B.COM. PART I
(SEMESTER-I)

B.C. 103
FINANCIAL ACCOUNTING

UNIT NO. 1

BOTH MEDIUM

Department of Distance Education
Punjabi University, Patiala

LESSON NO.

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B.COM. PART-I **B.C. 103**

FINANCIAL ACCOUNTING

LESSON NO. 1.1 **AUTHOR : MRS. DALBIR KAUR**

INTRODUCTION TO ACCOUNTING

Structure of the Lesson:

1.1.0 OBJECTIVES

The main purpose of this lesson is to introduce the students with the accounting system, which is required to ascertain profit or loss during a specified period, to show financial condition of the business on the particular date and to have control over the firm's property. So this lesson covers concept, objectives, functions, importance and limitations of Accounting system.

1.1.1. INTRODUCTION

Accounting is as old as money itself. In the early stages of civilisation, the number of transactions to be recorded were small that each businessman was able to record and check for himself the recorded transactions. However the modern system of accounting based on Principles of Double Entry owes its origin to Luco Pacioli with the increase in size of business. The complexities of business have increased the

importance of accounting as the ownership and management have gone into two different hands. Now, accounting is required by management, shareholders, investors, bankers, creditors, government departments and many other authorities.

1.1.2. BOOK KEEPING

In the words of Carter, "Book Keeping is the science and art of correctly recording in books of accounts all those transactions that result in the transfer of money or money's worth."

Book-keeping is thus art and science of recording, classifying and summarizing business transactions in money or money's worth accurately and systematically so that the business may be able to know his profit or loss during a specified period and also his financial position on a particular date.

1.1.3. CONCEPT OF ACCOUNTING

The actual record making phase (i.e. recording, classifying and summarising) of accounting is usually called book-keeping. However, accounting extents for beyond the actual making of records. Accounting is concerned with the use to which these records are put, their analysis and interpretation.

According to American Accounting Association (AAA), Accounting is the process of identifying, measuring, and communicating economic information to permit informed judgements and decisions by users of the information."

The main branches of accounting are financial, cost and management accounting.

1.1.3.1 Financial Accounting: The main purpose of this branch of accounting is to ascertain profit or loss during a specific period, to show financial position of the business on a particular date. Such accounting records are used to import useful information to outsiders and to meet the legal requirements.

1.1.3.2 Cost Accounting : The main aim of this branch of accounting is to ascertain cost relating to the various activities of the business and to have cost control. The cost accountant is required to assemble and interpret cost data for the use of management in controlling current operations and in planning for the future. It also helps the business in controlling the costