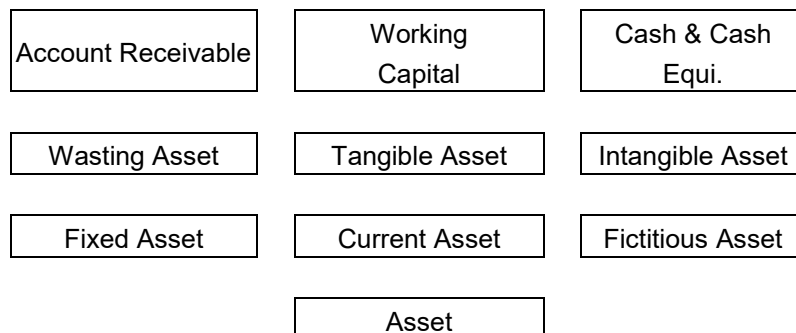
10.5.1. Assets

Assets are the economic resources for the businesses. It can be categorized as –

- **Fixed Assets** – Fixed assets are the purchased/constructed assets, used to earn profit not only in current year, but also in next coming years. However, it also depends upon the life and

utility of the assets. Fixed assets may be tangible or intangible. Plant & machinery, land & building, furniture, and fixture are the examples of a few Fixed Assets.

- **Current Assets** – The assets, which are easily available to discharge current liabilities of the firm called as Current Assets. Cash at bank, stock, and sundry debtors are the examples of current assets.
- **Fictitious Assets** – Accumulated losses and expenses, which are not actually any virtual assets called as Fictitious Assets. Discount on issue of shares, Profit & Loss account, and capitalized expenditure for time being are the main examples of fictitious assets.
- **Cash & Cash Equivalent** – Cash balance, cash at bank, and securities which are redeemable in next three months are called as Cash & Cash equivalents.
- **Wasting Assets** – The assets, which are reduce or exhausted in value because of their use are called as Wasting Assets. For example, mines, queries, etc.
- **Tangible Assets** – The assets, which can be touched, seen, and have volume such as cash, stock, building, etc. are called as Tangible Assets.



- **Intangible Assets** – The assets, which are valuable in nature, but cannot be seen, touched, and not have any volume such as patents, goodwill, and trademarks are the important examples of intangible assets.
- **Accounts Receivables** – The bills receivables and sundry debtors come under the category of Accounts Receivables.
- **Working Capital** – Difference between the Current Assets and the Current Liabilities are called as Working Capital.

10.5.2. Liability

A liability is the obligation of a business/firm/company arises because of the past transactions/events. Its settlement/repayments is expected to result in an outflow from the resources of respective firm.

There are two major types of Liability –

- **Current Liabilities** – The liabilities which are expected to be liquidated by the end of current year are called as Current Liabilities. For example, taxes, accounts payable, wages, partial payments of long term loans, etc.
- **Long-term Liabilities** – The liabilities which are expected to be liquidated in more than a year are called as Long-term Liabilities. For example, mortgages, long-term loan, long-term bonds, pension obligations, etc.

10.5.3. Grouping of Assets and Liabilities

There may be two types of Marshalling and grouping of the assets and liabilities –

- **In order of Liquidity** – In this case, assets and liabilities are arranged according to their liquidity.
- **In order of Permanence** – In this case, order of the arrangement of assets and liabilities are reversed as followed in order of liquidity.

Check Your Progress-1

True/False

- a. Raw material is not the main and basic material to produce items.
- b. Final Accounts are the accounts, which are prepared at the end of a fiscal year.
- c. The assets, which are easily available to discharge current liabilities of the firm called as Current Assets.
- d. Expenses which are paid in advance are called as Prepaid Expenses
- e. The income, which is earned during the year, but not yet received at the end of the Financial Year is called as Accrued Income.

10.6. Financial Statements with Adjustments Entries

In order to prepare a true and fair financial statement, there are some very important adjustments those have to be done before finalization of the accounts (*as shown in the following illustration*) –

Sr.No.	Adjustments	Accounting Treatments
1	<p>Closing Stock</p> <p>Unsold stock at the end of Financial year called Closing stock and valued at "Cost or market value whichever is less"</p>	<p>First Treatment</p> <p>Where an opening and closing stock adjusted through a purchase account and the value of Closing Stock given in Trial Balance –</p> <p>Closing stock will be shown as adjusted purchase account on the debit side of Trading account and will appear in the Balance Sheet under current Assets.</p>
2	<p>Outstanding Expenses</p> <p>Expenses which are due or not paid called as outstanding expenses.</p>	<p>Accounting Treatment</p> <p>Outstanding expenses will be added in Trading or Profit & Loss account in particular expense account and will appear in liabilities side of the Balance Sheet under the current liabilities.</p>
3	<p>Prepaid Expenses</p> <p>Expenses which are paid in advance are called as Prepaid Expenses.</p>	<p>Accounting Treatment</p> <p>Prepaid Expenses will be deducted from the particular expenses as appear in Trading & Profit & Loss account and will be shown in the Balance Sheet under the current assets.</p>
4	<p>Accrued Income</p> <p>The income, which is earned during the year, but not yet received at the end of the Financial Year is called as Accrued Income.</p>	<p>Accounting Treatment</p> <p>Accrued income will be added to a particular income under the Profit & Loss account and will be shown in the Balance Sheet as current assets.</p>
5	<p>Income Received in Advance</p> <p>An income received in advance, but not earned like advance rent etc.</p>	<p>Accounting Treatment</p> <p>An income to be reduced by the amount of advance income in profit & loss account and will appear as current liabilities in the Balance Sheet.</p>

6	<p>Interest on Capital</p> <p>Where an interest paid on the capital introduced by the proprietor or partner of the firm.</p>	<p>Accounting Treatment</p> <ul style="list-style-type: none"> • Debit Side of Profit & Loss account • Add to capital account (Credit side of Capital account).
7	<p>Interest on Drawing</p> <p>Where an interest paid on the capital introduced by the proprietor or partner of the firm.</p>	<p>Accounting Treatment</p> <ul style="list-style-type: none"> • Credit Side of Profit & Loss account • Reduced from capital account (Debit side of Drawing account).
8	<p>Provision for Doubtful Debts</p> <p>If there is any doubt on the recovery from Sundry Debtors.</p>	<p>Accounting Treatment</p> <ul style="list-style-type: none"> • Debit Side of Profit & Loss Account • In a Balance Sheet, provision for the Doubtful will be deducted from the Sundry Debtors' Account.
9	<p>Provision for Discount on Debtors</p> <p>If there is any offer of discount to pay the debtors within certain period.</p>	<p>Accounting Treatment</p> <ul style="list-style-type: none"> • Debit Side of Profit & Loss Account • In a Balance Sheet, provision for the Discount on Debtors will be deducted from the Sundry Debtors Account.
10	<p>Bad Debts</p> <p>Unrecovered debts or irrecoverable debts</p>	<p>Accounting Treatment</p> <ul style="list-style-type: none"> • Debit Side of Profit & Loss Account • In a Balance Sheet, Sundry debtors will be shown after deducting the Bad Debts.
11	<p>Reserve for Discount on Creditors</p> <p>If there is any chance to get discount on the payment of sundry creditors within certain period.</p>	<p>Accounting Treatment</p> <ul style="list-style-type: none"> • Credit Side of Profit & Loss Account • In a Balance Sheet, Sundry Creditors will be shown after deducting the Reserve for Discount.
12	<p>Loss of Stock by fire</p> <p>There may be three conditions in this case</p>	<p>Accounting Treatment</p> <p>1. If Stock is fully insured</p> <ul style="list-style-type: none"> • Credit Side of Trading Account • Assets side of Balance Sheet • (With full value of loss) <p>2. If Stock is partially insured</p> <ul style="list-style-type: none"> • Credit side of Trading Account

		(With Total value of Loss) ● Debit side of Profit & Loss a/c (With value of loss unrecoverable) ● Asset Side of Balance Sheet (With value recoverable) 3. If Stock is not insured ● Credit Side of Trading Account ● Debit side of Profit & Loss Account
13	Reserve Fund	Accounting Treatment ● Debit side of Profit & Loss Account ● Liabilities side of Balance Sheet
14	Free Sample to Customers	Accounting Treatment ● Credit side of Trading Account ● Debit Side of Profit & Loss Account
15	Managerial Commission	Accounting Treatment ● Debit side of Profit & Loss Account ● Liabilities side of Balance Sheet as commission payable
16	Goods on Sale or Approval Basis If there is any un-approved stock lying with the customers at the end of financial year.	Accounting Treatment ● Sales Account Dr To Debtors A/c (With Sale Price) ● Stock Account Dr To Trading Account (with cost price)

Illustration-1

Following is the Trial Balance of Rajesh Ltd., Gurgaon as on 31.12.2009.

Adjustments:

1. Transfer Rs. 10,000/- to Reserve Fund.
2. Provide depreciation on building at 5%.
3. Stock on 31.12.2009 was valued at Rs. 12,000/-.
4. Dividend at 15% on share capital is to be provided.
5. Depreciation on Plant and Machinery at 10%.

Prepare Trading, Profit and Loss Account, Profit and Loss Appropriation Account and Balance Sheet in the prescribed form.

Particulars	Debit (Rs)	Credit (Rs)
Share capital (8000 shares of Rs.10/- each)		80000
Stock on 1.1.2009	51000	—
Purchases and sales	220000	330000
Returns	3800	—
General Expenses	1800	—
Wages	12000	—
Salaries	18700	—
Travelling Expenses	3200	—
Advertisement	1550	—
Rent and Taxes	4900	—
Discount Received	—	2200
Bank Interest	850	—
Bad Debts	2500	—
Buildings	95000	—
Plant and machinery	98000	—
Sunday Debtors and Creditors	45000	55500
Loan	—	25000
Cash	1400	—
Reserve Fund	—	23000
Preliminary Expenses	11000	—
Profit and Loss Account (Cr.)	—	55000
	570700	570700

Solution:

The solution will be as follows:

Trading and Profit and Loss Account for the year ended 31.12.2009

Particulars	Amount (Rs)	Amount (Rs)	Particulars	Amount (Rs)	Amount (Rs)
To opening stock		51000	By sales	330000	
To Purchases	220000		Less: Returns	3800	
To Less : Returns	-	220000			326200
			By Closing stock		12000
To wages		12000			
To Gross Profit c/d		55200			
		338200			338200
To Salaries		18700	By Trading A/c		55200
To general expenses		1800	Gross profit b/d		
To travelling expenses		3200	To discount received		2200
To advertisement		1550			
To rent and taxes		850			
To bank interest					
To bad debts		2500			
To depreciation on plant and machinery		9800			
To depreciation on		4750			

building		930			
To net profit c/d		57400			57400

Profit and loss Appropriation A/c for the year ended 31.12.2009

Particulars	Amount (Rs)	Amount (Rs)	Particulars	Amount (Rs)	Amount (Rs)
To New reserves		10000	By balance b/d		55000
To dividend proposed		12000	By p/L A/c		9350
To balance c/d		42350			
		64350			64350
			By balance b/d		42350

Balance sheet for the year 31.12.2009

Liabilities	Amount (Rs)	Amount (Rs)	Assets	Amount (Rs)	Amount (Rs)
Share capital			Fixed assets		
Authorized capital		—	Buildings	95000	
Issued and subscribed Capital	80000		Less depreciation	4750	90250
Called up and paid up capital (8000 share of Rs. 10/- each)		80000	Plant and machinery	98000	
Less calls in arrears			Less depreciation	9800	88200
Reserves and surplus	23000		Investments		
Reserve fund	10000	33000	Current assets and loans advances		12000
Add: New reserve		42350	Closing stock		12000
p/L appropriation A/c (surplus)		---	Sundry debtors		1400
Secured loans			Cash		
Current liabilities and provisions			Miscellaneous expenses and losses		11000
Current liabilities		55500	Preliminary expenses		
Sundry creditors					
Provisions		12000			
Proposed dividend		57400			57400

Illustration:2

Prepare trading account from the following ledger balances presented by P. Sen as on 31st March, 2016.

Particulars	Rs.	Particulars	Rs.
Stock (1-4-2015)	10,000	Sales	3,00,000
Purchases	1,60,00	Returns inward	16,000
Wages	0	Returns Outward	10,000

Carriage inwards	30,000	Gas and Fuel	8,000
Freight inwards	10,000		
	8,000		

Additional information:

- i. Stock on 31st March, 2016 Rs. 20,000
- ii. Outstanding wages amounted to Rs. 4,000
- iii. Gas and fuel was paid in advance for Rs. 1,000

Trading account for the year ended 31st March, 2016

Dr.

Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		10,000	By Sales	3,00,000	
To Purchases	1,60,000		Less: Returns inward	16,000	2,84,000
Less: Returns outward	10,000	1,50,000	By Closing Stock		20,000
To Wages	30,000				
Add: Outstanding	4,000	34,000			
To Carriage inwards		10,000			
To Freight inwards		8,000			
To Gas and fuel	8,000				
Less: Prepaid	1,000	7,000			
To Gross profit c/d		85,000			
		3,04,000			3,04,000

Illustration 3

From the following particulars presented by Thilak for the year ended 31st March, 2017, prepare profit and loss account.

Particulars	Rs.	Particulars	Rs.
Cross profit	1,00,000	Interest received	6,000
Rent paid	22,000	Bad debts	2,000
Salaries	10,000	Provision for bad debts	4,000
Commission (Cr.)	12,000	(1-4-2016)	
Discount received	2,000	Sundry debtors	40,000
Insurance premium paid	8,000	Buildings	80,000

Adjustments:

- i. Outstanding salaries amounted to Rs. 4,000
- ii. Rent paid for 11 months
- iii. Interest due but not received amounted to Rs. 2,000
- iv. Prepaid insurance amounted to Rs. 2,000
- v. Depreciate buildings by 10%

- vi. Further bad debts amounted to Rs. 3,000 and make a provision for bad debts @ 5% on sundry debtors
- vii. Commission received in advance amounted to Rs. 2,000

Solution

Profit and Loss Account for the year ended 31st March, 2017

Dr.

Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Rent	22,000		By Gross profit b/d	-	1,00,000
Add: Outstanding	2,000	24,000	By Commission	12,000	
(22,000x1/11)	10,000		Less: Received in	2,000	10,000
To Salaries	4,000		advance	6,000	2,000
Add: Outstanding	8,000	14,000	By Discount received	2,000	8,000
To Insurance premium	2,000		By Interest received		
Less: Prepaid insurance	1,900	6,000	Add: Accrued		
To Provision for bad and doubtful debts (closing)	2,000				
	3,000				
Add: Bad debts	6,900				
Add: Further bad debts	4,000				
Less: Opening provision for bad and doubtful debts		2,900			
To Depreciation on building (80,000x10%)		8,000			
To Net profit (transferred to capital A/c)		65,000			
		1,20,000			1,20,000

Working Note:

Debtors : 40,000

Less: Further bad debts : 2,000

38,000 Provision for bad and doubtful debts at

5%: 38,000 x 5% = Rs. 190/-

Let Us Sum Up

In this unit, you have learned about the following:

At the time of preparing the final accounts a number of items need adjustments. It is because of certain expenses may relate to two or more accounting years or certain expenses incurred during the current year may still remain to be paid. Unless such adjustments are made, the final accounts will not reveal the true picture.

Check Your Progress-2

1. What does the term "credit" mean in business?
 - a) Agreement between a lender and a borrower
 - b) Revenue a business earns from selling its goods
 - c) Cost of operations that a company incurs to generate revenue
 - d) Own with the expectation to provide a future benefit

2. What kind of expenses are paid from Gross Profit?
 - a) Selling Expenses
 - b) Financial Expenses
 - c) General Expenses
 - d) All of the above

3. Which of the options is not an intangible asset?
 - a) Land
 - b) Patents
 - c) Goodwill
 - d) Franchise rights

Glossary

Abnormal Loss:	Loss caused by abnormal causes.
Adjustment Entry:	Journal entry passed to make an adjustment in the relevant accounts.
Adjustment Item:	An item given outside the Trial Balance which requires adjustment at the time of preparing final accounts.
Adjusted Purchases:	Amount of purchases after adjusting both the opening and closing stocks. Adjusted
Trial Balance:	Trial balance prepared after incorporating various adjustments.
Depreciation:	A permanent decrease in the value of a fixed asset caused by wear and tear or the passage of time.
Doubtful Debts:	Debts of doubtful recovery.
Outstanding Expenses:	Expenses incurred during the accounting year but not yet paid

Answers to Check Your Progress-1

a-False

b-True

c-True

d-True

e-True

Answers to Check Your Progress-2

1. a) agreement between a lender and a borrower

2. b) All of the above

3. c) Land

Suggested Readings

1. Paul V.A. &Korlahalli, J.S.,2018- Principle and Practice of Accountancy. New Delhi : S. Chand & Co., 2018
2. S.P.Jain, K.L.Narang,2019; Advanced Accountancy-Volume:1, Twenty Second Edition, Kalyani Publishers, Ludhiana.

Block-4: Introduction

The Block-4: **Bank Reconciliation Statement and Computerised Accounting** has been divided in to two Units. (Unit-11 to Unit-12).

Unit-11: Bank Reconciliation: In this Unit Students will be able to understand about the differences in Passbook and Cashbook and analyse those differences and reconcile them.

Unit-12: Computerised Accounting: By studying this unit students can have a practical understanding on how to create a company and other basic entry in Tally ERP-9.

In all the units of Block -4: **Bank Reconciliation Statement and Computerised Accounting**, the Check your progress, Glossary, Answers to Check your progress and Suggested Reading has been provided and the Learners are expected to attempt all the Check your progress as part of study.

STRUCTURE

Overview

Objectives

11.1. Introduction

11.2. Need and Importance of Bank Reconciliation

11.3. Reasons of Disagreement

11.4. Procedure for Ascertaining the Causes of Difference and Effects

11.5. Procedure of Preparing Bank Reconciliation Statement

11.6. Bank Reconciliation Report

11.7. Adjusting the Cash Book Balance

Let Us Sum Up

Check Your Progress

Glossary

Answers to Check Your Progress

Suggested Readings

Overview

In this Unit, the concept of Bank Reconciliation Statement, Need and Importance of Bank Reconciliation, Reasons of Disagreement, Procedure for Ascertaining the Causes of Difference and Effects thereof, Procedure of Preparing Bank Reconciliation Statement Bank Reconciliation Report and Adjusting the Cash Book Balance has been clearly explained.

Objectives

After studying this unit, learner should be able to:

- identify the need and importance of bank reconciliation of cash book and pass book balances;
- distinguish between the cash book and the pass book and locate the causes of difference in their balances;
- analyse the effect of each item causing the difference;
- prepare a bank reconciliation statement; and
- adjust the cash book balance and prepare bank reconciliation statement with the adjusted balance.

11.1. Introduction

As you know business entities maintain current accounts in banks, they deposit cash and cheques into bank and withdrawals are made from the bank. In order to record these transactions normally, a separate bank column is provided in cash book to record the transactions relating to bank. At the same time bank also maintains a separate account for each entities in its ledger.

Periodically, bank supplies a copy of the business entity amount in its ledger to entity for information and verification which is called bank pass book or bank statement. Periodically, the organisations check the balances appeared in the bank statement, with that in the bank column cash book. In such situation, both balances must tally each other.

However, sometimes these two balances, do not agree this may happen due to mistakes or due to time lag between the entries made by the staff of the organisation and the entities made by the bank's staff. Hence there is a need to identify the causes for disagreement and with the help of these causes a statement is prepared for reconciling these balances.

This statement is called bank reconciliation statement therefore; in this unit we shall learn the importance of bank reconciliation and reasons of cash book (bank column) and that of bank statement. It discusses how to ascertain the causes, procedure for preparation of Bank Reconciliation Statement. Further, it also explains adjusting the cash book balance and its advantages.

11.2. Need and Importance of Bank Reconciliation

You know that the organisation records all transactions relating to its bank account in the cash book. All deposits are shown in the bank column on debit side of cash book and all withdrawals on the credit side. The bank also maintains a separate account in its ledger for every firm. It credits the organisation account with all deposits made by him and debits it with all withdrawals.

Thus, what is shown on the debit side of the cash book appears on the credit side of the organisation account in bank's ledger, and vice versa.

You have also learnt that the bank gives a pass book to every customer or bank statement periodically. The bank statement is nothing but a copy of the customer's (organisation's) account in bank's ledger. It shows all deposits and withdrawals made by the customer, receipts and payments made by the bank on behalf of the customer, bank cheques, commission etc. The customer sends the pass book to the bank from time to time

and gets it updated. In case the bank does not provide a pass book, it sends a statement of account periodically to every customer. You also learnt that in practice, they would generally differ. This may be because of some mistakes committed either by the firm or by the bank in recording the transactions. But the main reason why, on a particular date, the balance shown in the pass book differs from the balance shown in the cash book is that many transactions are not recorded on the same date in both of these books.

For example, when the firm receives a cheque from a party and deposits it in the bank for collection, the entry is immediately made in the cash book. But the bank will credit the amount to the firm's account on the date when payment is received. Similarly, when a cheque is issued in favour of some party, the entry is immediately made in the cash book. But the bank will debit the customer's account only when the cheque is presented to the bank for payment.

Thus, there is always some time lag between the date of recording the transaction in the cash book and the date on which it is recorded in customer's account in bank's ledger. So, on a particular date, the balances in these two books are bound to be different.

Now you can appreciate that the difference in balances of these two books has arisen simply because of the time lag. In any case, when you find that the balance in the pass book differs from the balance as per cash book, it becomes necessary to ascertain the exact causes of difference and reconcile the two balances.

Only then you can be sure of the accuracy of entries in both the books. Therefore, every firm compares the entries in the cash book with those in the pass book periodically, and lists various causes of disagreement in the form of a statement called 'Bank Reconciliation Statement'.

A bank reconciliation statement is a statement prepared by organizations to reconcile the balance of cash at bank in a company's own records with the bank statement on a particular date." The main objective of reconciliation is to ascertain if there is any mismatch.

Bank Reconciliation Statement process is being outsourced to professional accounting firms by large organizations. These organizations make monthly reconciliation statements for clients and help them determine any discrepancy.

The advantages for outsourcing this work helps in faster processing, easy identification of errors and requirement of less manpower.

11.3. Reasons for Disagreement

The bank statement indicates the amount paid into the bank and the amount withdrawn there from. The statement balance on any given date must be the same as the balance shown by the ledger on the same date. But in actual practice, the bank statement balance seldom agrees with the balance shown by the ledger. This happens when some of the transactions appear in the organisation's ledger account but not in the bank statement or in the bank statement but not in the organisation's ledger.

The differences between the two balances are due to the following reasons:

1. **Cheques issued but not presented for payment:** When cheques are issued, the entry in the organisation's ledger account is made immediately. In the books of the bank, the entry is made only when the cheque is presented for payment. It is possible that at the time when the balances of the two books are being compared, some of the cheques might have been issued but might not have been presented for payment thus causing a disagreement between the two balances.
2. **Cheque paid into the bank but not yet cleared:** As soon as the cheques are deposited into the bank, the entry is passed on the debit side of the ledger account. The customer's account is credited by the bank only when the cheque is cleared. It is possible that when the ledger balance is compared with statement, some of the cheques deposited by the organization may remain uncollected.
3. **Interest allowed by the bank:** Bank might have credited the account of the customer with the interest and the entry appears in the statement. Till the time the bank statement is received, such interest may not have been made by the organization in the ledger thus causing a disagreement between the two balances.
4. **Interest and bank charges debited by bank:** The bank debits the account of the customer by way of interest on overdraft. It also debits the account of the customers by way of incidental charges, bank charges and collection charges. But the entries in the ledger account are made by the organization only when it receives the bank statement.
5. **Interest, dividend etc. collected by the bank:** Sometimes interest on government securities or dividend on shares is collected by the bank and is credited to customer's account. Till the time the bank

statement is received by the organisation, the entry for these does not appear in the ledger account and the two balances differ.

6. **Direct payment by the bank on behalf of the organisation:** Sometimes understanding instructions from the customer, certain payments like insurance premium, club fees etc. are made by the bank. The entry in the ledger is only made by the organization when the necessary intimation to that effect is received from the bank. Till that date the balances will not tie.
7. **Direct payment into the bank by organisation's customer:** Sometimes the organization's customers deposit money direct into its bank account. The corresponding entry for this may not appear in the ledger account, due to delay in necessary intimation by the customers or the receipt of the bank statement.
8. **Dishonor of cheques/bill discounted with the bank:** Sometimes customers get their bills discounted or cheques deposited for collection with the bank. If the bank is not able to get payment of these bills/cheques on the due date, it will debit the customer's account with the amount of the bills/cheques together with the noting charges, if any. The organization will pass the entry in its books on receipt of the information from the bank.
9. **Any error committed by the bank/organization besides the above reasons:** If any error is committed either by the bank or by the organization itself while recording the transactions in their respective books, it will cause disagreement between the two balances. Example wrong casting or totalling of the ledger account by the organisation or wrong debit or credit by the bank (Refer Mock vs. Mack above)

A reconciliation statement is, therefore, prepared at periodical intervals with a view to indicate the items which cause such disagreement between the balance as shown by the ledger and the bank statement on any given date.

Check Your Progress-1

True/False

- a. The main objective of reconciliation is to ascertain if there is any mismatch.
- b. The bank statement indicates the amount paid into the bank and the amount withdrawn there from.
- c. The bank debits the account of the manager by way of interest on overdraft.

- d. Periodically, bank supplies a copy of the business entity amount in its ledger to entity for information and verification which is called bank pass book or bank statement.
- e. Sometimes customers get their bills discounted or cheques deposited for collection with the bank.

11.4. Procedure for Ascertaining the Causes of Difference and Effects

When you find a difference between the balance shown by the pass book and the balance as per the cash book, take the following steps to identify the causes of the difference:

- a. Compare the items appearing on the debit side of the cash book with those on the credit side of the pass book (deposits column), and place a tick mark against items appearing in both the books.
- b. Compare the items appearing on the credit side of the cash book with those on the debit side of the passbook (withdrawals column), and place a tick mark against items appearing in both the books.

In the process, you will observe that some items remained unticked. This means they do not appear in both the books. These will now be considered as those responsible for the difference in the balances of the two books. Look at illustration-I. It shows the cash book with the complete entries. Tick mark has been placed against each item appearing in both the books. Then the causes of difference have been analysed.

11.5. Procedure of Preparing Bank Reconciliation Statement

Now let us see how the items shown in illustration-I will be presented in the form of a Bank Reconciliation Statement.

Illustration-1

Bank Reconciliation Statement as on December 31, 2017

	Rs.	Rs.
Balance as per Cash Book		13,000
Add: 1 Interest on Securities collected by the bank but not yet recorded in the cash book	2,000	
2 Cheque issued but not yet presented for payment	46,000	48,000
		61,000
Less: 1 Cheque deposited but not yet collected by bank		

2	Insurance premium paid by bank but not yet recorded in the cash book	1,000	
		5,000	
3	Bank charges debited in the bank but not yet recorded in cash book	300	6,300
Balance as per Pass Book			54,700

Note* The statement bears a heading 'Bank Reconciliation Statement' and mentions the date for which reconciliation is done. So, whenever you prepare a Bank Reconciliation Statement, make sure that it bears this heading along with the date of reconciliation.

You will notice that there are two amount columns in the above Statement. The first column, called the inner column, is meant for writing the amounts of the items to be added or deducted so that the total amount of addition or deduction can be easily worked out. These totals are then carried over to the second column, called outer column, for final addition and subtraction. Alternatively, we can have two separate columns for additions and deductions. The first column can be called 'plus column' and the second column can be called 'minus column'. In that case the Bank Reconciliation Statement will be prepared as follows:

Bank Reconciliation Statement As on December 31, 2017

Particulars	Plus Column Rs.	Minus Column Rs.
Balance as per Cash Book	13,000	
i) Cheque deposited but not yet collected by the bank		1,000
ii) Interest on securities collected by bank but not yet recorded in the Cash Book	2,000	
iii) Cheque issued but not yet presented for payment	46,000	
Insurance premium paid by Bank but not yet recorded in the cash book		5,000
Bank charges debited by bank but not yet recorded in the cash book		300
Total	61,000	6,300
Balance as per Pass Book	54,700	

As started earlier, the Bank Reconciliation Statement can also be prepared by starting with the pass book balance. In such a situation, the items which were added when cash book balance was the starting point would now be subtracted, and vice versa. The Bank Reconciliation Statement for illustration 1 is given below with pass book as the starting point.

Bank Reconciliation Statement

As on December 31, 2017

Particulars	Plus Column Rs.	Minus Column Rs.
Balance as per Pass Book	54,700	
i) Cheque deposited but not yet collected by the bank	1,000	
ii) Interest on securities collected by bank but not yet recorded in the Cash Book		2,000
iii) Cheque issued but not yet presented for payment		46,000
iv) Insurance premium paid by Bank but not yet recorded in the cash book	5,000	
v) Bank charges debited by bank but not yet recorded in the cash book Total	300	
Balance as per Pass Book		
	61,000	48,000
	13,000	

Illustration- 2

On September 30, 2018 the cash book of SL & Co. showed a bank balance of Rs.40,000/-. A comparison of the cash book with the pass book, revealed the following.

- 1 Cheque deposited but not collected by September 30, 2018, Rs. 25,000/-.
- 2 Interest on investments collected by the bank as per standing instruction, appearing in the pass book only Rs. 3,000/-.
- 3 Cheques for a total amount of Rs. 75,000/- were issued during the month of September. Of these, cheques for Rs. 60,000/- only were presented for payment by the end of the month.
- 4 The bank has made a direct payment of Rs. 2,000/- towards insurance premium, as per the standing instructions. This payment has not yet been recorded in the cash book.
- 5 A customer has made a direct deposit of Rs. 6,000/- in the bank account. There was no corresponding entry for this in the cash book.
- 6 Bank charges appearing only in the pass book Rs.250/-.
- 7 A debit of Rs. 4,000/- in respect of dishonoured cheque (this was discounted earlier) appear in the pass book only.
- 8 A cheque of Rs. 5,000/- deposited in the bank, was entered twice in the cash book.

From the above particulars, prepare a Bank Reconciliation Statement as on September 30, 2018 and ascertain the pass book balance as on that date.

Bank Reconciliation Statement as on September 30, 2018

Particulars	Plus Column Rs.	Minus Column Rs.
Balance as per Cash Book	40,000	
1. Cheque deposited but not yet collected 25,000		
2. Interest on investments collected by bank but not yet recorded in the Cash Book	3,000	
3. Cheques issued but not yet presented for payment	15,000	
4. Insurance premium paid by Bank but not recorded in the cash book		2,000
5. Direct deposit by a customer into the bank account	6,000	
6. Bank charges debited by bank but not yet recorded in the cash book		250
7. Dishonoured cheque not recorded in the cash book		4000
8. Amount debited twice in the cash book		5000
	64,000	36,250
TotalBalance as per Pass Book	27,250	

Reconciliation Statement in case of Overdraft

When the businessman requires more funds than are available to him in the bank account, he may request the bank to extend him an overdraft facility. The bank after completing various formalities, permits the businessman to withdraw more than the amount available in his account, subject to certain conditions. When the businessman actually withdraws more than the available amount, he is said to have utilised the overdraft facility. An overdraft implies that the businessman has borrowed money from the bank. The bank, therefore, charges interest on the amount overdrawn and debits the same to businessman's account periodically.

When the businessman has favourable balance in the bank, the cash book shows a debit balance and the pass book a credit balance. But in case of overdraft (an unfavourable balance), the cash book will be showing a credit balance and the pass book a debit balance. This is because now the firm owes to the bank. For the firm, the bank is a creditor, and for the bank the firm is a debtor. It is very important to note as to which book shows what type of balance (debit or credit) when (i) there is a favourable balance, and (ii) when there is an overdraft.

Table 6.1 presents a clear picture.

Table 6.1

Nature of Debit and Credit Balances

Nature of Balance	Cash Book Shows	Pass Book Shows
Favourable balance	Debit Balance	Credit Balance
Unfavourable Balance or Overdraft	Credit Balance	Debit Balance

The preparation of the Bank Reconciliation Statement does not differ much whether there is a favourable balance or an overdraft, especially when you follow plus and minus method. You know all favourable balance is shown in the plus column of the Bank Reconciliation Statement (refer Illustration 1). But, if there is an overdraft, it will be shown in the minus column. This is the main point you have to remember when there is an overdraft. The treatment with regard to items causing difference in the balances of the two books remains the same.

11.6. Bank Reconciliation Report

Bank Reconciliation Report provides a detailed inquiry and reporting on posted bank reconciliation statement. It is a statement which is prepared while reconciling the cash balance in the company books and the bank statement.

Many organizations, auditors often requires a simplified bank reconciliation statement report which gives details regarding book balance and bank balance. They also want a detailed report on cleared and unclear transactions from the particular statement.

Components of Reconciliation Statement:

- **Heading:** The name of the bank for which we are preparing the reconciliation statement and the date of the reconciliation
- **Period of reconciliation:** Indicates the period for which the reconciliation statement is being prepared.
- **Preparer:** The person who has prepared the statement
- **Reviewer:** The person who has reviewed the statement
- **First Row:** A record (it is preferable to circle it or mark it in hold) of the balance that appears in our accounts and in the books of the bank as at the reconciliation date.
- **The Last Row** - The adjusted GL balance

- **Unresolved variances:** The non-reconciling items, their amounts and details, which could not be resolved at the time of preparing the statement
- **Responsibility and timeline:** Who is responsible for resolving above mentioned non-reconciling items and by when?

11.7. Adjusting the Cash Book Balance

When you look at various items that normally cause the difference between the cash book balance and the pass book balance, you find a number of items which appear only in the pass book. Why not record such items in the cash book before preparing the Bank Reconciliation Statement? This shall reduce the number of items responsible for the difference. So, as soon as the pass book is received, the firm may record all those items in the cash book which appear only in the pass book and work out a fresh balance of the cash book. This is called 'adjusted balance' or corrected balance' as per cash book. Similarly, it may pass correcting entries for errors committed in the cash book. This will also change the cash book balance.

When you work out an adjusted balance of the cash book as above, the Bank Reconciliation Statement may be prepared with this adjusted balance. It would reduce the number of items shown in the Bank Reconciliation Statement. As a matter of fact, this is exactly what is done in practice.

The items which can usually be adjusted in the cash book are:

1. Interest allowed by bank
2. Amounts collected by bank as per standing instructions
3. Payments made by bank as per standing instructions
4. Bank charges
5. Interest on overdraft
6. Direct deposits by customers
7. Dishonoured cheques or bills receivable
8. Errors committed in the cash book

Look at Illustration 1 once again. You will find that out of five items difference, three items appeared only in the pass book. These are:

- i) Interest on securities Collected by bank Rs.2,000 ii) Insurance premium paid by bank Rs. 5000 iii) Bank charges debited by bank Rs. 300 These items can be adjusted in the cash book as follow

Cash Book

(Bank Column only)

Dr.				Cr.			
Date	Particulars	₹.	Amount	Date	Particulars	₹.	Amount
2017 Dec. 31	To Balanced b/d		13,000	2017	(By Insurance A/c		5,000
"31	To Interest on Securities A/c		2,000	"31	By Bank Charges A/c		300
				"31	By Balance c/d		9,700
			15,000				15,000
Jan. 1	To Balanced b/d		9,700				

The adjusted balance as per cashbook is Rs. 13,470. Now, if we prepare the Bank Reconciliation Statement with the adjusted balance, it will appear as follows:

Bank Reconciliation Statement

As on December 31, 2017

Particulars	Plus Column Rs.	Minus Column Rs.
Balance as per Cash Book	9,700	
1. Cheque issued but not yet presented for payment	46,000	
2. Cheques deposited but not yet collected by the bank		1,000
Total Balance as per Pass Book	55,700	1,000
	54,700	

Thus, you observe that the Bank Reconciliation Statement prepared with the adjusted balance included only two items. These are (i) unpresented cheques, and (ii) uncollected cheques. Both of these items could not be adjusted in the cash book because they had already been recorded in the cash book correctly. The difference arose only on account of the time lag.

It may, however, be emphasised that you should concentrate on preparing the Bank Reconciliation Statement in the normal manner. The statement with an adjusted balance of the cash book is to be prepared only when it is specifically asked for.

Let Us Sum Up

In this unit, you have learned about the following:

When the cash book and the pass book are compared it is often found that the balances shown by these two books do not agree. The difference is mainly due to time lag i.e. transactions are not recorded in both the books on the same date. It can also arise on account of errors committed either in the cash book or in the pass book. As the balances in these two books may not agree, they are compared periodically and items of disagreement listed. A reconciliation statement is prepared to explain the difference and take necessary follow up action.

Check Your Progress-2

1. In cash book, the favourable balance indicates
 - a) Credit Balance
 - b) Debit Balance
 - c) Bank Overdraft
 - d) Adjusted Balance
2. On the bank statement, cash deposited by the company is known as
 - a) Credit
 - b) Debit
 - c) Liability
 - d) Expenses
3. Bank reconciliation statement compares a bank statement with _____
 - a) Cash payment journal
 - b) Cash receipt journal
 - c) Financial statements
 - d) Cashbook

Glossary

Bank Reconciliation

Statement: A statement reconciling the bank balance as shown by the cash book with that of the pass book.

Favourable Balance: Balance indicating that the businessman has got money in his account with the bank.

Overdraft: An unfavourable balance indicating that the businessman has withdrawn more than what he has in his account.

Standing

Instructions: Instructions to the bank for making certain payments and collections regularly on behalf of the account holder.

Answers to Check Your Progress-1

a-True

b-True

c-False

d-True

e-True

Answers to Check Your Progress

1. a) Debit Balance

2. b) Credit

3. c) Cashbook

Suggested Readings

1. Briston, R.J.,2017, Introduction to Accountancy and Finance, London: The Macmillan Press Ltd.,

2. Goel D. K., 2020-Accountancy Arya Publications, 1569/30 Naiwala, Karol Bagh, New Delhi

Unit-12

Computerised Accounting

STRUCTURE

Overview

Objectives

12.1. Introduction to Computerised Accounting

12.2. Difference between Manual and Computerised Accounting System

12.3. Advantages and Disadvantages of Computerised Accounting System

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Let Us Sum Up

Check Your Progress

Glossary

Answers to Check Your Progress

Suggested Readings

Overview

In this Unit, the concept of Computerised Accounting, Advantages and Disadvantages of Computerised Accounting System, Consideration while Choosing Accounting Software, Accounting Software in India, Introduction to Tally ERP.9, Creation of a Company, Features and Configurations has been clearly explained.

Objectives

After studying this unit, you will be able to:

- define computerised accounting system
- distinguish between manual and computerised accounting system;
- highlight advantages and disadvantages of computerised accounting system;
- describe Tally ERP.9 system;
- identify various components of Tally ERP.9;
- set, alter, delete and shut a company under Tally ERP.9; and
- understand the features and configuration option in Tally ERP.9

12.1. Introduction

An accounting system is a collection of processes, procedures and controls designed to collect, record, classify and summarize financial data for interpretation and management decision-making. Whether the accounting system is simple or complex, it must meet certain objectives to keep the business running smoothly.

It is difficult to make informed business decisions without accurate accounting information that helps the managers to see where the business is, where it has been and (based upon trends) foresee where it is headed. Thus, an accounting system should be devised as an effective tool that provides information which is easy to understand.

While some firms still do their book-keeping by hand, most firms generally have too many transactions to sustain a manual accounting system. The more complicated the financial activities of a business are, the more likely it will need a computerized accounting system to ensure effective financial reporting.

Computerized accounting systems involve making use of computers and accounting software to record, store and analyze financial data. These are software programs that are stored on a company's computer, a network server, or remotely accessible via Internet.

Computerized Accounting represents a technological advancement in the field of business accounting which allows the user(s) to set up income and expense accounts, such as rental or sales income, salaries, advertising expenses, and material costs. They also can be used to manage bank accounts, to pay bills, and prepare budgets. Also, depending upon the program, some accounting systems also allow users to prepare tax documents, handle payroll, and manage project costing.

12.2. Difference between Manual and Computerised Accounting System

Owners and other stakeholders of any business, whether large or small, want to know whether the business is making a profit or not. Many small businesses do their accounting manually and they are happy with this setup. Others may be considering using a computerized system, since accounting software is also affordable these days. Manual and computerized accounting systems perform basically the same processes; the accounting principles and concepts are the same with differences lying in the mechanics of the process. Let us now see the difference between these two:

Speed

The main difference between manual and computerized systems is speed. Accounting software processes data and creates reports much faster than manual systems. Calculations are done automatically in software programs, minimizing errors and increasing efficiency. Once data is fed into the system, one can create reports literally by pressing a button in a computerized system.

Cost

Another difference between manual and computerized systems is cost. Manual accounting with paper and pencil is much cheaper than a computerized system, which requires a machine and software. Other expenses associated with accounting software include training and program maintenance. Expenses can add up fast with costs for printers, paper, ink and other supplies. However, manual accounting requires more staff. Therefore, more expenditure on salaries/ wages in case of manual accounting.

Backup

A third difference between manual and computerized systems is the ease of backup of a computerized system. All transactions can be saved

and backed up, in case of fire or other mishap. You cannot do this with paper records, unless you make copies of all pages a long and inefficient process.

The following table makes a further attempt to explain the difference between the manual and computerized accounting systems:

Basis	Manual Accounting	Computerized Accounting
1. Definition	Manual accounting is the system in which we keep physical register of journal and ledger for keeping the records of each transaction.	In this system of accounting, we make use of a computer and different accounting software for maintaining a digital record of every transaction.
2. Ledger Accounts	We check the journal and then we transfer figures to related accounts debit or credit side by manually posting it.	Computerized Accounting System will automatically process the system and will make all the accounts' ledgers since the voucher entries under its respective ledger account have already been passed.
3. Trial Balance	We collect the information of all the balances of all accounts in our ledger and on this basis we manually prepare the trial balance.	The computerized accounting system will automatically produce the Trial Balance.
4. Adjustment Entries Record	Both, the adjustment journal entries and its posting in the ledger accounts will be done manually, one after another.	Only adjustment entries will be passed in the computerized accounting software, these will then be automatically posted to respective ledger accounts.

12.3. Advantages and Disadvantages of Computerised Accounting System

Advantages of Computerized Accounting

There are many advantages of computerized Accounting System. Let us discuss few of them in detail.

1. **Automation:** As all the calculations are handled by the software, computerized accounting eliminates many of the mundane and time-consuming processes associated with manual accounting. For example, once issued, invoices are processed automatically thus saving time.
2. **Accuracy:** This accounting system is designed to be accurate to the minutest detail. Once the data is entered into the system, all the calculations, including additions and subtractions, are done automatically by software.
3. **Data Access:** Using accounting software, it becomes much easier for different individuals to access accounting data outside the office, securely. This is particularly true if an online accounting solution is being used.
4. **Easy representation of data in various formats:** Viewing the accounts using a computer allows the users to take advantage of the option to view the data in different formats i.e. one can view data in tables and using different types of charts.
5. **Reliability:** Since the calculations are very accurate, the financial statements prepared by computers are highly reliable.
6. **Scalable:** When a company grows, the number of transactions entered into the system increases, as a result of which the need for accounting not only increases but also becomes more complex. With computerized accounting, everything is kept straight forward because shifting data using software is easier than sifting through a bunch of papers.
7. **Speed:** Using accounting software, the entire process of preparing accounts becomes faster. Furthermore, statements and reports can be generated instantly at the click of a button. Managers do not have to wait for hours, even days, to lay their hands on an important report.
8. **Security:** The latest data can be saved and stored in offsite locations so it is safe from natural and man-made disasters like earthquakes, fires, floods and terrorist attacks. In case of disasters, the system

can be quickly restored on other computers. This level of precaution is taken by Computerized Accounting.

9. **Cost-effective:** Since using computerized accounting is more efficient than paper-based accounting, than naturally, work will be done faster and time will be saved.

Disadvantages of Computerized Accounting

Computerized Accounting suffers from many limitations. Let us discuss those limitations one by one.

1. **Cost of Software:** In case of computerized accounting, you must buy the software. Some software requires you to purchase upgrades or updates for additional features. You must also ensure your computer is capable of running the software. If not, you'll need to upgrade your computer as well.

Most accounting software requires you to have additional software in order to view reports. For instance, some programs allow you to export data as a PDF file or an Excel spreadsheet. This allows users without the accounting program to view the data. However, the viewing software may pose an additional expense to the user.

2. **Reliance on Computers:** If your computer crashes or data is corrupted by a virus, you won't be able to use your accounting software until the problem is fixed. This also means you won't have access to any entered data until the computer is running again. Your data can also be corrupted. It means you will have to re-enter information unless you've backed up your files. In addition, if there's a power failure, your software will be unusable unless you're on a battery-powered laptop.
3. **Fraud:** Accounting software data requires extra levels of security to prevent fraud and embezzlement. Software makes it easier for users to alter data, making fraud easier to accomplish. As a result, there is an increased need for internal auditors to check for any data inaccuracies. Security measures must also be taken to limit the amount of control users have over any accounting software's features.
4. **Human Error:** While it is easy to write down numbers incorrectly, it is even easier to mistype a number. Entering data into accounting software too quickly may result in serious errors. With the program performing calculations, it can be more difficult to trace the cause of

the problem. Spreadsheets, digital ledgers or written ledgers make tracking simpler and faster.

5. **Training:** Accounting software requires you to take the time to learn how to use it. While you may be an experienced accountant, you'll still need to learn what each button and menu command does in order to use accounting software effectively. This learning curve can result in costly affairs. In some cases, paid training may be necessary to learn how to perform certain tasks. If you're not tech savvy, the process could be even more difficult.
6. **Time:** Many accountants find that it takes more time to enter data into accounting software than it does to write it or type it into a spreadsheet. Due to step-by-step screens, the process often takes longer, especially for those who don't use the software often or are still new to using the program.

If the software requires numerous steps to enter basic data, the time requirements may outweigh the benefits of automatic calculations.

12.4. Consideration while Choosing Accounting Software

When it comes to selecting accounting software, there are a number of options available in the market and it can be overwhelming to choose the best one. The following is a list of factors to be considered while choosing accounting software:

1. **The size of the Business Organization:** The size of the organization and the volume of the business transactions entered into influence the choice of software. While a large organization will require software that meets the multi-user requirements because it is geographically scattered and connected through complex networks, a smaller organization may opt for simple, single user operated software.
2. **Ease of Use:** The interface and navigation should be simple and self-explanatory. There should also be an option for data back-up. Preference can be given to vendors that offer help at no additional cost, have reasonable service plans or offer tutorial training that walks the clients through the most popular business tasks and transactions.
3. **Features:** What particular software offers is an important consideration. A list of the primary things that the business needs to track and account for should be carefully prepared. The business must know how much each service or product costs and be able to

track the Cost Of Goods Sold (COGS). Features like invoicing, online payments, payroll, auto payments, reporting, bank balances will help to stay up to date on sources of business income, expenses and where it may need to make adjustments.

4. **Protects Classified Data:** When financial data is stored in the cloud, there is no longer the possibility of vital information being lost in the event of a hard drive crash, power surge, or coffee spill. The data is backed up on external servers. However, with cloud-based software comes, the threat of classified data falling victim to malicious activity. Online banking has set a standard for security, so it becomes necessary to ensure that the chosen software either meets or exceeds this standard. This means Secure Socket Layer (SSL) encryption, multi-layered firewall server protection, and routine external audits and inspection.
5. **Compatibility:** If there are other financial tools that are used in the business – for example, an e-commerce system, then business would want to look into the compatibility of the financial software with any other essential software to run the online or storefront portion of the business. In an ideal world, it may want a solution that provides most of what it requires in a single program. However, if it must have multiple software packages, it will have to ensure that the data can automatically be linked for real time updates or transferred daily with the upload of an Excel or CSV file.
6. **Price:** While price is a necessary factor to be considered, it shouldn't necessarily be the deciding one. The ability to manage money is far more important if it's the difference of saving just a few rupees. What one should be aware of is the different pricing models that are used by software product providers.

Having suitable software in place, will allow a business to stay on top of cash flow and focus on what it does best (i.e. allow the business to focus on its core competence). It also helps keep the records clean.

Check Your Progress-1

True/False

- a. Many accountants find that it takes more time to enter data into accounting software than it does to write it or type it into a spreadsheet

- b. Computerized accounting systems involve making use of computers and accounting software to record, store and analyze financial data.
- c. The main difference between manual and computerized systems is time.
- d. The business must know how much each service or product costs and be able to track the Cost Of Goods Sold (COGS).
- e. Only a few years ago, accounting applications lived on the desktop of the small business owner or an accountant's computer.

12.5. Accounting Software in India

Only a few years ago, accounting applications lived on the desktop of the small business owner or an accountant's computer. The books were not accessible from another location and only one person could view them at a time. Then cloud computing took off and business **accounting** software providers caught on.

In a computerized accounting system, the framework of storage and processing of data is called operating environment that consists of hardware as well as software in which the accounting system works. The type of accounting system used determines the operating environment.

Some of the most prevalent business accounting software systems are:

1. **Tally ERP.9:** Tally ERP.9 is a business accounting software for the purposes of accounting, inventory and payroll. Tally has been one of the dominating accounting software for almost two decades. The software has been developed by Tally Solutions Pvt Ltd. It is the most user-friendly for accounting software and thus, employers prefer Tally for easy availability of trained professionals for this specific software. Almost all accounting activities like inventory, purchase, sales, cost, payroll and statutory year end processes can be easily handled by Tally.
2. **Profit books:** This is an Online accounting software developed for small enterprises. It can only be operated on the internet as it is cloud based. The data can be securely placed in a cloud and can be accessed anywhere.
3. **Marg:** Accounting Software is developed by Marg Compusoft Pvt Ltd and is well accepted in small and medium enterprises of India. The software is marketed for the last two decades in the Indian market.

4. **Wave:** Wave's accounting tools are 100% free, secure, and very popular in accounting community. It is one of the best web based accounting software solution available at present.
5. **Xero:** Developed by Xero, it is an award winning web based accounting software for small business owners and accountants. The user interface is nicely designed and is easy to use for online bookkeeping.
6. **Reach:** Reach Accounting Software is developed by Reach Accountant. It is an online Accounting Software aimed at Small & Medium Businesses. The significant part of Reach is that all the business operations are bundled in single software and it ensures that the business owner is able to track every aspect of the business.

12.6. Introduction to Tally ERP.9

12.6.1. About Tally Software

Tally ERP.9, developed by Tally Solutions Ltd., is one of the most popular and widely used business management software available in India and other countries. It can be used by small to large business organization. It is available with two types of licensing system:

1. **Silver Edition Mode (Single user):** It is for single use PC. It can be activated online or offline. It can be accessed from the system on which it is installed by only a single user.
2. **Gold Edition Mode (Unlimited Multi user):** It is for unlimited number of user PCs. It is installed on LAN (local area network) and supports a maximum of ten users.

12.6.2. How to Start Tally ERP.9

Go to start button, click 'all programs'. With in 'All Program', go to Tally ERP.9

or installation of Tally icon on the desktop. If you double click on Tally icon, Tally will open and you can start working on it.

12.6.3. Components of Tally

The gateway of Tally displays menus, screens, reports and options that you select. The components of Tally ERP.9 are:

- **Top Horizontal Button Bar:** This is a collection of buttons that are fixed and provide quick interaction
- **Close Button:** This helps in moving out of Tally application.
- **Screen Name:** It shows the name of the current screen.

- **Right Pane:** In right pane menus are displayed. The red letter in each menu represents short cut and by pressing that alphabet from keyboard one can open the menu.
- **Left Pane:** It shows current period, current date and name of companies with last date of voucher entry done in each company.
- **Vertical Panel Bar:** It is used for quick interaction.
- **Calculator:** It can be used for calculation work and figures can be computed. (Ctrl + N)
- **Information Panel:** This displays details of product, version, license and configurations.
- **Task Bar:** It shows the complete navigation path of the current menu or screen selected.

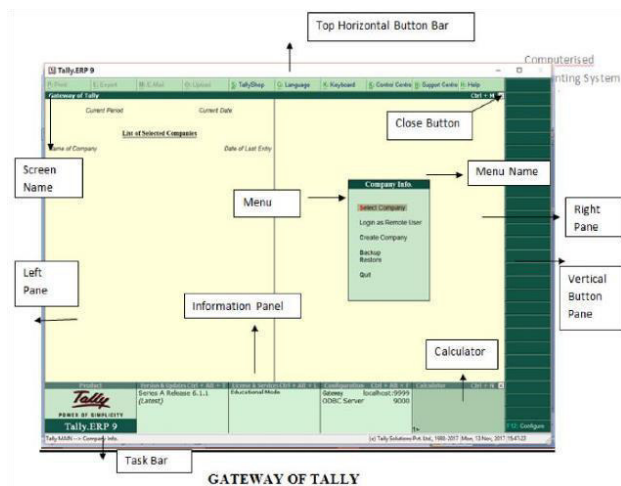


Fig. 12.1

12.7. Creation of a Company

Creating company is the first step towards starting working with Tally ERP.9. A company is an organization for which financial records are to be maintained and therefore, it can be called as a central repository from where any financial statement or report can be extracted at any time. A company can be Partnership Firm or a Sole Proprietor or a Limited Liability Partnership or Non-Governmental Organization or a Company registered under Companies Act, 2013.

12.7.1. Procedure of Creating a Company

To create a company, click on the 'create company' in 'Company Info'. Alternatively, one can press ALT+ F3 and the company info screen will appear as appeared in Fig. 12.2.

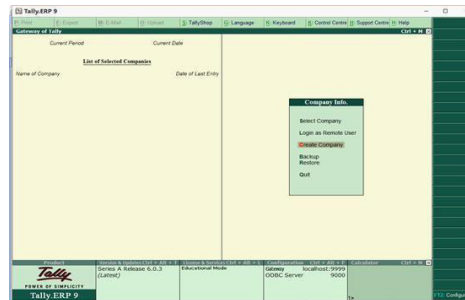


Fig. 12.2

Once, you click 'create company', the following screen will appear as appeared in Fig. 12.3 in front of you.

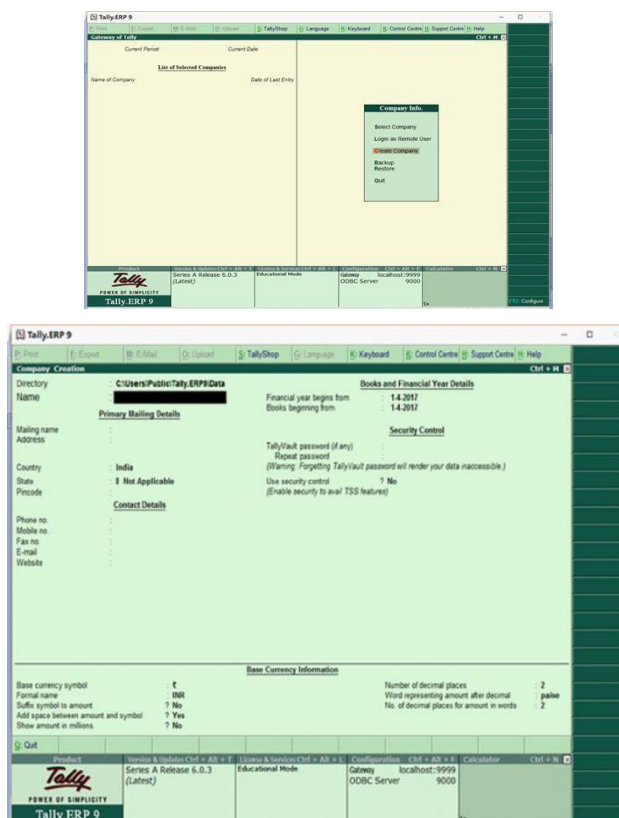


Fig. 12.3

The various fields appearing in company creation in Fig. 12.3 are explained below:

Directory: It will display the path where your company data is stored. By default, it would automatically be stored in Tally ERP.9 data folder, but you can change its path and can specify any location where you want to store the data relating to the company by pressing backspace key

Name: It means providing a name to the company. Example: Surbhi Ltd.

Primary Mailing Details:

Mailing Name: You can specify any other name if you want for mailing purpose. By default, it will always show the name which you have entered in the Name field earlier.

Address: Provide the address of the company in this field

Statutory Compliance: Choose the country in which the company is located. For example, we have selected India.

State: Choose the state in which the company is located. For example, we have selected Delhi.

Pin-code: Provide the Pin code for the company where it is located.

Contact Details

- Provide telephone number, mobile number and Fax number (if any) of the company. Also, provide the official email address of the company which would be further used for emailing of reports and statements.
- **Auto-Back up:** Putting 'Yes' to enable auto backup will result in automatically creating backup of the data of the company in the company data folder.
- **Company Details:** Currency Symbol: Once country is selected, Tally will automatically choose the currency of the country. In this example, we have selected India, so currency symbol would be of 'Rupee'.
- **Maintain:** If company maintains inventory with them, select accounts with inventory otherwise accounts only. Selecting accounts with inventory would combine both financial accounts and inventory books.
- **Financial Year:** Financial year is a period of 12 months starting from 1st April. The accounting period in this example, will begin from 1st April, 2017.
- **Books beginning from:** Provide a date at which you started maintaining your books. It can be a date later than 1st April, 2017. By default, it would automatically take date mentioned in previous field.
- **Security Control:** Tally Vault Password: Entering this password will require, opening the company with password each time. The name of the company having tally vault password will be shown with asterisk '*' mark.

- **Repeat Password:** Password entered in various field has to re-enter for confirmation.
- **Use Security Control:** Enabling this field as 'Yes' will allow to define access administrator user name and password. Every time you open a company, it would ask for name of administrator and password.
- **Base Currency Information:** Base Currency Symbol: The selection of country will define base currency symbol. In this example, we have selected India, so currency symbol would be of 'Rupee'
- **Formal Name:** The formal name of the currency like INR (Indian Rupee) will be displayed.
- **Suffix Symbol to amount:** This will allow putting symbol of currency after the amount.
- **Add space between amount and symbol:** This will allow space between amount and symbol.
- **Show amounts in millions:** This will allow the values of amount to be expressed in millions i.e. international system of numeration.
- **Number of Decimal Places:** By default, it will be set to 2 places only and Indian currency has 2 decimal places whereas some currency has 3 decimal places. It can go upto 4 decimal places.
- **Words representing amount after decimal:** By default, it will be automatically set according to currency.

Number of Decimal places for amounts in words: Provide the number of decimal places for which printing is required. It can be equal to or less than number of decimal places field but can't be more than that. After filling all the requisite details, the company creation screen will appear as follows shown in Fig. 12.4

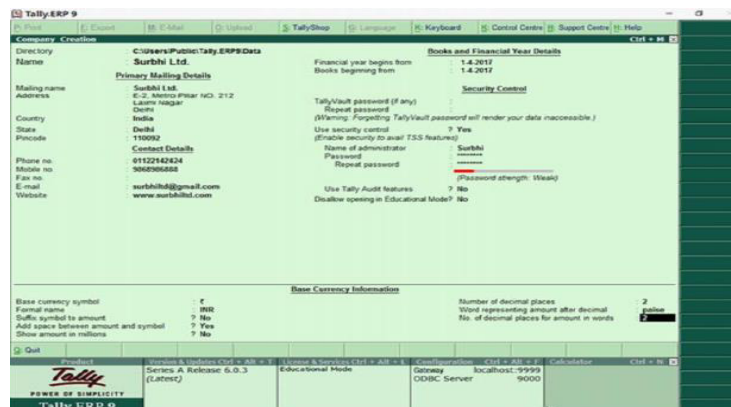


Fig. 12.4

Once the details are filled and you press enter again, screen will displays a box saying accept Yes or No? If all the details are correctly filled, then proceed to select 'yes' otherwise select 'No' as shown in Fig. 12.5.

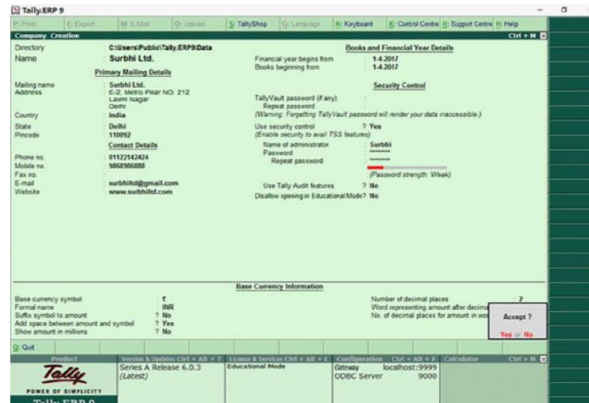


Fig. 12.5

Once you select 'Yes', the company creation is complete and the following screen will appear as shown in Fig. 12.6.



Fig. 12.6

The Gateway of Tally will appear as above with current period and current date on left side pane of tally screen. Below that it will display the name of the company which is open. Since it is a new company created, therefore in date of last entry it is written no vouchers entered.

In the right pane, you can see masters where ledger and group creation along with inventory are created. In transactions, vouchers are created related to accounting and inventory. Utilities consist of importing of data from outside and other banking related operations like cheque printing, deposit slip etc.

Finally reports include all financial statements like balance sheet and profit and loss, stock summary and ratio analysis. Display includes trial balance, day book, cash/fund flow etc. and in the end finally quit where you will be able to close the tally programme if selected 'Yes'.

12.7.2. Selecting a Company

By using 'select company' field you can open another company from list of companies already existing in tally.

Click Alt+F3 and company info will open as shown in Fig. 12.7. Click select company field or press S.

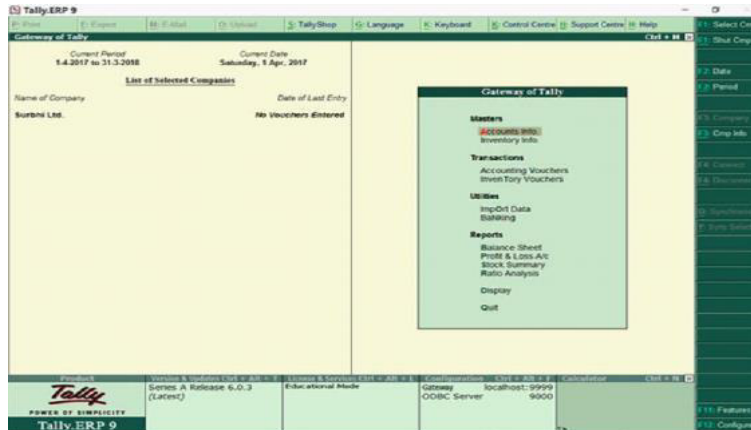
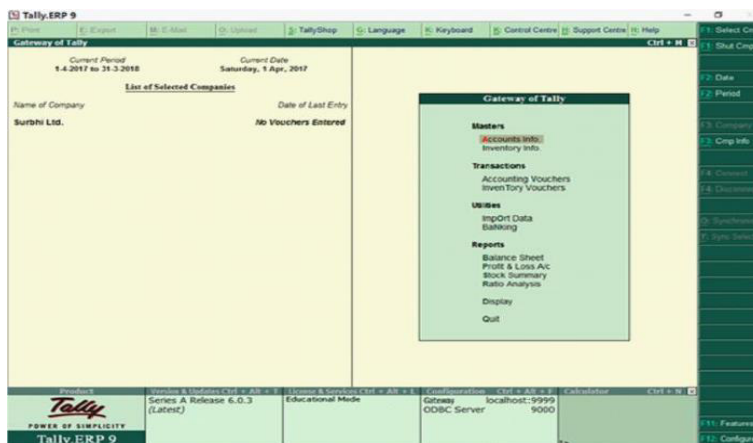


Fig. 12.7



Once you click select company, the following screen will appear as shown in Fig. 12.8:

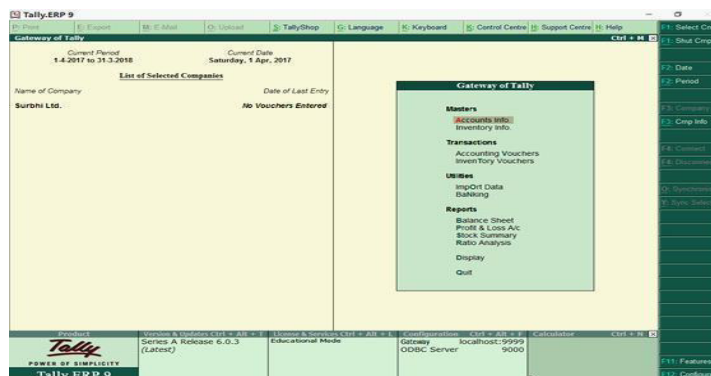
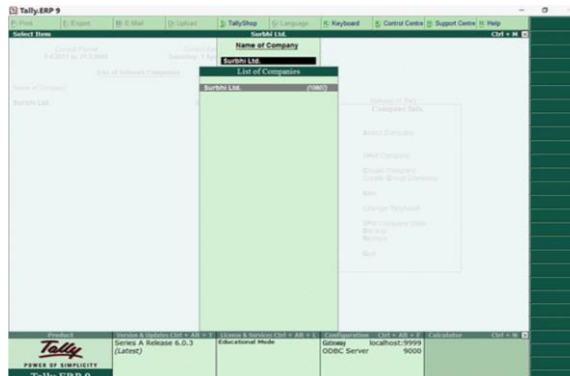


Fig. 12.8

You can select the company which you want by using arrow key and then pressing enter or by clicking the company through mouse.

12.7.3. Alteration of Details of a Company



Once company is created, you might need to update details related to company already created before. Again go to gateway of tally, click company info or Press F3, the following screen will appear as shown in Fig. 12.9.

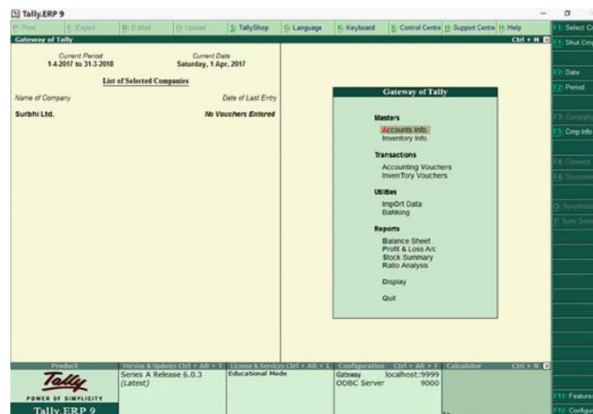


Fig. 12.9

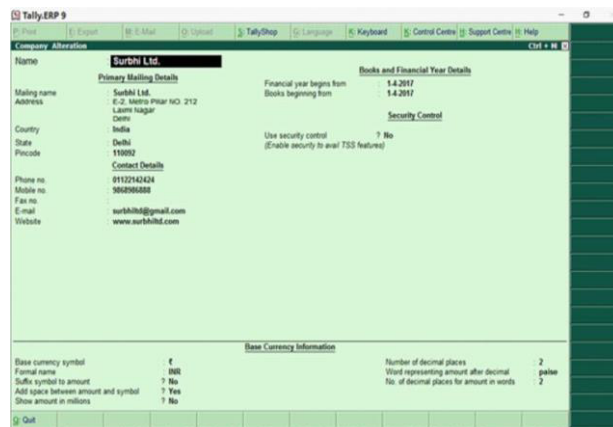
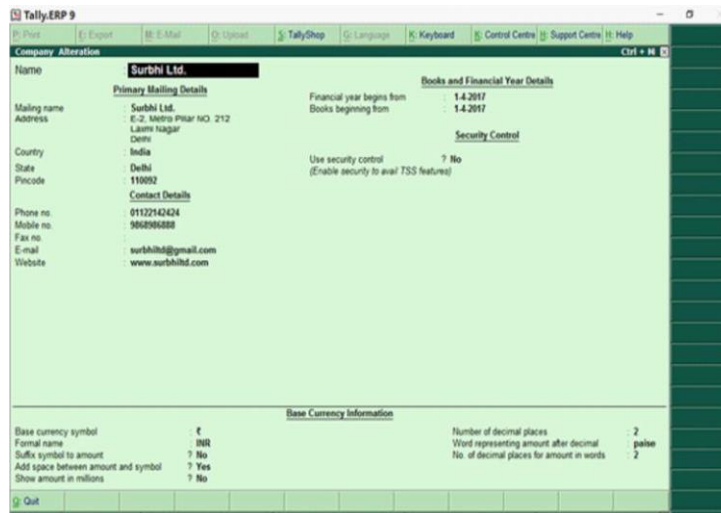
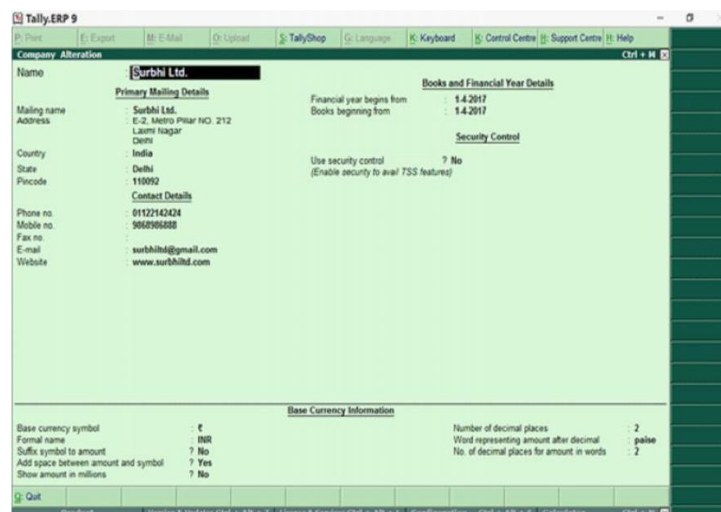


Fig. 12.10



Select the company for which you wish to alter details and after selecting, the following screen will appear and you can alter any details you want as shown in Fig. 12.12.

Once you click 'alter', the following screen shall appear as shown in Fig. 12.12.



After altering the same, once again a box will appear saying Accept 'Yes' or 'No'? Click 'yes' if alteration is done and click 'no' if you further wish to alter the details of the company.

12.7.4. Deletion of a Company

For deletion of a company, you have to go to gateway of tally and then company info and then alter (same like alteration of details of a company). Once you click alter and select the company, the company details screen will appear as follows as shown in Fig. 12.12:

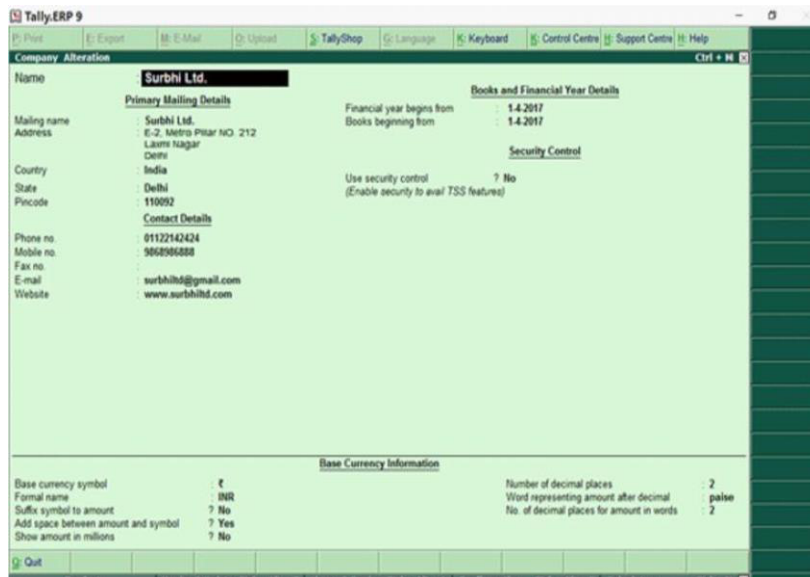


Fig. 12.12

Now, Press Alt+ D and it will ask you to delete the company i.e. yes or No. If you wish to delete the company press 'Yes' or otherwise 'No'. Once you press Y or select 'Yes' through mouse click, company will be deleted and the data will not be available as shown in Fig. 12.13:

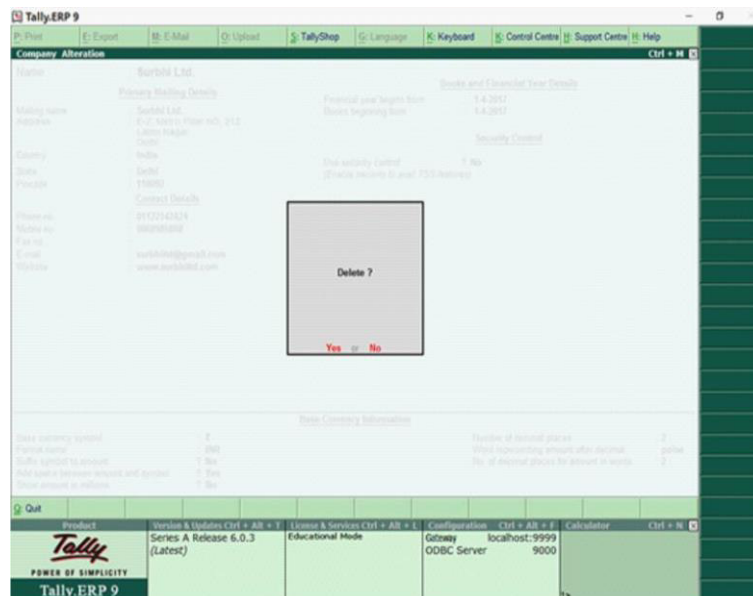


Fig. 12.13

12.7.5. Shutting of a Company

Once company is created, if you want to shut the company which is already open, again go to gateway of tally, click company info or Press F3, the following screen will appear as shown in Fig. 12.14:

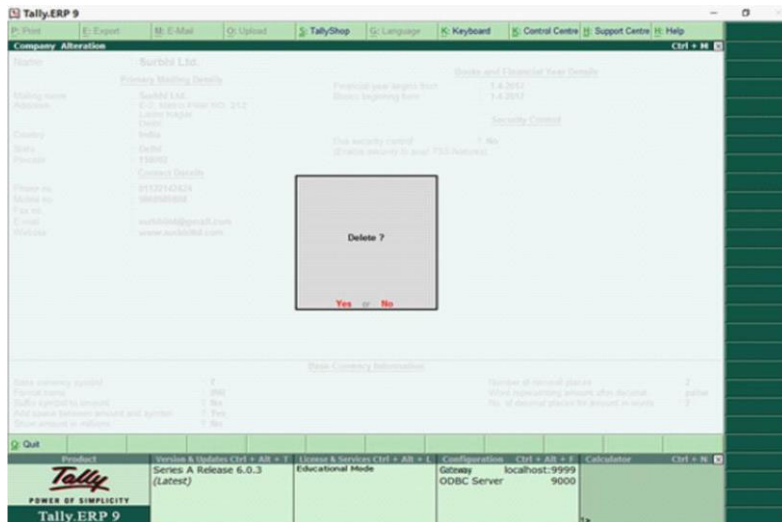


Fig. 12.14

Press shut company field or Press H or Alt+ F1 or click F1: Shut Company on the right pane.

12.8. Features and Configurations

Once you have created a company, it is now time to set features and configurations as per requirement. Features will affect only the company in which they are enabled as 'Yes' or 'No' whereas configurations will have an effect on all companies in the directory data.

12.8.1. Features

Features are set of capabilities which are provided as options, which will enable you to set and maintain your records of financial statements as per your need. It can be found by Clicking FEATURES on vertical button bar on right pane. Alternatively you can press F11 and features screen will appear as follows as shown in Fig. 12.15:

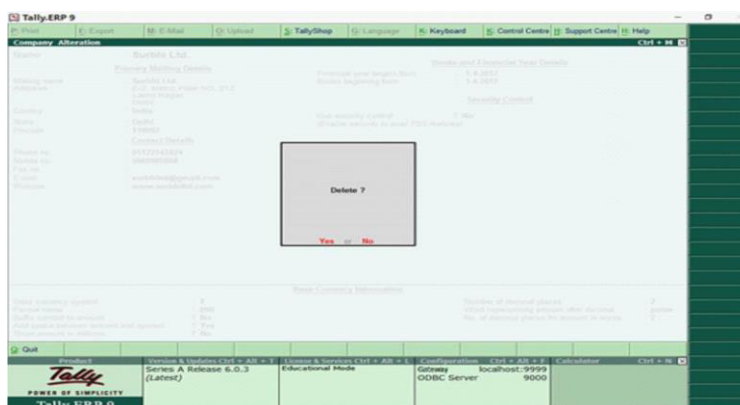


Fig. 12.15

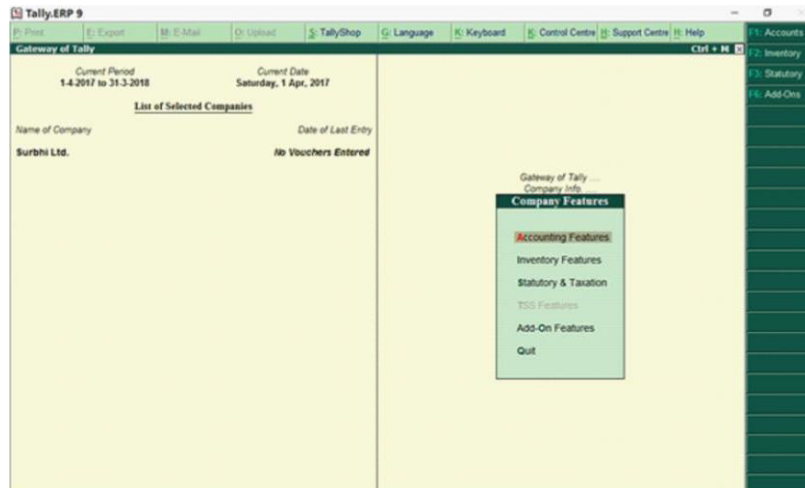


Fig. 12.16

You can now see various features like accounting, inventory, statutory and taxation and add on features as shown in Fig. 12.16. You can open say accounting feature by clicking it or pressing 'A' or pressing F1 or by clicking

F1: Accounts on the vertical button bar on right pane. Once you do so, the following screen will appear as shown in Fig. 12.17:

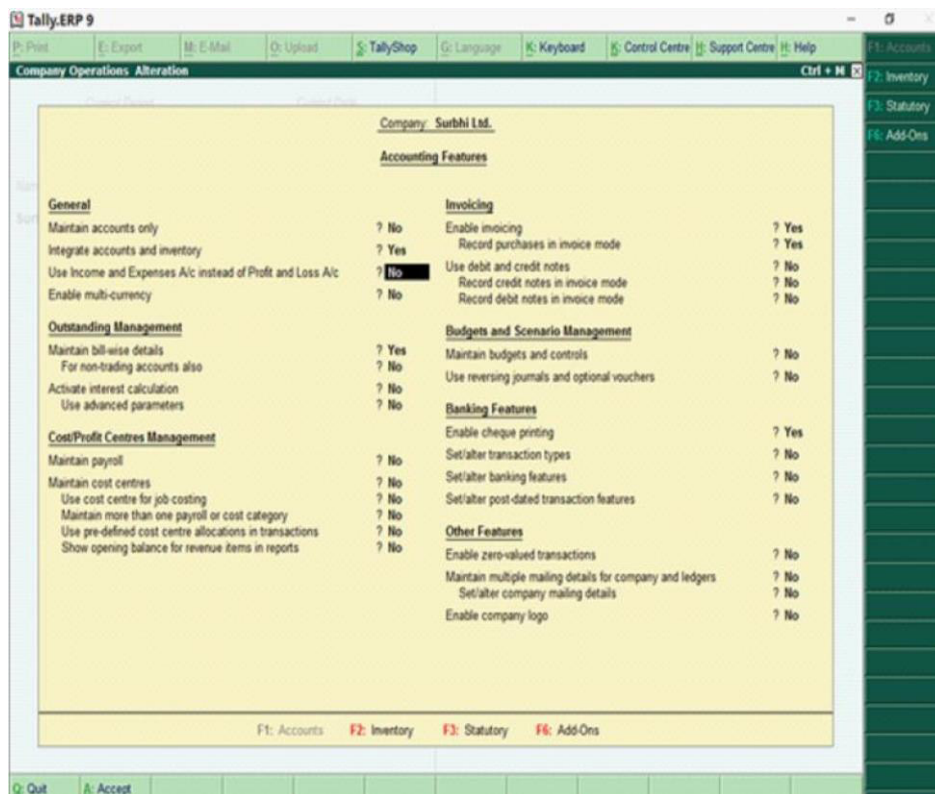


Fig. 12.17

There are three categories of features viz; (i) Accounting Features; (2) Inventory features, and (3) Taxation and statutory features.

12.8.1. Accounting Features

The **accounting features** consists of general, outstanding management, cost/ profit centres management, invoicing, budgeting and scenario management, banking features and other features as shown in Fig. 12.17:

- **General:** If you have chosen accounts with inventory while creating company, maintain accounts only option will be set as 'No' and integrate accounts with inventory option as 'Yes'. If you have chosen accounts only while creating company, maintain accounts only option will be set as 'Yes' and integrate accounts with inventory option will not be highlighted and will be grey in color. If you wish to have income and expenditure account in place of Profit and loss account (Like for NPO) you can enable this as 'Yes'.
- **Outstanding Management:** This will help maintain bill wise details and also, calculate interest on outstanding.
- **Cost/Profit Centres Management:** It helps in maintaining payroll and cost centres.
- **Invoicing:** To enable recording purchase in invoice mode, type 'Yes'. To record sales and purchase return, debit and credit note is used. Set Debit and credit note as 'Yes'
- **Budgeting and scenario management:** To maintain budget, enable the option as "Yes".
- **Banking Features:** To enable cheque printing, enable cheque option as 'Yes'.
- **Other Features:** To enable zero valued transactions while recording transactions, enable this option as 'Yes'.
- After carrying out all requisite changes in accounting features, Accept 'yes' or 'No'. The tally screen will appear as follows as shown in Fig. 12.18:

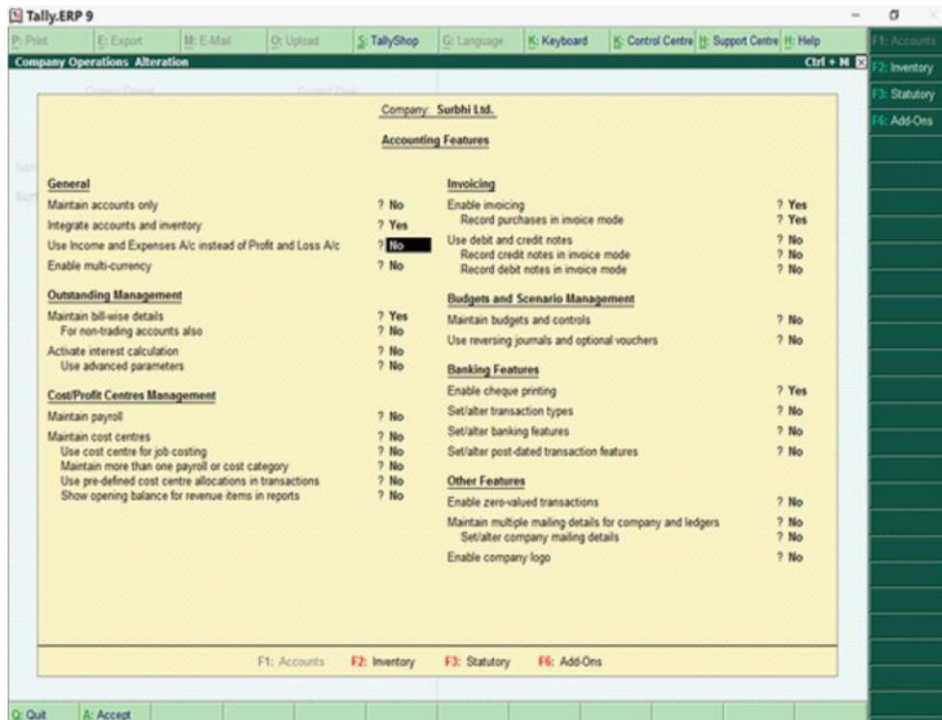


Fig. 12.18

12.8.1.2. Inventory Features

The **inventory features** consists of general, storage and classification, order processing, invoicing, purchase and sales management and other features. You can open inventory feature by clicking it or pressing 'I' or pressing F2 or by

clicking F2: inventory on the vertical button bar on right pane. Once you do so, the following screen will appear as shown in Fig. 12.19:

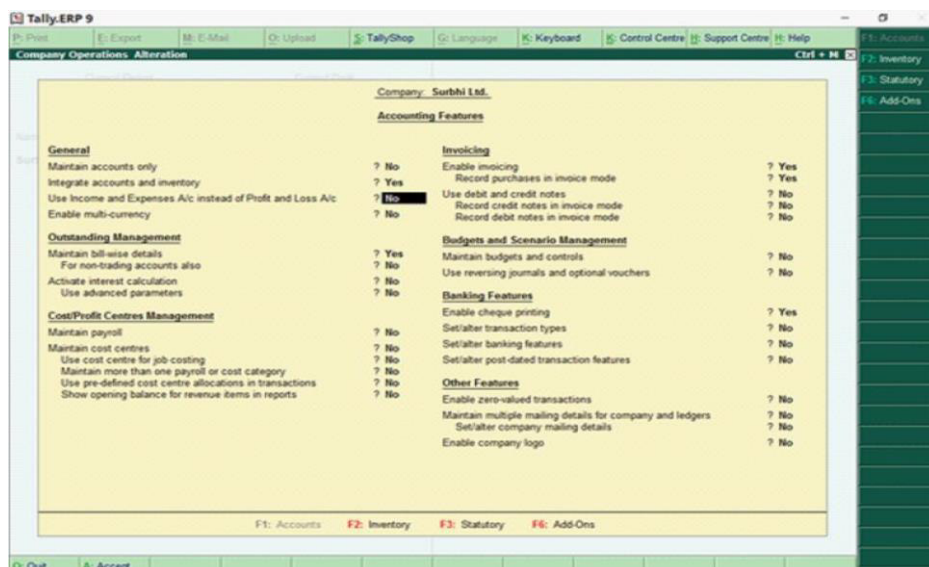


Fig. 12.19

In general, integrate accounts and inventory will be set as 'Yes' if you have selected accounts with inventory while creating company. If you want to enable zero valued transactions, set this option as 'Yes'.

In storage and classification, if you want to maintain stock according to location or warehouse, enable maintain multiple godowns/locations as 'Yes'. To maintain stock category wise, enable maintain stock categories as 'Yes'.

Set invoicing as 'Yes' and use debit and credit notes in invoice mode as 'Yes'. To record discount in invoice in separate column, enable this option as 'Yes'.

After all settings, the screen will appear as follows as shown in Fig. 12.20: and accept 'Yes' to proceed further:

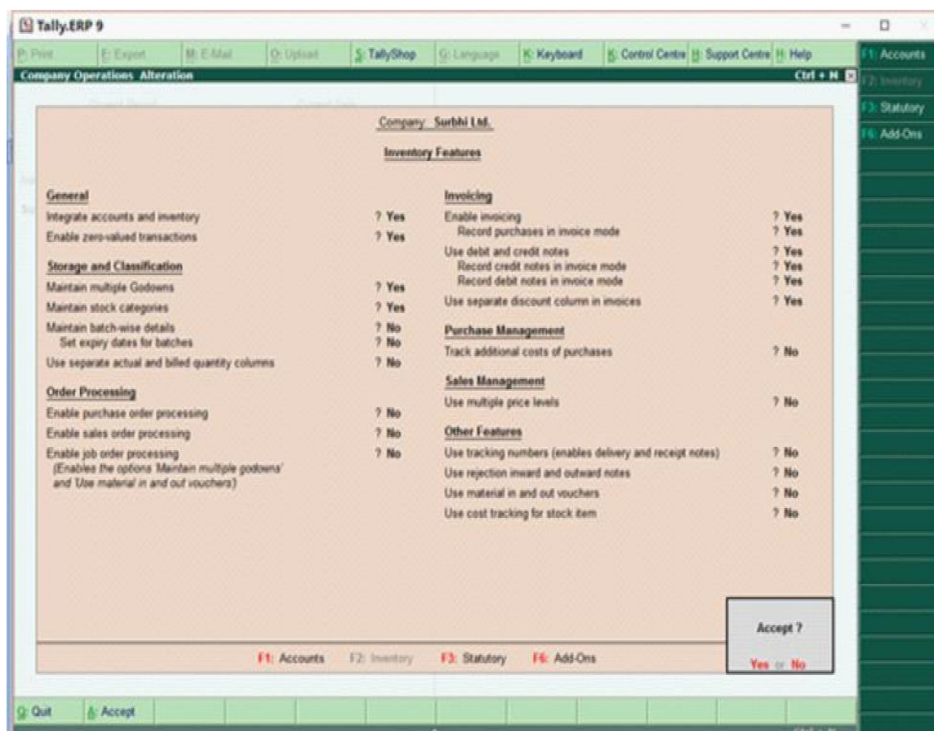


Fig. 12.20

12.8.1.3. Statutory and Taxation Features

Next feature is **Statutory and taxation**. You can open inventory feature by clicking it or pressing 'S' or pressing 'F3' or by clicking 'F3': statutory on the vertical button bar on right pane. Once you do so, the following screen will appear as shown in Fig. 12.21:



Fig. 12.21

Please note statutory compliance is country specific. Since we have selected India as option in statutory compliance for, therefore the displayed statutory and taxation features are those that are relevant to India. One can set these according to business specific requirement. To enable GST, VAT, Service Tax, TDS & TCS enable option as 'Yes' along with set/alter details option. Suppose, GST is relevant to our business, then setting GST as 'Yes' will appear like above as shown in Fig. 12.22:

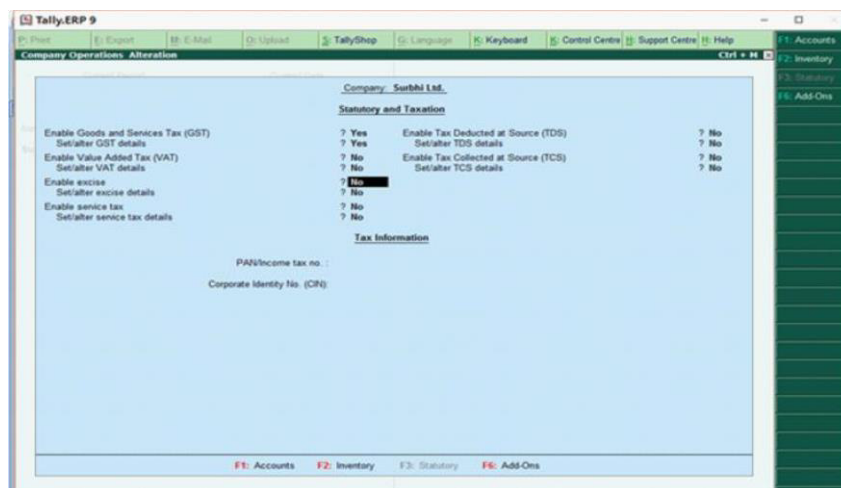


Fig. 12.22

In tax information, put PAN number and Corporate Identity Number if available. After all settings, the screen will show accept 'Yes' or 'No'. If

all the settings have been done, accept as 'Yes' otherwise 'No' and do the required settings.

Sometimes, there are specific problems which relates to specific organization or company or business. The solution provider i.e. Tally partners provide a new feature as solution which is specific to that organization or company or business only. It is known as customized solution and it gets placed as add on feature. One can see add on feature by clicking it or pressing 'O' or pressing 'F6' or by clicking 'F6': Add-Ons on the vertical button bar on right pane as shown in Fig. 12.23:.

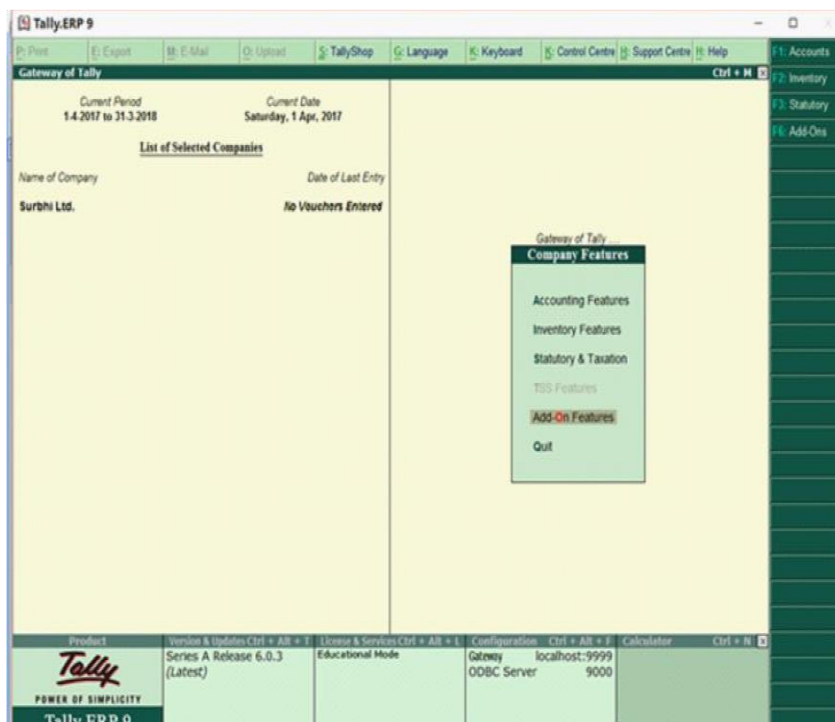


Fig. 12.23

To return to the main screen, either click quit or Ctrl +M.

12.8.2. Configurations

Configurations are options that help you modify the way a feature works. Configuration can be located on vertical button bar in the last. You can also press F12 or click F12: Configure.

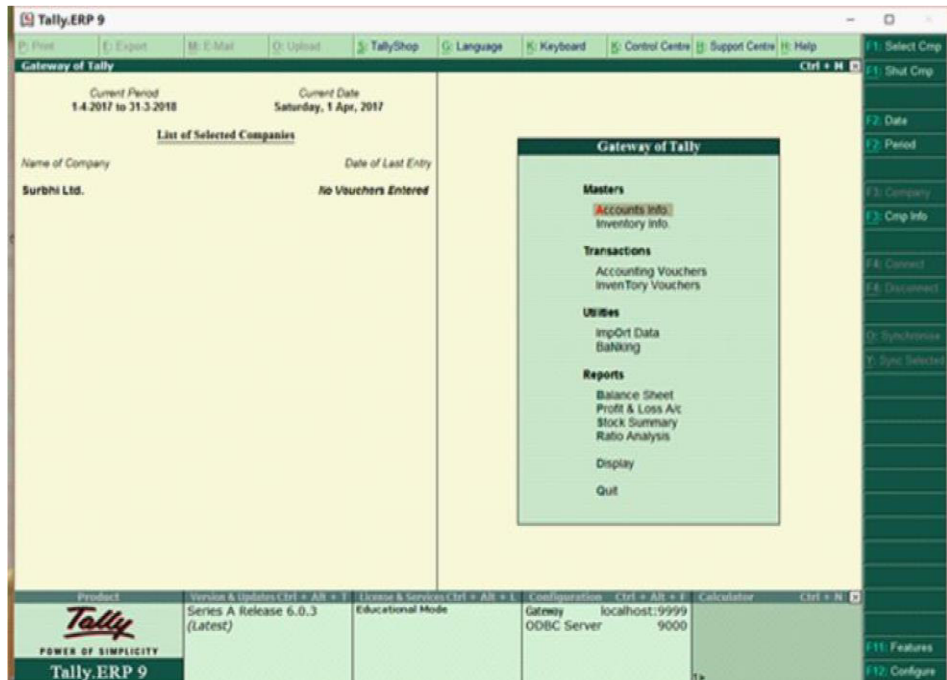


Fig. 12.24

Once you press F12 or open F12: Configure, the following screen will appear as shown in Fig. 12.24:

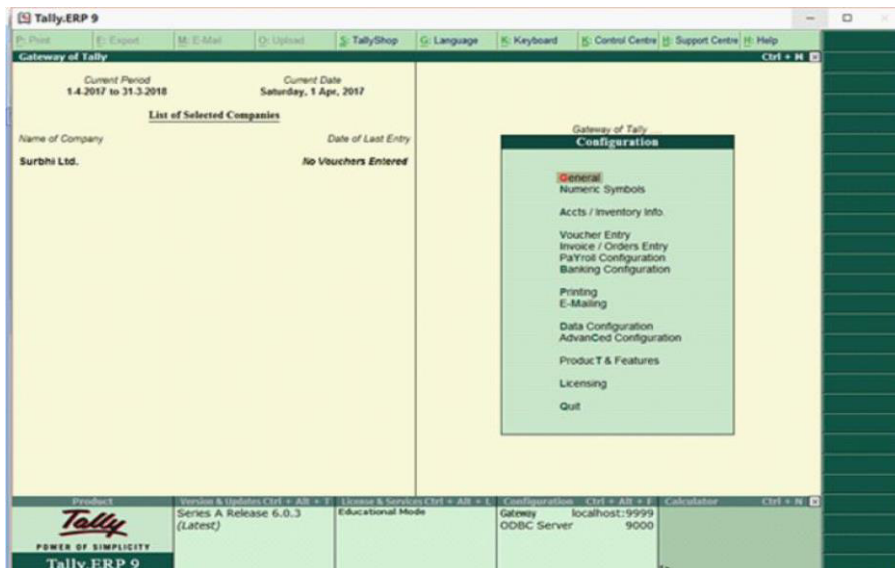


Fig. 12.25

This gateway of tally screen of configuration will allow different configuration like general configuration, numeric symbols, accounts/inventory info, voucher entry, order entry, payroll and banking configuration etc. as shown in Fig. 12.25:

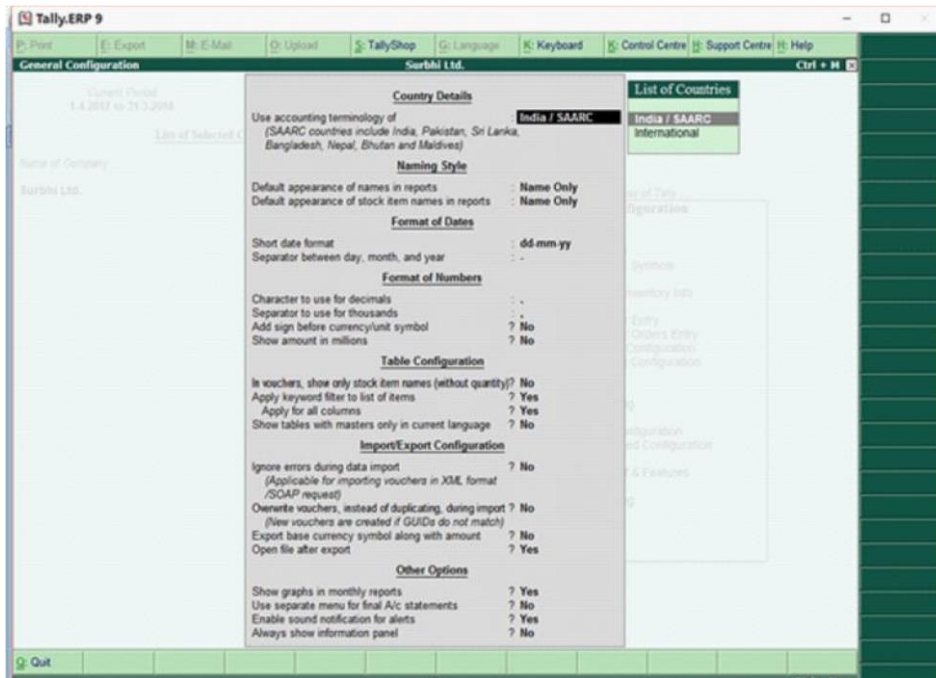


Fig. 12.26

In the above screen as shown in Fig. 12.26, you can see general configurations where you can select country from India/SAARC or international, different styles of displaying names of reports and stock items, different styles of writing dates, formatting of numbers (character to use for decimal, separator to use for thousands etc) and other options like monthly reports in form or graph. If you enable use separate menu for final account statement as 'Yes', then on main screen of gateway of tally, balance sheet and profit and loss will come under Final Accounts field as below as shown in Fig. 12.27:

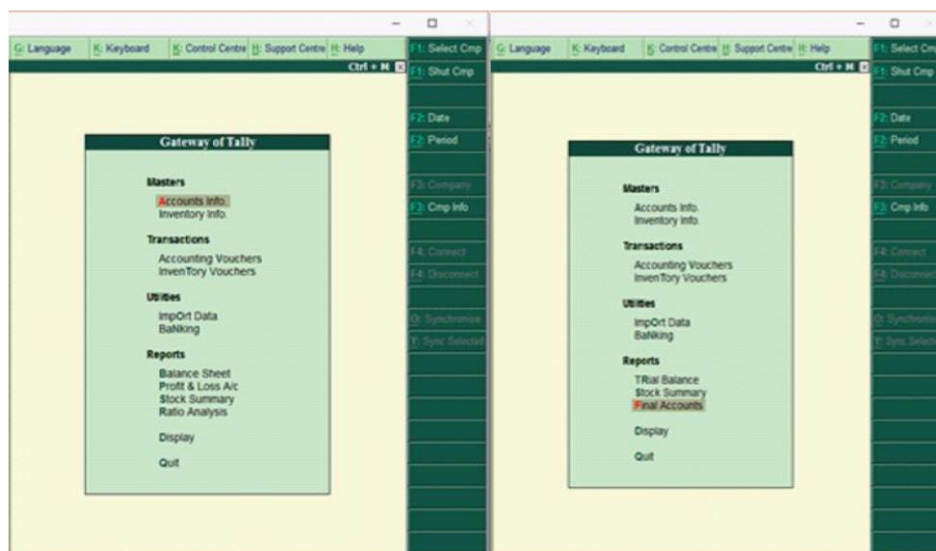


Fig. 12.27

To configure the numeric symbols, select the option 'Numeric Symbols' and the following screen will appear as shown in Fig. 12.28:

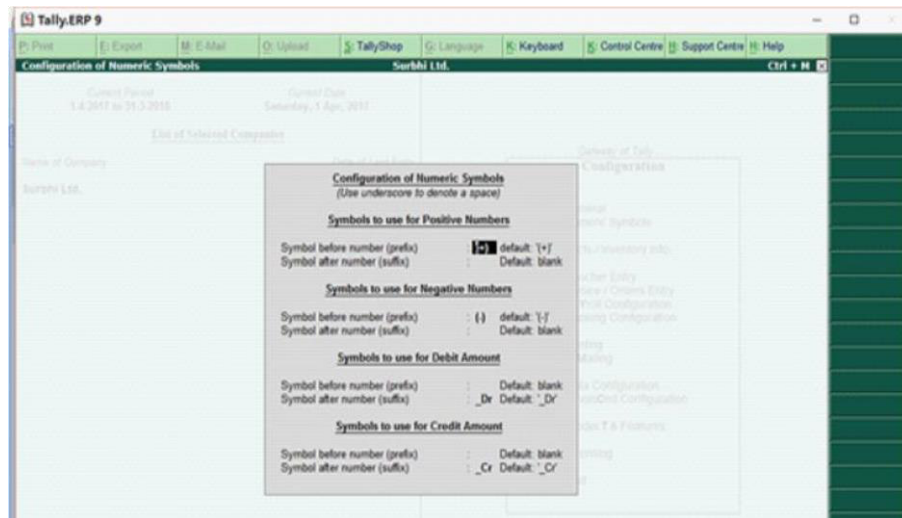


Fig. 12.28

It includes symbols to be used for negative and positive numbers and debit and credit amounts.

The screen below as shown in Fig. 12.29 shows master configurations related to accounts and inventory.

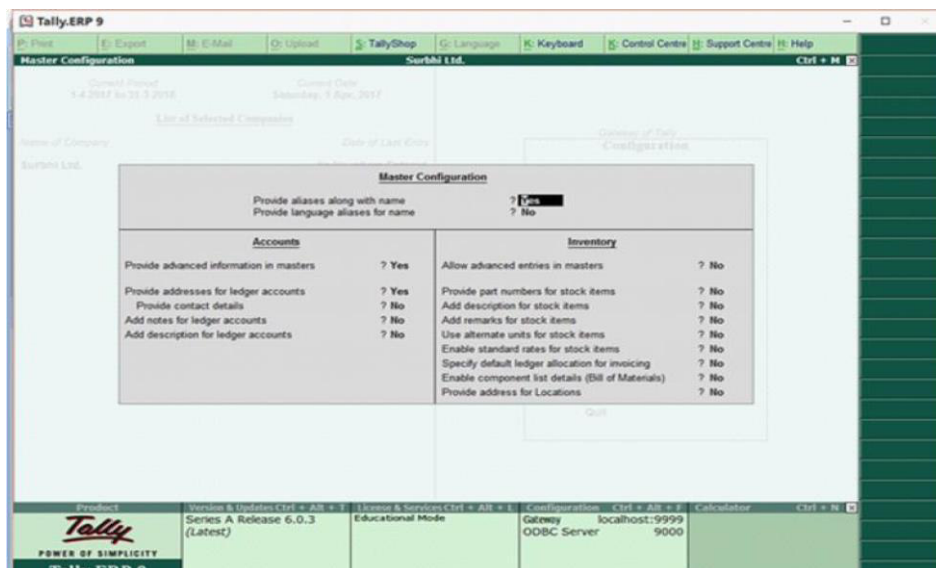


Fig. 12.29

Next is voucher entry related configurations pertaining to both accounting and inventory info. On opening voucher entry, the following screen will appear as shown in Fig. 12.30.

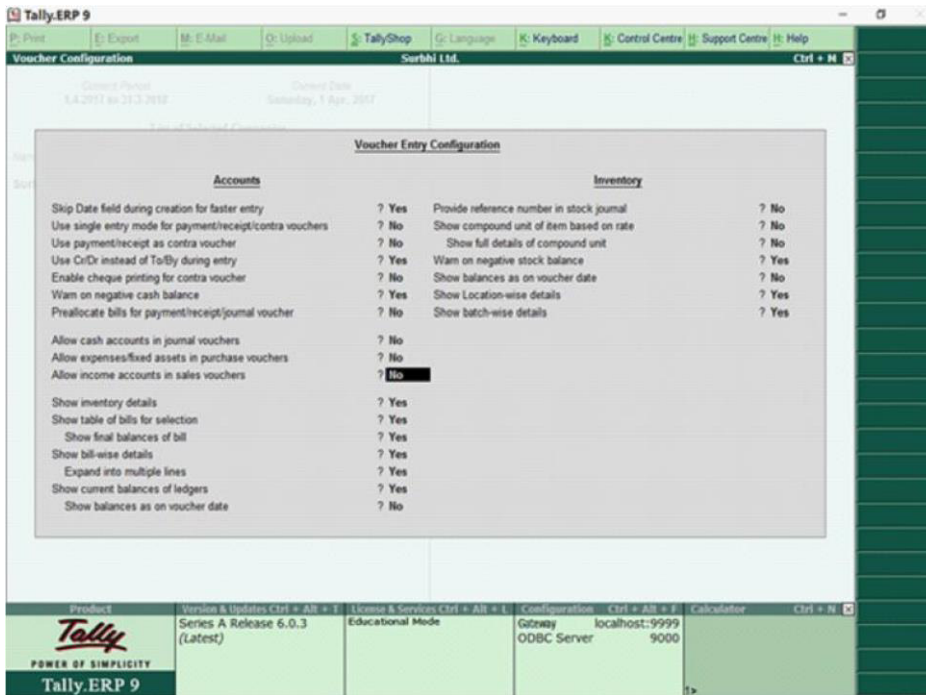


Fig. 12.30

If you wish to skip date for faster entry, enable this option as 'Yes'. It will jump to next field automatically.

Set use single entry mode for Pymt/Rcpt/Contra and Use payment/Receipt as contra as 'NO' and use Cr/Dr instead of To/By during entry as 'Yes'. Set warn on negative cash balance as 'Yes' so that whenever cash balance goes negative, it will show warning as shown in Fig. 12.31.

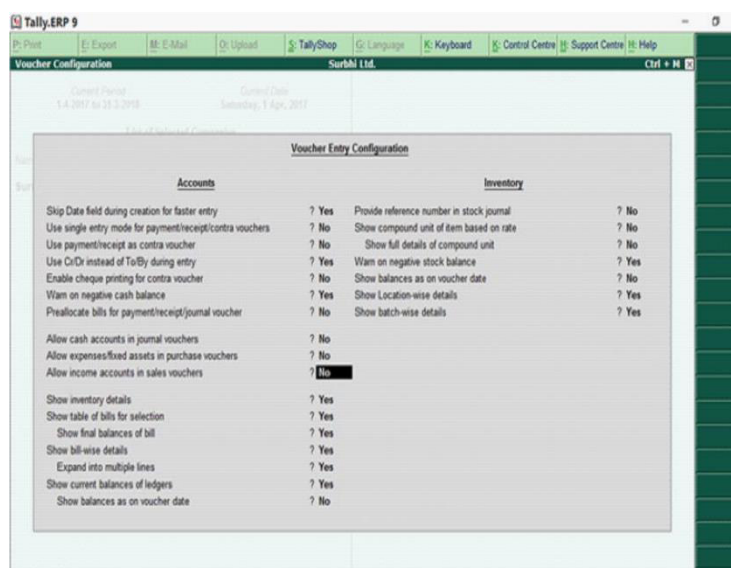


Fig. 12.31

Invoice /Order Entry will let you configure additional things like export details, shipping details etc.

Payroll configuration is used to configure additional details for the employees. Banking configuration will let you configure banking details.

Printing configuration helps to configure the printing screens for the reports and transactions.

E-mailing will help you configure email related details.

Data configuration will enable configuration of data i.e. location of tally files, export files etc.

Product and features will tell you about the details of current product installed in your system.

Licensing will help you update, surrender, reset license and also configure existing license.

Quit will enable you to return to the main screen of gateway of tally.

12.9. Shutting Tally Erp.9

To exit out of Tally application, close all the screens. Once all the screens are closed, you can see gateway of tally, now press 'Esc key from keyboard and when prompted to quit, press yes. Otherwise you can also click Ctrl +M on the extreme right corner and when prompted to quit, press yes.

You can also click Ctrl+Q to exit without confirmation.

12.10. Keyboard Conventions

ACTIONS	PARTICULARS
Fn (F11: FEATURES)	Press the Key
Fn (K: KEYBOARD)	Press Alt+ Key
Fn (K: CONTROL CENTRE)	Press Ctrl+ Key

Let Us Sum Up

In this unit, you have learned about the following:

With the advancement of technology, maintaining records of financial transactions has also changed from manual to electronic form. Computerised Accounting system has been adopted by most business organizations because of its comparative advantages like speed, ease, security, reliability to name a few. But these advantages come at a cost. There are chances of data being corrupt, electricity issues, theft of data

and too much reliance on computer. Still its advantages outperform in relation to disadvantages. Business organization should keep in mind various factors while choosing accounting software as varied software are available in market. The main difference between computerized accounting and manual accounting is that ledgers are created first and then journal entries are done through vouchers instead of journal entries being followed by ledger posting as done in manual accounting system. First step in computerized accounting system is creation of company where all the basic details like name, address, email, mobile number, maintaining accounts with or without inventory, financial year are filled in the software. The company details can be altered at any stage if needed. The company can also be deleted if required. The features and configurations help the business organization to maintain financial record as per requirement of business. Features are applicable to only company where as configurations are for overall Tally Software. The next step after company creation is creating masters.

Check Your Progress

1. The short key for company creation is _____
 - a) Ctrl +f2
 - b) alt+f2
 - c) alt+f3
 - d) Ctrl + f3

2. F10 is the short key for _____ voucher
 - a) Payment
 - b) Memo
 - c) Receipt
 - d) Purchase

3. The home screen of tally is also known as
 - a) Menu bar
 - b) Gate way of tally
 - c) Accounts Info
 - d) Button tool bar

Glossary

Accounting Features: The accounting features consists of general, outstanding management, cost/profit centres, management, invoicing, budgeting and scenario management, banking features and other features.

Alteration of Details of a Company:

A process of making changes in the details of company or any data which is misspelt or wrongly taken while putting information during company creation process.

Computerised Accounting System:

A process of digitally collecting, recording, classifying and summarising financial data using accounting software for managerial decision making.

Configuration:

Configurations are options that help you modify the way a feature works. Configuration can be located on vertical button bar in the last. You can also press F12 or click F12: Configure.

Features:

Features are set of capabilities which are provided as options, which will enable you to set and maintain your records of financial statements as per your need.

Gateway of Tally:

The gateway of Tally displays menus, screens, reports and options that you select.

Inventory Features:

The inventory features consists of general, storage and classification, order processing, invoicing, purchase and sales management and other features.

Manual Accounting System:

A process of physically maintaining books of accounts.

Statutory and Taxation

Features:

You can open statutory and taxation feature by clicking it or pressing 'S' or pressing F3 or by clicking F3: statutory on the vertical button bar on right pane.

Shutting a Company:

Once company is created, if you want to shut the company which is already open, go to gateway of tally, click company info or Press F3, a screen will appear, press shut

company field or Press H or Alt+ F1 or click F1: Shut Cmp on the right pane.

Tally ERP.9: A business accounting software for purposes of accounting, inventory and payroll.

Answers to Check Your Progress-1

- a-True
- b-True
- c-False
- d-True
- e-True

Answers To Check Your Progress-2

1. c) alt+f3
2. b) Memo
3. b) Gate way of tally

Suggested Readings

1. Neeraj Goyal & Rohit Sachdeva, Computerised Accounting, Kalyani Publishers.2018
2. Manoj Bansal & Ajay Sharma, Computerised accounting system using ERP 9, Sahitya Bhawan Publications: Agra 2018

Block-5: Introduction

The Block-5: **Depreciation, Single Entry system and Self Balancing Ledgers** has been divided in to three Units (Unit-13 to Unit-15).

Unit-13: Concept and Accounting of Depreciation: By studying this unit students can explore the knowledge about the Introduction to Depreciation, Meaning of Depreciation, Definition of Financial Accounting, Objectives of Providing depreciation and nature of providing Depreciation.

Unit-14: Single Entry System: By studying this unit students can understand the single entry system and practically understand the methods of converting the single entry system into double entry system-

Unit-15: Self-Balancing Ledgers: By studying this unit students can explore the Self Balancing System.

In all the units of Block -5: **Depreciation, Single Entry system and Self Balancing Ledgers**, the Check your progress, Glossary, Answers to Check your progress and Suggested Reading has been provided and the Learners are expected to attempt all the Check your progress as part of study.

Unit-13

Concept and Accounting of Depreciation

STRUCTURE

Overview

Objectives

13.1. Introduction

13.1.1. Concept of Depreciation

13.1.2. Depreciation on Components of an Assets

13.1.3. Objectives for Providing Depreciation

13.2. Factors in the Measurement of Depreciation

13.3. Methods for Providing Depreciation

13.3.1. Straight Line Method

13.3.2. Reducing or Diminishing Balance Method or Written
Down Value (WDV) Method

13.3.3. Machine Hour Method

13.3.4. Production Units Method

13.3.5. Depletion Method

13.4. Profit or Loss on the Sale/Disposal of Property, Plant and
Equipment

Let Us Sum Up

Check Your Progress

Glossary

Answers to Check Your Progress

Suggested Readings

Overview

In this Unit, the Concept of Depreciation, Depreciation on Components of An Assets, Objectives for Providing Depreciation, Factors in The Measurement of Depreciation, Methods for Providing Depreciation, Straight Line Method, Reducing or Diminishing Balance Method or Written Down Value (WDV) Method, Machine Hour Method, Production Units Method, Depletion Method, Profit or Loss on The Sale/Disposal of Property, Plant And Equipment has been clearly explained.

Objectives

After studying this chapter, you will be able to:

- Understand the meaning and nature of depreciation.
- Understand how to determine the amount of depreciation from the total value of Property, Plant and Equipment and its useful life.
- Understand various methods of depreciation and learn advantages and disadvantages of such methods.
- Understand how to calculate the amount of profit or loss resulting from the sale/disposal of Property, Plant and Equipment.
- Familiarize with the accounting treatment for change in the method of depreciation from Straight Line Method to Reducing Balance method.

13.1. Introduction

13.1.1. Concept of Depreciation

Property, plant and equipment are tangible items that:

- a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- b) are expected to be used during more than a period of twelve months.

These are also called fixed assets in common parlance. When a fixed asset is purchased, it is recorded in books of account at its original or acquisition/purchase cost. However fixed assets are used to earn revenues for a number of accounting periods in future with the same acquisition cost until the concerned fixed asset is sold or discarded. It is therefore necessary that a part of the acquisition cost of the fixed assets is treated or allocated as an expense in each of the accounting period in which the asset is utilized. The amount or value of fixed assets allocated in such manner to respective accounting period is called depreciation. Value of such assets decreases with passage of time mainly due to following reasons.

1. Wear and tear due to its use in business
2. Efflux of time even when it is not being used
3. Obsolescence due to technological or other changes
4. Decrease in market value
5. Depletion mainly in case of mines and other natural reserves

It is important to account for value of portion of property, plant and equipment utilized for generating revenue during an accounting year to

ascertain true income. This portion of cost of Property, Plant & Equipment allocated to an accounting year is called depreciation.

As per Schedule II under the Companies Act, 2013, Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. The depreciable amount of an asset is the cost of an asset or other amount substituted for cost, less its residual value. The useful life of an asset is the period over which an asset is expected to be available for use by an entity, or the number of production or similar units expected to be obtained from the asset by the entity.

Thus, there are 3 important factors for computing depreciation:

- Estimated useful life of the asset
- Cost of the asset
- Residual value of the asset at the end of the of its estimated useful life

Depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Thus it is not necessary that an asset must be used to be depreciated. There is decrease in value of assets due to normal wear and tear even when these are not physically used. Accordingly, value of such wear and tear should be estimated and accounted for.

Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Depreciation for a period helps to charge that portion of the cost of the asset against the revenues earned, which is expired for that period and hence follows matching principle. In other words the total cost of the asset is reflected in form of a) Expired cost (depreciation) and b) Unexpired Cost which shall be the written down value of the asset being reflected in balance sheet. Also charging depreciation every year reduces the distributable profits and hence ensuring the availability of funds whenever the replacement is required.

The depreciation is type of loss in the value of assets employed for carrying on a business. Being an essential element of business expenditure, it is necessary to calculate the amount of such loss and to make a provision, and therefore, arrive at the amount of profit or loss made by the business.

Basically, the cost of an asset used for purpose of business has to be written off over its economic (not physical) life which must be estimated.

A point to remember is that usually, at the end of the economic life, an asset has some value as scrap or otherwise. The amount to be written off in each year should be as such which will reduce the book value of the asset, at the end of its economic life, to its estimated scrap value.

13.1.2. Depreciation on components of an assets

It may be noted that Accounting Standards as well as the Companies Act, 2013 requires depreciation to be charged on a component basis. Each part of an item of Property, Plant and Equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately. An enterprise should allocate the amount initially recognised in respect of an item of property, plant and equipment to its significant parts/components and should depreciate each such part separately based on the useful life and residual value of each particular component.

For Example- Aircraft is a classic example of such an asset. The airframe (i.e. the body of the aircraft), the engines and the interiors have different individual useful lives. If the life of the airframe (being the longest of the individual lives of the three major types of components) is taken as the life of the aircraft, it is important that other two major components i.e. engine and interiors are depreciated over their respective useful life and not over the life of airframe. Other components (usually small and low value) which will require replacement very frequently may be depreciated over the useful life of airframe and their frequent replacement cost may be charged to expense as and when it is incurred. Here it is important to note that a part of Property, Plant & Equipment to be identified as a separate component should have both

- (a) significant cost when compared to overall cost of item of property, plant and equipment and
- (b) and estimated useful life or depreciation method different from rest of the parts of the property plant and equipment.

A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

13.1.3. Objectives for Providing Depreciation

Prime objectives for providing depreciation are:

- (1) **Correct income measurement:** Depreciation should be charged for proper estimation of periodic profit or loss. In case an enterprise

does not account for depreciation on Property, Plant & Equipment, it will not be considering loss in value of property, plant & equipment due to their use in production or operations of the enterprise and will not result in true profit or loss for the period.

- (2) **True position statement:** Value of the Property, Plant & Equipment should be adjusted for depreciation charged in order to depict the actual financial position. In case depreciation is not accounted for appropriately, the property, plant and equipment would be disclosed in financial statements at a value higher than their true value. Whereas we should always present the same at its unexpired cost which is after charging the expired cost as depreciation.
- (3) **Funds for replacement:** Generation of adequate funds in the hands of the business for replacement of the asset at the end of its useful life. Depreciation is a good indication of the amount an enterprise should set aside to replace a fixed asset after its economic useful life is over. However, the replacement cost of a fixed asset may be impacted by inflation or other technological changes.
- (4) **Ascertainment of true cost of production:** For ascertaining the cost of the production, it is necessary to charge depreciation as an item of cost of production.

Further depreciation is a non-cash expense and unlike other normal expenditure (e.g. wages, rent, etc.) does not result in any cash outflow. Further depreciation by itself does not create funds it merely draws attention to the fact that out of gross revenue receipts, a certain amount should be retained for replacement of assets used for carrying on operation which is achieved by charging depreciation that reduces the distributable profits.

13.2. Factors in the Measurement of Depreciation

Estimation of exact amount of depreciation is not easy as it involves lot of estimation. Generally following factors are taken into consideration for calculation of depreciation.

1. Cost of asset including expenses for installation, commissioning, trial run etc.
2. Estimated useful life of the asset (both in terms of time & also utility/units).
3. Estimated scrap value (if any) at the end of useful life of the asset. The above mentioned factors can be explained, in detail, as follows:

Cost of a depreciable asset represents its money outlay or its equivalent in connection with its acquisition, installation and commissioning as well as for additions to or improvement thereof for the purpose of increase in efficiency. We have discussed this in more detail in coming paragraphs.

'Useful Life' is either (i) the period over which a depreciable asset is expected to be used by the enterprise or (ii) the number of production or similar units expected to be obtained from the use of the asset by the enterprise. Determination of the useful life is a matter of estimation and is normally based on various factors including experience with similar type of assets. Several other factors like estimated working hours, production capacity, repairs and renewals, etc. are also taken into consideration on demanding situation.

Determination of the residual value is normally a difficult matter. If such value is considered as insignificant, it is normally regarded as nil. On the other hand, if the residual value is likely to be significant, it is estimated at the time of acquisition/installation, or at the time of subsequent revaluation of asset.

Depreciable amount of a depreciable asset is its historical cost, or other amount substituted for historical cost in the financial statements (for example- revalued amount), less the estimated residual value.

For example, a machinery is purchased for ` 1,10,000. The residual value is estimated at ` 10,000. It is estimated that the machinery will work for 5 years. The cost to be allocated as depreciation in the accounting periods will be calculated as:

Acquisition cost	1,10,000
Less: Residual value <u>(10,000)</u>	
Depreciable amount	1,00,000
Estimated useful life of the asset 5 years	Depreciation
	$= \frac{1,00,000}{5} = 20,000$

Cost of Property, Plant and Equipment comprises:

- (a) its purchase price, including non-refundable import duties and purchase taxes, after deducting trade discounts and rebates.
- (b) any cost directly attributable to bring the asset to the location and condition necessary for it to be capable of operating in a manner intended by the enterprise.
- (c) the initial estimate of the costs of dismantling, removing, the item and restoring the site on which an asset is located.

Examples of costs directly attributable costs are:

- (a) cost of employee benefits arising directly from acquisition or construction of an item of property, plant and equipment.
- (b) cost of site preparation
- (c) initial delivery and handling costs
- (d) installation and assembly costs
- (e) cost of testing whether the asset is functioning properly, after deducting the net proceeds from selling the items produced while testing (such as samples produced while testing)
- (f) professional fees e.g. engineers hired for helping in installation of a machine

Thus, all the expenses which are necessary for asset to bring it in condition and location of desired used will become part of cost of the asset. However, following expenses should not become part of cost of asset:

- (a) costs of opening new facility or business, such as inauguration costs;
- (b) cost of introducing new product or service (for example cost of advertisement or promotional activities).
- (c) cost of conducting business in a new location or with a new class of customer (including cost of staff training); and
- (d) administration and other general overhead costs.

Once an asset has been brought to its intended condition and location of use, no cost should recognized as part of cost of the asset unless there is major repair or addition which increases the useful life of the asset or improves the production capacity of the asset. Accordingly, cost incurred while and item is capable of operating in intended manner but it is not yet put to use or is used at less than full capacity should not be capitalized as part of cost of the asset. Similarly, cost of relocation of an asset should not be capitalized.

Any additions made to a particular item of property, plant and equipment after it is initially put to use are depreciated over the remaining useful life of the asset. Any addition or extension which has a separate identity and is capable of being used after the existing asset is disposed of, is accounted for separately. Therefore, it is important to maintain an asset register capturing asset wise details of cost, rate of depreciation, date of capitalization etc. All these details need to be captured for any additions

to existing assets as well. In the absence of the adequate information, it will be very difficult to compute depreciation expense year on year. Also, at the time of disposal or discard of a particular asset, it will not be possible to compute gain or loss on such disposal/discard.

Check your Progress-1

True/False

- a. Estimation of exact amount of depreciation is easy as it involves lot of estimation.
- b. It is important to account for value of portion of property, plant and equipment utilized for generating revenue during an accounting year to ascertain true income.
- c. Generation of adequate funds in the hands of the business for replacement of the asset at the end of its useful life.
- d. Determination of the residual value is normally a difficult matter.
- e. The expenditure incurred on repairs and maintenance will be low in earlier years, whereas the same will be high as the asset becomes old.

13.3. Methods for Providing Depreciation

Generally, methods for providing depreciation are based on formula, developed on a study of the behavior of the assets over a period of years for readily computing the amount of depreciation suffered by different forms of assets. Each of the methods, however, should be applied only after carefully considering nature of the asset and the conditions under which it is being used.

The Income Tax Rules, however, prescribe the Diminishing Balance Method except in the case of assets of an undertaking engaged in generation and distribution of power.

13.3.1. Straight Line Method

According to this method, an equal amount is written off every year during the working life of an asset so as to reduce the cost of the asset to nil or its residual value at the end of its useful life. The advantage of this method is that it is simple to apply and gives accurate results especially in case of leases, and also in case of plant and machinery. This method is also known as Fixed Instalment Method.

$$\text{Straight Line Depreciation} = \frac{\text{Cost of Asset}}{\text{Scrap Value}}$$

Useful life the underlying assumption of this method is that the particular tangible asset generates equal utility during its lifetime. But this cannot be true under all circumstances. The expenditure incurred on repairs and maintenance will be low in earlier years, whereas the same will be high as the asset becomes old.

Apart from this the asset may also have varying capacities over the years, indicating logic for unequal depreciation provision. However, many assets have insignificant repairs and maintenance expenditures for which straight line method can be applied.

While using this method the period of use of an asset in a particular year should also be considered. In the year of purchase of an asset it may have been available for use for part of the year only, accordingly depreciation should be proportioned to reflect the period for which it was available for use.

For example, if an asset was purchased on March 1, 2017 and the enterprise prepares financial statements for the year ending on March 31, 2017 depreciation will be provided for a period of 1 month only. Similar situation will arise in the year in which an asset is retired from its intended use or is sold. However, under income tax rules depreciation is provided for full year if the asset was used for more than 180 days in a particular financial year.

13.3.2. Reducing or Diminishing Balance Method or Written Down Value (WDV) Method

Under this system, a fixed percentage of the diminishing value of the asset is written off each year so as to reduce the asset to its residual value at the end of its life. Repairs and small renewals are charged to revenue. This method is commonly used for plant, fixtures, etc. Under this method, the annual charge for depreciation decreases from year to year, so that the earlier years suffer to the benefit of the later years. Also, under this method, the value of asset can never be completely extinguished, which happens in the earlier explained Straight Line Method.

However, it is very simple to operate. This method is based on the assumption that cost of repairs will increase as the asset get old, therefore, depreciation in earlier years should be high when the repair cost is expected to be low and depreciation in later years should be low when the repair cost is expected to be high. Therefore, this method will result in almost equal burden in all the years of use of the asset as depreciation will reduce with increase in repair costs will increase with every passing year. On the other hand, under the Straight Line Method,

the charge for depreciation is constant, while repairs tend to increase with the life of the asset. Among the disadvantages of this method is the danger that too low a percentage may be adopted as depreciation with the result that over the life of the asset full depreciation may not be provided; also if assets are grouped in such a way that individual assets are difficult to identify, the residue of an asset may lie in the asset account even after the asset has been scrapped. The last mentioned difficulty could be, however, overcome if a Plant register is maintained.

The rate of depreciation under this method may be determined by the following formula:

$$\frac{1}{n} \text{ Residual Value} = \frac{\text{Cost of Asset}}{\text{Scrap Value}} \times 100$$

where, n = useful life

Similar to straight line method, in this method also period of use in a particular year e.g. year of purchase or sale an item of property plant and equipment needs to be considered while computing the depreciation amount.

Accounting Entries under Straight Line and Reducing Balance Methods:

A provision for depreciation or Accumulated Depreciation account is opened to accumulate the balance of depreciation and the assets are carried at historical cost. This method is preferred by most of the organizations as it presents both the gross investment and the current value of the assets.

Accounting entry

Depreciation Account	Dr.	
To Provision for Depreciation Account or Accumulated Depreciation		
Profit and Loss Account	Dr.	
To Depreciation Account		

Illustration-1

Jain Bros. acquired a machine on 1st July, 2018 at a cost of ₹ 14,00,000 and spent ₹ 1,00,000 on its installation. The firm writes off depreciation at 10% p.a. of the original cost every year. The books are closed on 31st December every year.

Required

Show the Machinery Account and Depreciation Account for the year 2018 and 2019.

Machinery Account

		Rs.			Rs.
2018 July 1	To Bank A/c	14,00,000	2018 Dec. 31	By Depreciation A/c	75,000
July 1	To BankA/c - Installation Expenses	1,00,000	Dec. 31	10% on ` 15,00,000 for 6 months	
		15,00,000			14,25,000
2019 Jan. 1	To Balance b/d	14,25,000	2019 Dec. 31	By Balance c/d	15,00,000
			Dec. 31	By Depreciation A/c	1,50,000
			Dec. 31	10% on ` 15,00,000	
		14,25,000	Dec. 31	By Balance c/d	12,75,000
					14,25,000

Depreciation Account

		Rs.			Rs.
2018 Dec. 31	To Machinery A/c	75,000	2018 Dec. 31	By Profit & Loss A/c	75,000
2019 Dec. 31	To Machinery A/c	1,50,000	2019 Dec. 31	By Profit & Loss A/c	1,50,000

13.3.3. Machine Hour Method

Where it is practicable to keep a record of the actual running hours of each machine, depreciation may be calculated on the basis of hours that the concerned machine worked. The machine hour rate of the depreciation, is calculated after estimating the total number of hours that machine would work during its whole life; however, it may have to be varied from time to time, on a consideration of the changes in the economic and technological conditions which might take place, to ensure that the amount provided for depreciation corresponds to that considered appropriate in the changed circumstances.

It would be observed that the method is only a slight variation of the Straight Line Method under which depreciation is calculated per year. Under this method it is calculated for each hour the machine works.

Schedule II to the Companies Act 2013, prescribes estimated useful life of different assets for companies, also recognizes this method to some extent. It prescribes that depreciation should be charged using estimate useful life suggested in it, however, in certain category of plant and machinery it prescribes to charge higher amount of depreciation if these assets are used for 2 shifts or 3 shifts. In a way, schedule II combines straight line method and machine hour method.

Illustration-4

A machine was purchased for ₹ 30,00,000 having an estimated total working of 24,000 hours. The scrap value is expected to be ₹ 2,00,000 and anticipated pattern of distribution of effective hours is as follows :

Year

1 – 3 3,000 hours per year

4 - 6 2,600 hours per year

7 - 10 1,800 hours per year

Required

Determine Annual Depreciation under Machine Hour Rate Method.

Solution

Statement of Annual Depreciation under Machine Hours Rate Method

Year	Annual Depreciation
1-3	$24,000 \times \frac{3,000}{(₹ 30,00,000 - ₹ 2,00,000)} = ₹ 3,50,000$
4-6	$24,000 \times \frac{2,600}{(₹ 20,00,000 - ₹ 2,00,000)} = ₹ 3,03,333$
7-10	$24,000 \times \frac{1,800}{(₹ 30,00,000 - ₹ 2,00,000)} = ₹ 2,10,000$

13.3.4. Production Units Method

Under this method depreciation of the asset is determined by comparing the annual production with the estimated total production. The amount of depreciation is computed by the use of following method

The method is applicable to machines producing product of uniform specifications.

Illustration- 5

A machine is purchased for ₹ 20,00,000. Its estimated useful life is 10 years with a residual value of ₹ 2,00,000. The machine is expected to produce 1.5 lakh units during its life time. Expected distribution pattern of production is as follows:

Year	Production
1-3	20,000 units per year
4-7	15,000 units per year
8-10	10,000 units per year

Required

Determine the value of depreciation for each year using production units method.

Solution

Statement showing Depreciation under Production Units Method

Year	Annual Depreciation
1-3	$1,50,000 \times \frac{20,000}{(20,00,000 - 2,00,000)} = ₹ 2,40,000$
4-7	$1,50,000 \times \frac{15,000}{(20,00,000 - 2,00,000)} = ₹ 1,80,000$
8-10	$1,50,000 \times \frac{10,000}{(20,00,000 - 2,00,000)} = ₹ 1,20,000$

13.3.5. Depletion Method

Depletion is the allocation of the cost of wasting natural resources such as oil, gas, timber, and minerals to the production process. This method is used in case of mines, quarries etc. containing only a certain quantity of product. The depreciation rate is calculated by dividing the cost of the asset by the estimated quantity of product likely to be available to be extracted. Annual depreciation will be the quantity extracted multiplied by the rate per unit.

Illustration 6

M/s Surya & Co. took lease of a quarry on 1-1-2017 for ₹ 1,00,00,000. As per technical estimate the total quantity of mineral deposit is 2,00,000 tonnes. Depreciation was charged on the basis of depletion method. Extraction pattern is given in the following table:

Year Quantity of Mineral extracted

2017 2,000 tonnes

2018 10,000 tonnes

2019 15,000 tonnes

Required

Show the Quarry Lease Account and Depreciation Account for each year from 2017 to 2019.

Solution

Quarry Lease Account

Date		Rs.	Date		Rs.
2017 Jan.	To Bank A/c	1,00,00,000	2017 Dec. 31	By Depreciation A/c [(2,000/2,00,000) × `1,00,00,000]	1,00,000
			Dec. 31	By Balance c/d	99,00,000
		1,00,00,000			1,00,00,000
2018 Jan.1	To Balance b/d	99,00,000	2018 Dec. 31	By Depreciation A/c	5,00,000
		99,00,000	Dec. 31	By Balance c/d	94,00,000
		94,00,000			99,00,000
2019 Jan.1	To Balance b/d	94,00,000	2019 Dec. 31	By Depreciation A/c	7,50,000
		94,00,000	Dec. 31	By Balance c/d	86,50,000
					94,00,000

Depreciation Account

		Rs.			Rs.
2017 Dec. 31	To Quarry lease A/c	1,00,000	2017 Dec. 31	By Profit & Loss A/c	1,00,000
		1,00,000			1,00,000
2018 Dec. 31	To Quarry lease A/c	5,00,000	2018 Dec. 31	By Profit & Loss A/c	5,00,000

2019 Dec. 31	To Quarry lease A/c	5,00,000	2019 Dec. 31	By Profit & Loss A/c	5,00,000
		7,50,000			7,50,000
		7,50,000			7,50,000

13.4. Profit or Loss on the Sale/Disposal of Property, Plant and Equipment

Whenever any depreciable asset is sold during the year, depreciation is charged on it for the period it has been used in the sale year. The written down value after charging such depreciation is used for calculating the profit or loss on the sale of that asset. The resulting profit or loss on sale of the asset is ultimately transferred to profit and loss account. Thus, all entries related to sale and profit or loss on sale of asset are posted in the respective asset account. Alternatively, a new account titled Asset disposal Account may also be opened in the ledger for the purpose of calculating profit or loss on sale of asset. In that case the book value of the asset will be transferred from the asset account to the asset disposal account and all entries related to sale like sale proceeds and calculation of profit or loss on sale will be posted in the Asset disposal account.

For example: The book value of the asset as on 1st January, 2019 is ` 50,00,000. Depreciation is charged on the asset @10%. On 1st July

2019, the asset is sold for ` 32,00,000. In such a situation, profit or loss on the sale will be calculated as follows:

	Rs.
Book value as on 1st Jan., 2019	50,00,000
Less: Depreciation for 6 months @10% (from 1st Jan., 2019 to 30th June, 2019)	(2,50,000)
Written down value as on 1st July, 2019	47,50,000
Less: Sale proceeds as on 1st July, 2019	(32,00,000)
Loss on sale of the asset	15,50,000

Illustration-7

A firm purchased on 1st January, 2018 certain machinery for ` 5,82,000 and spent ` 18,000 on its erection. On July 1, 2018 another machinery for ` 2,00,000 was acquired. On 1st July, 2019 the machinery purchased on 1st January, 2018 having become obsolete was auctioned for ` 3,86,000 and on the same date fresh machinery was purchased at a cost of ` 4,00,000.

Depreciation was provided for annually on 31st December at the rate of 10 per cent p.a. on written down value.

Required

Prepare machinery account.

Solution

Machinery Account

		`Rs.			`Rs.
2018			2018		
Jan. 1	To Bank A/c	5,82,000	Dec.31	By Depreciation A/c	70,000
Jan. 1	To Bank A/c – erection charges To Bank A/c	18,000		By Balance c/d	7,30,000
July 1		2,00,000			
		8,00,000			8,00,000
2019	To Balance b/d To Bank A/c	7,30,000	2019		
Jan. 1		4,00,000	July 1	By Depreciation on sold machine	27,000
July 1		11,30,000		By Bank A/c	3,86,000
				By Profit and Loss A/c	1,27,000
			Dec.31	By Depreciation A/c	39,000
				By Balance c/d	5,51,000
					11,30,000

Working Note:

Book Value of Machines

	Machine I Rs.	Machine II Rs.	Machine III Rs.
Cost	6,00,000	2,00,000	4,00,000
Depreciation for 2018	(60,000)	(10,000)	
Written down value	5,40,000	1,90,000	
Depreciation for 2019	(27,000)	(19,000)	(20,000)
Written down value	5,13,000	1,71,000	3,80,000
Sale Proceeds	(3,86,000)		
Loss on Sale	1,27,000		

Illustration-8

On April 1, 2018 Shubra Ltd. purchased a machinery for ` 12,00,000. On Oct 1, 2020, a part of the machinery purchased on April 1, 2018 for ` 80,000 was sold for ` 45,000 and a new machinery at a cost of ` 1,58,000 was purchased and installed on the same date. The company has adopted the method of providing 10% p.a. depreciation on the written down value of the machinery.

Required : Show the necessary ledger accounts for the years ended 31st March 2019 to 2021 assuming that (a) 'Provision for Depreciation Account' is not maintained (b) Provision for Depreciation Account is maintained.

Solution

(a) When 'Provision for Depreciation Account' is not maintained.

Dr. Machinery Account

Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
01.04.2018	To Bank A/c	12,00,000	31.03.2019	By Depreciation A/c	1,20,000
				By Balance c/d	10,80,000
		12,00,000			12,00,000
01.04.2019		10,80,000	31.03.2020	By Depreciation A/c	1,08,000
				By Balance c/d	9,72,000
		10,80,000			10,80,000
01.04.2020	To Balance b/d	9,72,000	01.10.2020	By bank A/c	45,000
01.10.2020	To Bank A/c	1,58,000		By Profit & Loss A/c	16,560
				By Depreciation A/c	3,240
			31.3.2020	By Depreciation A/c (7,900+ 90,720)	98,620
				ByBalance	9,66,580
		11,30,000			11,30,000

(b) When 'Provision for Depreciation Account' is maintained

Dr. Machinery Account (at original cost)

Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
01.04.2018	To Bank A/c	12,00,000	31.03.2019	By Balance c/d	12,00,000
01.04.2019	To Balance b/d	12,00,000	31.03.2020	By Balance c/d	12,00,000
01.04.2020	To Balance b/d	12,00,000	01.10.2020	By Machinery Disposal A/c	80,000
01.10.2020	To Bank A/c	1,58,000	31.03.2021	By Balance c/d	12,78,000
		13,58,000			13,58,000

Dr. Provision for Depreciation Account

Cr.

31.03.2019	To Balance c/d	1,20,000	31.03.2019	By Depreciation A/c	1,20,000
31.03.2020	To Balance c/d	2,28,000	1.04.2019	By Balance b/d	1,20,000
		2,28,000	31.03.2020	By Depreciation A/c	1,08,000
01.10.2020	To Machinery Disposal A/c	18,440	01.04.2020	By Balance b/d	2,28,000
31.03.2021	To Balance c/d	3,11,420	01.10.2020	By Depreciation A/c	3,240
		3,29,860	31.03.2021	By Depreciation A/c	98,620
					3,29,860

Dr.

Machinery Disposal Account

Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
01.10.2020	To Machinery Disposal A/c	80,000	01.10.2020	By Provision for Depreciation A/c	18,440
				By Bank A/c	45,000
				By Profit and Loss A/c	16,560
		80,000			80,000

Working Notes:

1. Calculation of Profit/Loss on Sale of Machinery

Particulars	Rs.
A. Original Cost	80,000
B. Less : Depreciation @ 10% WDV p.a. for 2 ½ years	18,440
C. Book Value as on date of Sale (A – B)	61,560
D. Less : Sale proceeds	45,000
E. Loss on Sale (C – D)	16,560

2. Calculation of Depreciation for Current Year on Machines (other than sold)

Particulars	Rs.
A. On Old Machines of ₹ 9,07,200 for 1 year (10% WDV)	90,720
B. On New Machine of ₹ 1,58,000 for ½ year	7,900
	98,620

Let Us Sum Up

In this unit, you have learned about the following:

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. Objectives for providing depreciation are: Correct income measurement by matching the charge for the year, True financial position statement by showing PP&E at their current value, Funds for replacement, Ascertainment of true cost of production.

Check Your Progress-2

- The main objective of depreciation is
 - To show the previous profit
 - To calculate net profit
 - To reduce tax
 - To satisfy the tax department
- Depreciation is generated due to
 - Increase in the value of liability
 - Decrease in capital
 - Wear and tear
 - Decrease in the value of assets
- What is the purpose of making a provision for depreciation in the accounts?
 - To charge the cost of fixed assets against profits
 - To show the current market value of fixed asset
 - To make cash available to replace fixed assets
 - To make a provision for repairs

Glossary

Depreciation: It is the systematic allocation of the depreciable amount of an asset over its useful life

Scrap value: It is the worth of a physical asset's individual components when the asset itself is deemed no longer usable

Rate:	The rate of depreciation
SLM:	Straight Line Method
WDV:	Written Down Value Method

Answers to Check Your Progress

- a-False
 - b-True
 - c-True
 - d-True
 - e-True
-

Answers to Check Your Progress

1. b) To calculate net profit
 2. c) Wear and tear
 3. a) To charge the cost of fixed assets against profits
-

Suggested Readings

1. Matulich, S. &Heitger, L.E.,2010- Financial Accounting (New York: McGraw Hill Book Company..
2. Mr Barry Elliott, Jamie Elliott,2017- Financial Accounting and Reporting- ,Pearson Publications.

Unit-14

Single Entry System

STRUCTURE

Overview

Objectives

14.1. Introduction

14.2. Types

14.3. Ascertainment of Profit by Capital Comparison

14.3.1. Methods of Capital Comparison

14.3.2. Difference between Statement of Affairs and Balance Sheet

14.3.3. Preparation of Statement of Affairs and Determination of Profit

14.4. Analysis of Sales Ledger and Purchase Ledger

Let Us Sum Up

Check Your Progress

Glossary

Answers to Check Your Progress

Suggested Readings

Overview

In this Unit, the concept of Single Entry System and its Types, Ascertainment of Profit by Capital Comparison, Methods of Capital Comparison, Difference Between Statement of Affairs and Balance Sheet, Preparation of Statement of Affairs and Determination of Profit, Analysis of Sales Ledger and Purchase Ledger has been clearly explained.

Objectives

After studying this Unit, you will be able to:

- Learn how to derive capitals at two different points of time through statement of affairs.
- Learn the technique of determining profit by comparing capital at two different points of time.
- Prepare trading and profit and loss account and balance sheet from Single Entry System.

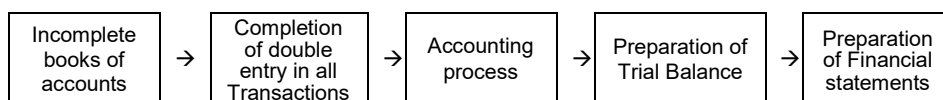
14.1. Introduction

Very often small sole proprietorship and partnership businesses do not maintain double entry bookkeeping system. They keep a record of the cash transactions and credit transactions only. But at the end of the accounting period, they will want to know the performance and financial position of their businesses. This creates some special problems to the accountants. This chapter discusses how to complete the accounts from available Single Entry System and addresses the problems faced in a single entry system.

The term “**Single Entry System**” is popularly used to describe the problems of accounts from Single Entry System. In practice, quack accountants follow some hybrid methods. For some transactions they complete double entries and for some others they complete just one aspect of the transaction. In fact, for some other transactions, they even do not pass any entry. Briefly, this may be stated as Single Entry System. The task of the accountant is to establish link among the available information and to finalize these accounts.

Features

- It is an inaccurate, unscientific and unsystematic method of recording business transactions.
- There is generally no record of real and nominal accounts and, in most of the cases; a record is kept for cash transactions and personal accounts.
- Cash book mixes up business and personal transactions of the owners.
- There is no uniformity in maintaining the records and the system may differ from firm to firm depending on the requirements and convenience of each firm.
- Profit under this system is only an estimate based on available information and therefore true and correct profits cannot be determined. The same is the case with the financial position in the absence of a proper balance sheet.



14.2. Types

A scrutiny of many procedures adopted in maintaining records under single entry system brings forth the existence of following three types:

- (i) **Pure single entry:** In this, only personal accounts are maintained with the result that no information is available in respect of cash and bank balances, sales and purchases, etc.

In view of its failure to provide even the basic information regarding cash etc., this method exists only on paper and has no practical application.

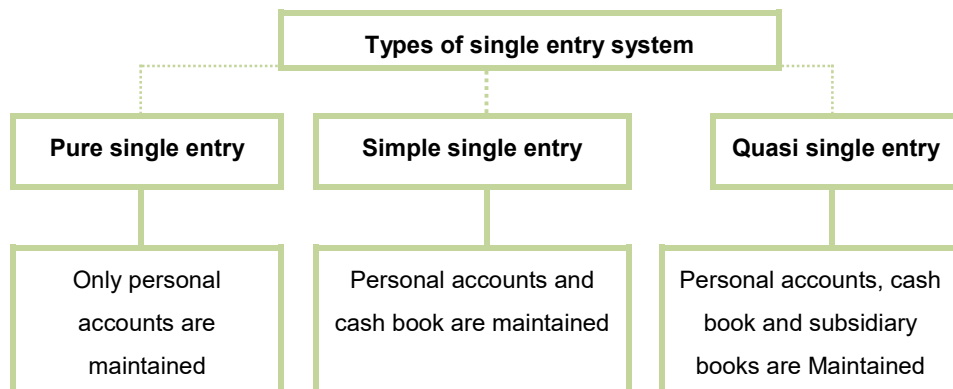
- (ii) **Simple single entry:** In this, only: (a) personal accounts, and (b) cash book are maintained. Although these accounts are kept on the basis of double entry system, postings from cash book are made only to personal account with no other account to be found in the ledger.

Cash received from debtors or cash paid to creditors is simply noted on the bills issued or received as the case may be.

- (iii) **Quasi single entry:** In this: (a) personal accounts, (b) cash book, and (c) some subsidiary books are maintained. The main subsidiary books kept under this system are Sales book, Purchases book and Bills book.

No separate record is maintained for discounts, which are entered into the personal accounts. In addition, some scattered information is also available in respect of few important items of expenses like wages, rent, rates, etc.

In fact, this is the method which is generally adopted as a substitute for double entry system.



Check Your Progress-1

True/False

- a. The term "Single Entry System" is popularly used to describe the problems of accounts from Single Entry System.
- b. In a Simple single entry only personal accounts, and cash book are maintained.
- c. Very often small sole proprietorship and partnership businesses do not maintain double entry bookkeeping system.
- d. Instead by collecting information about assets and liabilities, it is easier to prepare balance sheet at five different points of time.
- e. Closing capital increases if there is profit, while it reduces if there is loss incurred during the year.

14.3. Ascertainment of Profit by Capital Comparison

This method is also known as **Net Worth method** or **Statement of Affairs Method**.

Closing Capital

If detailed information regarding revenue and expenses is not known, it becomes difficult to prepare profit and loss account. Instead by collecting information about assets and liabilities, it is easier to prepare balance sheet at two different points of time. So, while preparing accounts from Single Entry System, if sufficient information is not available, it is better to follow the method of capital comparison to arrive at the profit/loss for the current year.

14.3.1. Methods of Capital Comparison

Closing capital increases if there is profit, while it reduces if there is loss incurred during the year. However, if the proprietor/partners make fresh investments in the business, capital increases; and any withdrawal made by them, decreases the capital. The following points shall be considered while computing the profit/loss under capital comparison method-

Particulars

Capital at the end (a)....

Add: Drawings....

Less: Fresh capital introduced.....

Capital at the beginning (b).....

Profit (a-b).....

Alternatively

Profit/Loss can also be ascertained as balancing figure by preparing capital account as follows:

Particulars	Rs.	Particulars	Rs.
		By Balance b/d	XX
To drawings	XX	By additional capital	XX
To Net Loss (Bal Fig)	XX	By Net Profit (Bal Fig)	XX
To Balance c/d	XX		
	XX		XX

It is clear from the above discussion that to follow the capital comparison method, one should know the opening capital and closing capital. This should be determined by preparing statement of affairs at the two respective points of time. Capital = Assets(-) liabilities.

Thus, the preparation of statement of affairs will require listing up of assets and liabilities and their amount. The accountant utilizes the following sources for the purpose of finding out the assets and liabilities of a business enterprise:

- (i) Cash book for cash balance
- (ii) Bank pass book for bank balance
- (iii) Personal ledger for debtors and creditors
- (iv) Inventory by actual counting and valuation.
- (v) As regards fixed assets, he prepares a list of them.

The proprietor would help him by disclosing the original cost and date of purchase. After deducting reasonable amount of depreciation, the written down value would be included in the Statement of Affairs.

After obtaining all necessary information about assets and liabilities, the next task of the accountant is to prepare statement of affairs at two different points in time.

The design of the statement of affairs is just like balance sheet as given below:

Statement of affairs as on.....

Liabilities		Assets	
Capital (Bal. Fig.)	xx	Building	Xx
Loans, Bank overdraft	xx	Machinery	Xx
Sundry creditors	xx	Furniture	Xx
Bills payable	xx	Inventory	Xx
Outstanding expenses		Sundry debtors	Xx
		Bills receivable	Xx
		Loans and advances	Xx
		Cash and bank	Xx
		Prepaid expenses	Xx
	xx		Xx

Now from the statement of affairs prepared at two different dates, the opening and closing capital balances can be obtained

14.3.2 Difference between Statement of Affairs and Balance Sheet

Basis	Statement of affairs	Balance sheet
Source	It is prepared on the basis of transactions partly recorded under the double entry book keeping and partly under the single entry. Most of the assets are recorded based on the estimates, assumptions, information gathered from memory rather from the records.	It is based on transactions recorded strictly on the basis of double entry bookkeeping; each item in the balance sheet can be verified from the relevant subsidiary books, ledger and documentary evidences.
Capital	In this statement, capital is merely a balancing figure being excess of assets over liabilities. Hence assets need not be equal to liabilities.	Capital is derived from the capital account in the ledger and therefore the total of assets side will always be equal to the total of liabilities side.

Omission	Since this statement is prepared from Single Entry System, it is very difficult, to identify and record those assets and liabilities, if omitted from the books.	There is no possibility of omission of any item of asset and liability since all items are properly recorded. Moreover, it is easy to locate the missing items since the balance sheet will not agree.
Basis of Valuation	The valuation of assets is generally done in an arbitrary manner; therefore no method of valuation is disclosed.	The valuation of assets is done on scientific basis, fixed assets are shown at the original costs less depreciation till date.. Any change in the method of valuation is properly disclosed.
Objective	The objective of preparing this statement is to identify the capital figures in the beginning and at the end of the accounting period respectively.	The objective of preparing the balance sheet is to ascertain the financial position on a particular date.

14.3.3. Preparation of Statement of Affairs and Determination of Profit

It has been discussed in Para 3.1 that figures of assets and liabilities should be collected for preparation of statement of affairs. Given below an example:

Illustration 1

Assets and Liabilities of Mr. X as on 31-03-20X1 and 31-03-20X2 are as follows:

Particulars	31-03-20X1	31-03-20X2
Assets		
Building	1,00,000	?
Furniture	50,000	?
Inventory	1,20,000	2,70,000
Sundry debtors	40,000	90,000
Cash at bank	70,000	85,000
Cash in hand	1,200	3,200
Liabilities		
Loans	1,00,000	80,000
Sundry creditors	40,000	70,000

Decided to depreciate building by 2.5%p.a. and furniture by 10% p.a. One Life Insurance Policy of the Proprietor was matured during the period and the amount ` 40,000 is retained in the business. Proprietor took @ ` 2,000 p.m. for meeting family expenses.

Prepare Statement of Affairs as on 31-03-20X1 and 31-03-20X2.

Solution

Mr. X

Statement of Affairs

as on 31-03-20X1 & 31-03-20X2

Liabilities	31-03-20X1	31-03-20X2	Assets	31-03-20X1	31-03-20X2
Capital	2,41,200	4,40,700	Building	1,00,000	97,500
			Furniture	50,000	45,000
Loans	1,00,000	80,000	Inventory	1,20,000	2,70,000
Sundry creditors	40,000	70,000	Sundry debtors	40,000	90,000
			Cash at bank	70,000	85,000
			Cash in hand	1,200	3,200
	3,81,200	5,90,700		3,81,200	5,90,700

Illustration 2

Take figures given in Illustration 1. Find out profit of Mr. X for the year ended 31-03-20X2.

Solution

Determination of Profit by applying the method of the capital comparison

Particulars	Rs.
Capital Balance as on 31-03-20X2	4,40,700
Less: Fresh capital introduced	(40,000)
	4,00,700
Add: Drawings ($\text{₹ } 2000 \times 12$)	24,000
	4,24,700
Less: Capital Balance as on 31-03-20X1	(2,41,200)
Profit	1,83,500

Note:

- Closing capital is increased due to fresh capital introduction, so it is deducted.
- Closing capital was reduced due to withdrawal by proprietor; so it is added back.

ALTERNATIVELY

Capital account can be prepared as follows:

Particulars	Rs.	Particulars	Rs.
To drawings	24,000	By Balance b/d	2,41,200
		By additional capital	40,000
To Balance c/d	4,40,700	By Net Profit (Bal Fig)	1,83,500
	4,64,700		4,64,700

14.4. Analysis of Sales Ledger and Purchase Ledger

Sales Ledger: It would disclose information pertaining to the opening balances of debtors, transactions made with them during the year such as goods sold to them on credit, bills receivable drawn on them, bills dishonored, if any; cash received from them, sales returns, discount, rebate or any other concession allowed to them, receipts of bills receivable, bad debts written off and transfers. Journal entries must be made by debiting or crediting the impersonal accounts concerned with contra credit or debit given to total debtors account.

Analysis of Sales Ledger of the year

Op. Customer Balance	Sales	Bills Disho- nored	Total Debits	Cash Recd.	Dis- counts Allow.	Bills Recd.	Sales Returns	Bad Debts	Total Credit	Balance (cl.)
----------------------------	-------	--------------------------	-----------------	---------------	--------------------------	----------------	------------------	--------------	-----------------	------------------

From the aforementioned, it will be possible to build up information about sales and other accounts which can then be posted in totals, if so desired. It would also be possible to prepare Total Debtors

Account in the following form:

Proforma of Total Debtors Account (assumed figures)

Particulars	Rs.	Particulars	Rs.
To Opening balance	5,000	By Cash/Bank	10,000
To Sales	38,000	By Discount	500
To Bills dishonoured	280	By Bills receivable	20,000
To Interest	100	By Bad debts	280
		By Closing balance	12,600
	43,380		43,380

It can be seen from the above format that, if any one figure is not given it can be found out easily as the balancing figure. It can be opening balance, credit sales, cash collected or closing balance etc. For instance, if the information about sales is not available it could be ascertained as the balancing figure, *i.e.*, in the total Debtors Account given above, if all other figures are given, amount of sales on credit basis can be easily ascertained.

Purchases Ledger: Generally speaking, a Purchases Ledger is not as commonly maintained as the Debtors Ledger for it being convenient to make entries in respect of outstanding liabilities at the time they are paid rather than when they are incurred. The information is available in respect of opening balance of the creditors, goods purchased on credit, bills payable accepted, bills payable dishonored; cash paid to the creditors during the year, discount and other concessions obtained, returns outwards and transfers. Here also, journal entries must be made by debiting or crediting the respective impersonal accounts. Contra credit or debit being given to total creditor's account.

From the available information total creditors account can be prepared as follows

Proforma of Total Creditors Account (assumed figures)

	<i>Rs.</i>		<i>Rs.</i>
To Cash/bank	25,000	By Opening Balance	10,000
To Purchase Returns	400	By Purchases	30400
To Bills Payable	8,700	By Bill payable dishonoured	450
To discount received	100		
To Closing Balance	6,650		
	40,850		40,850

If a proper record of return to creditors, discount allowed by them etc., has not been kept, it may not be possible to write up the Total Creditors A/c. In such a case, net credit purchase can be ascertained as follows:

Cash paid to Creditors including on account of bills

payable during the period.....

Closing balance of Creditors and Bills Payable.....

Total _____

Less: Opening balance of Creditors and Bills Payable.....

Net credit purchase during the period

Alternatively

Cash paid to creditors during the period

Add: Bills Payable issued to them.....

Total _____

Closing balance of Creditors

Less: Opening balance of creditors.....

Credit Purchases during the period.....

Nominal Accounts: It is quite likely that the total expenditure shown by balance of nominal account may contain items of expenditure which do not relate to the year for which accounts are being prepared and, also, there may exist certain items of expenditure incurred but not paid, which have not been included therein. On that account, each and every account should be adjusted in the manner shown below (figures assumed):

	<i>Cash and Particulars</i>	<i>Amount Bank Payment</i>	<i>Paid out of Accrued</i>	<i>Total Private Fund</i>	<i>Pre Payment</i>	<i>Expenses for the period</i>
<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5 (2+3+4)</i>	<i>6</i>	<i>7 (5-6)</i>
	,	,	,	,	,	,
Rent & Rates	2,200	300	100	2,600	150	2,450
Salaries	4,500	500	1,000	6,000	250	5,750

Only the amount entered as “expenses for the period” should be posted to the respective nominal accounts. A similar adjustment of nominal accounts in respect of revenue receipt should be made.

Let us continue with the example given in para 4.2. Given some other information, how to compute credit purchase and credit sale is discussed below:

Opening balance (1-4-20X1)	,
Inventory	20,000
Sundry creditors	12,300
Sundry debtors	15,000
Closing Balance (31-03-20X2)	
Inventory	15,000
Sundry creditors	13,800
Sundry debtors Cash paid to creditors	25,600
Cash received from debtors Cash sales	26,370
Cash purchases	45,600
	8,340
	3,000
Discount received during the year	1,130
Discount allowed	1,870

What are the purchases for 20X1-20X2? Let us prepare the Sundry Creditors Account.

Sundry Creditors Account

	₹		₹
To Cash	26,370	By Balance b/d	12,300
To Discount (received)	1,130	(opening)	
To Balance c/d (closing)	13,800	By Purchases	29,000
		(balancing figure)	
	41,300		41,300

The credit purchases are ₹ 29,000; cash purchases are ₹ 3,000: hence total purchases are ₹ 32,000.

Likewise prepare the Sundry Debtors Account:

Sundry Debtors Account

	₹		₹
To Balance b/d	15,000	By Cash	45,600
To Credit sales (balancing figure)	58,070	By Discount (allowed)	1,870
		By Balance c/d	25,600
	73,070		73,070

So total sales = credit sales + cash sales = ₹ 58,070 + ₹ 8,340 = ₹ 66,410

Let Us Sum Up

In this Unit, you have learned the following:

Single entry system is generally found in sole trading concerns or even in partnership firms to some extent but never in case of limited liability companies on account of legal requirements. There are basically 3 types of single entry systems: Pure Single Entry + Simple Single Entry + Quasi Single Entry

Check Your Progress-2

1. _____ system of book keeping is the only scientific method to record framing transaction.
 - a) Single Entry
 - b) Double Entry
 - c) Balance Sheet
 - d) Adjustment A/c

2. In single entry system its difficult to detect
- a) Account
 - b) Fraud
 - c) Profit
 - d) Gross Profit
3. Single entry constitutes incomplete records rather than single entry
- a) Credit
 - b) Profit
 - c) Accounting
 - d) Net Profit

Glossary

Single entry system:	A system of Accounting used by small scale sole proprietorship concerns
Pure single entry system:	It records all the personal accounts like sundry debtors and sundry creditors.
Simple single entry system:	Under this system, a cash book is prepared that shows the payment and receipts of the cash transactions.
Quasi Single Entry System:	Under this method, Personal Accounts, Cash Book and some Subsidiary book are maintained.

Answers to Check Your Progress-1

- a-True
- b-True
- c-True
- d-False
- e-True

Answers to Check Your Progress-2

1. b) Double Entry
2. b) Fraud
3. c) Accounting

Suggested Readings

1. Mr Barry Elliott, Jamie Elliott,2017- Financial Accounting and Reporting- ,Pearson Publications.
2. Paul V.A. &Korlahalli, J.S.,2018- Principle and Practice of Accountancy. New Delhi : S. Chand & Co., 2018

Unit-15

Self-Balancing Ledgers

STRUCTURE

Overview

Objectives

15.1. Introduction

15.2. Advantages of Self-Balancing System.

Let Us Sum Up

Check Your Progress

Glossary

Answers to Check Your Progress

Suggested Readings

Overview

In this Unit the concept of Self-Balancing ledgers and its Advantages of Self-Balancing System has been clearly explained.

Objectives

After studying this unit, you should be able to:

- Understand the Self Balancing Ledger System
- Form the General Ledger Adjustment Account
- Understand their advantages

15.1. Introduction

Under Self Balancing Ledger system each ledger is prepared under double entry system and a complete trial balance can also be prepared by taking up the balances of ledger accounts. Within the ledger itself principles of double entry is completed. Under this method three ledger accounts are prepared, viz, General Ledger Adjustment Account which is maintained under Debtors Ledger and Creditors Ledger and Debtors or Sales Ledger Adjustment Account and Creditors or Purchase Ledger Adjustments Accounts which are maintained under General Ledger.

The use of these ledgers are: Debtors Ledger: It is also known as Sold Ledger or Sales Ledger which is maintained for recording personal accounts of trade debtors. If this ledger is maintained customers account

(i.e., to whom we sell goods on credit) are taken out from the general ledger and the same is maintained in this ledger. In short, this ledger deals with account relating to trade debtors. Creditors Ledger: It is also known as Bought Ledger or Purchase Ledger which is prepared for recording personal accounts of trade creditors. By preparing this ledger creditors account (i.e., from whom we purchase goods on credit) are taken out from the general ledger and the same is maintained in this ledger. In short, this ledger deals with accounts relating to trade creditors.

General or Nominal Ledger: Needless to say that in this ledger all real accounts, nominal accounts and remaining personal accounts are opened for example: Personal Account: Drawings, Capital, Bank, Outstanding Salary etc. Real Account: Plant & Machinery, Land & Building, B/R, Stock, etc. Nominal Account: Salaries, Rent, Insurance, Carriage etc. Preparation of Trial Balance By taking up the balances from all the three ledgers a trial balance can be prepared. We cannot prepare a trial balance from any single ledger. e.g., a trial balance cannot be prepared by taking up only the balances from debtor's ledger as it has no credit balance and so also in case of creditor's ledger as it has no debit balance. Moreover, In case of errors it becomes very difficult to locate and detect such error or errors if the trial balance is prepare by taking up either from debtors ledger only or from creditors ledger only and at the same time trial balance will not agree. Thus, the system under which each ledger is made to balance is called self-balancing system. It must be remembered that the ledger which does not balance scrutiny of the same is practically very limited.

15.2. Advantages of Self-Balancing System.

The advantages of Self-Balancing system are:

- (a) If ledgers are maintained under self-balancing system it becomes very easy to locate errors.
- (b) This system helps to prepare interim account and draft final accounts as a complete trial balance can be prepared before the abstraction of individual personal ledger balances.
- (c) Various works can be done quickly as this system provides sub-division of work among the different employees.
- (d) This system is particularly useful, where there are a large number of customers or suppliers and (ii) where it is desired to prepare periodical accounts.

- (e) Committing fraud is minimized as different ledgers are prepared by different clerks.
- (f) Internal check system can be strengthened as it becomes possible to check the accuracy of each ledger independently

	Transaction	Usual Entry	Self-Balancing Entry
1.	For Credit Sales	Individual Customer A/c Dr. To. Sales A/c (in General Ledger)	Debtors Ledger Adjustment A/c Dr. (in General Ledger) To, General Ledger Adjustment A/c (in Debtors Ledger)
2.	For Cash/Cheque received from customers	Cash A/c Dr. (in General Ledger) To. Individual Customer A/c (in Debtors Ledger)	General Ledger Adjustment A/c Dr. (in Debtors Ledger) Debtors Ledger Adjustment A/c Dr. (in General Ledger)
3.	For Discount Allowed or allowance to customers	Discount Allowed A/c Dr. Or, Allowances A/c Dr. (in General Ledger) To. Individual Customer A/c (in Debtors Ledger)	Do
4.	For Bad Debts	Bad Debts A/c Dr. (in General Ledger) To. Individual Customer A/c (in Debtors Ledger)	Do
5.	For Bills Receivable received from customers	Bill Receivable A/c Dr. (in General Ledger) To. Individual Customer A/c (in Debtors Ledger)	Do
6.	For Returns Inward	Returns inward A/c Dr. (in General Ledger) To. Individual Customer A/c (in Debtors Ledger)	DO
7.	For Bills / Cheque received /Dishonoured	Individual Customer A/c Dr. (in Debtors Ledger) To Bills Receivable / Bank, A/c (in General Ledger)	Debtors Ledger Adjustment A/c Dr. (in General Ledger) To, General Ledger Adjustment A/c (in Debtors Ledger)
1.	For interest on Customer's overdue Account or cost of carriage charged to customers	Individual Customer A/c Dr. (in Debtors Ledger) To, Interest / Charges A/c (in General Ledger)	

Illustration 1

Stock (1.1.2013):		
Dept. A	5,400	
Dept. B	4,900	
Purchases:		
Dept. A	9,800	
Dept. B	7,350	
Sales:		
Dept. A		16,900
Dept. B		13,520
Wages:		
Dept. A	1,340	
Dept. B	240	
Rent	1,870	
Salaries	1,320	
Lighting and Heating	420	
Discount Allowed	441	
Discount Received		133
Advertising	738	
Carriage Inward	469	
Furniture and Fittings	600	
Plant and Machinery	4,200	
Sundry Debtors	1,820	
Sundry Creditors		3,737
Capital		9,530
Drawings	900	
Cash in hand	32	
Cash at Bank	1,980	
	43,820	43,820

The following information is also provided:

Rent and Lighting and Heating are to be allocated between Factory and Office in the ratio of 3:2.

Rent, Lighting and Heating, Salaries and Depreciation are to be apportioned to A and B Depts. as 2:1.

Other expenses and incomes are to be apportioned to A and B Depts. on suitable basis.

The following adjustments are to be made:

Rent Prepaid ₹370; Lighting and Heating outstanding ₹180; Depreciation of Furniture and Fittings @ 10% p.a. and

Plant and Machinery @ 10% p.a.

The Stock at 31.12.2012: Dept. A ₹2,748; Dept. B ₹2,401

Solution:

In the books of Sri S. Malty Departmental Trading and Profit & Loss Account for the year ended 31.12.2013

Particulars	Dept. A Rs.	Dept. B Rs.	Total Rs.	Particulars	Dept. A Rs.	Dept. B Rs.	Total Rs.
To Opening Stock	5,400	4,900	10,300	By Sales	16,900	13,520	30,420
“ Purchase	9,800	7,350	17,150	“ Closing Stock	2,748	2,401	5,149
“ Wages	1,340	240	1,580				
“ Carriage Inwards (4:3)	268	201	469 ¹				
“ Rent	600	300	900 ⁶				
“ Lighting and Heating	240	120	360 ²				
“ Gross Profit C/d	2,000	2,810	4,810				
	19,648	15,921	35,569		19,648	15,921	35,569
To Rent	400	200	600 ⁶	By Gross Profit b/d	2,000	2,810	4,810
“ Advertisement	410	328	738 ⁴				
“ Salaries (2:1)	880	440	1,320 ⁵	“ Dis. Received (4:3)	76	57	133 ⁷
“ Lighting and Heating	160	80	240 ²	“ Net Loss	339	---	---
“ Discount Allowed (on Sales)	245	196	441 ³				
“ Dep. On (2:1) Plant & Machinery	280	140	420				
Furniture & Fixture	40	20	60				
“ Net Profit	---	1,463	1,124				
	2,415	2,867	4,943		2,415	2,867	4,943

Balance Sheet as at 31.12.2013

Liabilities	Amount Rs.	Amount Rs.	Assets	Amount Rs.	Amount Rs.
Capital	9,530		Plant and Machinery	4,200	
Add: Net Profit	<u>1,124</u>		Less: Depreciation	<u>420</u>	3,780
	10,654		Furniture and Fittings	600	
Less: Drawings	<u>900</u>	9,754	Less: Depreciation	<u>60</u>	540
Sundry Creditors		3,737	Closing Stock:		
Outstanding Liabilities:					

Lighting and Heating		180	Dept. A	2,748	
			Dept. B	2,401	5,149
			Sundry Debtors		1,820
			Prepaid Rent		370
			Cash at Bank		1,980
			Cash in Hand		32
		13,671			13,671

Workings:

Allocation of Expenses and incomes

Sl.No.	Expense / Income	Basis	Dept.A	Dept.B
1	Carriage Inward	Purchase(4:3)	= Rs.469 x 4/7 = 268	= Rs. 469 x 3/7 =201
2	Lighting & Heating (Rs. 420 +180) Factory part = 600 x 3/5 = Office part = 600 x 2/5 =	Rs. 600 (Given) 360 240	= Rs.360 x 2/7 = 268 = Rs.240 x 2/3= 160	= Rs.360 x 1/3 = 120 = Rs.240 x 1/3= 80
3	Discount Allowed	= Sales	= Rs. 441x (16900/30420) = 245	=Rs. 441 x (13520/30420) = 196
4	Advertisement	= Sales	= Rs. 738 x (16900/30420) = 410	=Rs. 738 x (13520/30420) = 328
5	Salaries	2:1	= Rs. 1,320 x (2/3) = 880	= Rs. 1,320 x (1/3) = 440
6	Rent Rs. 1,500 = (Rs. 1,870 – Rs. 370) Factory part = 1,500 x 3/5 = 900 Office part = 1,500 x 2/5 = 600	2:1 2:1	= Rs.900 x (2/3) = Rs. 600 = Rs.600 x (2/3) = Rs. 400	= Rs.900 x (1/3) = Rs. 300 = Rs.600 x (1/3) = Rs. 200
	Discount Received	Purchase (4:3)	= Rs.133 x (4/7) = Rs. 76	= Rs.133 x (3/7) = Rs. 57

Let Sum Up

In this Unit, you have learned the following:

Under Self Balancing Ledger system each ledger is prepared under double entry system and a complete trial balance can also be prepared by taking up the balances of ledger accounts. General Ledger Adjustment Account which is maintained under Debtors Ledger and Creditors Ledger and Debtors or Sales Ledger Adjustment Account and Creditors or Purchase Ledger Adjustments Accounts which are maintained under General Ledger

Check Your Progress

1. In self Balancing ledger system, generally _____ ledger are prepared
 - a) Nine
 - b) Seven
 - c) Three
 - d) Five
2. What is Debtors Ledger?

Glossary

Self Balancing Ledger:	It is one whose balances, when extracted, form a complete trial balance
Debtors Ledger:	This ledger should contain the accounts only trade debtors (customers).
Creditors Ledger:	This ledger should contain the accounts only trade creditors (suppliers)
General Ledger:	This ledger should contain all the remaining accounts i.e other than trade debtors and trade creditors

Answers to Check Your Progress

1. c) Three
2. It is also known as Sold Ledger or Sales Ledger which is maintained for recording personal accounts of trade debtors. If this ledger is maintained customers account (i.e., to whom we sell goods on credit) are taken out from the general ledger and the same is maintained in this ledger

Suggested Readings

1. Maheshwari, S.N., 2018, Principles and Practice of Book-Keeping (New Delhi: Arya Book Publications).
2. Matulich, S. &Heitger, L.E.,2010- Financial Accounting (New York: McGraw Hill Book Company).

Model End Semester Examination Question Paper

**Bachelor of Commerce (B.Com)/Bachelor of Business
Administration (BBA)**

Course Code: DCBBA-12/ Course Title: Business Management

Max. Marks: 70

Time: 3 hours

PART – A (5x2 =10 Marks)

Answer any FIVE questions out of EIGHT questions
[All questions carry equal marks]

- (1). Define Financial Accounting.
- (2). What do you mean by Double entry system?
- (3). What do you mean by three column cash book?
- (4). What is common errors?
- (5). What is Provision for bad debts?
- (6). What is Balance Sheet?
- (7). Define Bank Reconciliation Statement.
- (8). What is Annuity method of depreciation?

PART – B (4X5=20 Marks)

Answer any FOUR questions out of SEVEN questions
[All questions carry equal marks]

- (9). The following Trial Balance has been prepare wrongly you are asked to prepare the TrialBalance correctly.

Name of the Account	Debit	Credit
Cash in hand		2,000
Purchase returns	4,000	
Wages	8,000	
Establishment expenses	12,000	
Sales returns		8,000
Capital	22,000	
Carriage outwards		2,000
Discount received	1,200	
Commission earned	800	
Machinery		20,000
Stock		10,000
Debtors	8,000	
Creditors		12,000
Sales		44,000
Purchase	28,000	
Bank over draft	14,000	
Manufacturing expenses		14,000
Loan from akash	14,000	
Carriage inwards	1,000	
Interest on investment		1,000

(10). Prepare Two Column Cash Book from November 2000.

S.No	Particulars	Amount
1	Cash in hand	390
5	Sold goods for cash	6,420
6	Credit purchase from Varun	4,350
10	Received from Mohan	4,240
	Discount allowed to him	40
14	Paid for electricity charges	250
16	Bought stationary	336
19	Drew from bank for office use	2,800
24	Paid for Varun Rs. 4,300/- in full settlement	
29	Received cash from Velavan	770
	Discount allowed to him	30
30	Paid salaries	2,000

(11). From the following Trial Balance of Ram, Prepare Trading Profit & loss and Balance sheet for the year ended 31st December 1993.

Particulars	Debit	Credit
Capital		40,000
Sales		25,000
Purchase	15,000	
Salaries	2,000	
Rent	1,500	
Insurance	300	
Drawings	5,000	
Machinery	28,000	
Bank balance	4,500	
Cash	2,000	
Stock 1-1-1993	5,200	
Debtors	2,500	
Creditors		1,000

Adjustments:

Stock on 31-12-1993	4,900
Salaries Unpaid	300
Rent paid in advance	200
Insurance prepaid	90

(12). What are the scope and uses of Final Accounts?

(13). Prepare a bank reconciliation statement from the following on 28th Feb, 2009. Cashbook showed a bank balance Rs.11000.

(i).A cheque issued but not presented for payment Rs.900/-

(ii).A post-dated cheque if Rs.1000 has be debited in the bank column of the cash book but it was notpossible to present.

(iii).Three cheque of Rs.1500 sent for collection but not cleared so far by the bank

(iv).A cheque for rs.500 deposited in the bank has been dishonored.

(v).Trade subscription directly paid by the bank Rs.200

(vi).The bank debit for Rs.100 in respect of bank charges and credit Rs.200 for dividend collected bythe bank.

(14).A company whose accounting year is the calendar year purchased on 1st April 2006 machinery costing Rs. 30,000/-. It purchased further machinery on 1st October 2006 costing Rs. 20,000/- andon 1st July 2007 costing Rs.10,000/-. On 1st Jan. 2008 one-third of the machinery installed on 1st April 2006 became obsolete and was sold for Rs. 3,000/-. Show how the machinery A/c would appear in the books of the company. Machinery is depreciated at 10% p.a. under fixed instalment method.

Mohan maintains books on Single Entry System. He gives you the followinginformation:

Capital on 1st April, 2017	Rs.15,200/-
Capital on 31st March, 2018	Rs.16,900/-
Drawings made during the year	Rs.4,800/-
Capital introduced on 1st August, 2017	Rs.2,000/-

(15).You are required to calculate the Profit or Loss made by Mohan.

PART - C (10 Marks) 4X10= 40 Marks
 Answer any FOUR questions out of SEVEN questions
 [All questions carry equal marks]

(16). Journalize the following transactions, post them in the ledger and balance the accounts on 31st Jan 1999.

Jan. 1	Lakshmi started business with a Capital of	50,000	
2	She purchased goods from Mala on credit	10,000	
5	She paid cash to Mala	5,000	
7	She sold goods to Shanthi		10,000
10	She received cash from Shanthi		8,000
15	She further purchased goods from Mala		12,000
20	She paid cash to Mala	4,000	
25	She further sold goods to Shanthi		13,000
30	She received cash from Shanthi		3,000

(17). Prepare a three Column Cash Book from the following

2000 Mar 1	Cash in hand	90,000
	Cash at bank	
3	Cash sales deposited in bank	3
4	Amount deposited by a customer directly in Bank	4
5	Sold goods to Rakesh on credit	5
6	Deposited cash for opening a fixed deposit account	6
7	Received a cheque from Jagan	7
	Discount allowed	
	The cheque was sent to bank for collection	
9	Paid to Vivek by cheque	9
12	Goods returned by Rakesh	1,500
13	Interest allowed by Bank	3,000
14	Cheque received from Jagan is dishonoured	
	Bank charges Rs.10/- for dishonour of the cheque.	
15	A bill received for Rs.15,000/- discount in Bank at 10%	
17	Received a cheque from Rakesh for Rs.7,000/- in full and final settlement	
19	Withdrew from Bank for paying medical expenses of the owner	3,000
20	Rakesh's cheque deposited in bank	
22	Purchased building and payment made by cheque	1,00,000
24	Bad debts recovered	1,000
31	An insolvent debtor pays 40% of Rs.5,000/- due from him.	

(18). From the following balances extracted from the books of Arun Prepare Trading and Profit & Loss and Balance sheet for the year ended 31-12-2009.

Particulars	Amount	Particulars	Amount
Capital	50,000	Land	13,500
Cash in hand	2,000	Sales	1,25,000
Cash at bank	500	Carriage inwards	800
Building	30,000	Fuel	2,200
Wages	15,000	Creditors	12,200
Salaries	10,000	Debtors	15,000
Rent	1,800	Purchase returns	2,000
Printing and stationary	1,200	Sales returns	1,500
Stock 1-4-2008	8,000	Bills receivable	4,000
Purchase	70,000	Discount received	400
Insurance	800	Discount allowed	1,500
Machinery	12,000	Furniture	3,000
Drawings	5,000	Travelling expenses	1,800
Closing stock	10,000	Loan	10,000

Adjustments:

- (i).Insurance prepaid –Rs.200/-
- (ii).Depreciation on machinery 10%, furniture 5%,
- (iii).Interest on capital 3%
- (iv).Outstanding wages Rs.800/-, outstanding salaries – 600
- (v).Write off bad debts Rs.1,000/-
- (vi).Create 3% reserve on debtors for doubtful debts

(19). Prepare Bank Reconciliation Statement as on 31st January 2011 from the following details.

- (a).Cash Book shows debit balance of Rs.5000/- as on 31st January, 2011.
- (b).Out of cheques of Rs. 8,000/- issued, cheques of Rs.4,000/- has not been presented for payment till 31st January, 2011.
- (c).Bank commission Rs. 75/- debited in the Pass Book only.
- (d).Transferred Rs. 2,000/- from Fixed deposit account to Current account, but not recorded.
- (e).A cheque of Rs. 4,500/- deposited into Bank but not cleared by Bank.
- (f).Dividend collected by Bank, though recorded in the Pass Book, failed to be recorded in the Cash Book Rs. 650/-.

(20). On 1st January, 2006, A Ltd. Purchased a machine for Rs.2,50,000/- and spent Rs.10,000/- on its erection. On 1st July, 2006 an additional machinery costing Rs.1,00,000/- was purchased. On 1st July, 2008 the machine purchased on 1st January, 2006 was sold for Rs.1,45,000/- and on the same date, a new machine was purchased at a cost of Rs.2,00,000/-.

Show the Machinery Account for the first three calendar years after charging depreciation at 5% by the Straight Line Method.

(21). Explain about the Importance and Limitations of single entry system.

(22). From the following information calculate total sales

Debtors opening	1,50,000
Bills receivable opening	20,000
Bills receivable encashed	2,00,000
Cash received from debtors	2,00,000
Return inwards	12,000
Bad debts	5,000
Bills receivable dishonoured	10,000
Bills receivable closing	60,000
Debtors	2,50,000
Cash sales	3,50,000

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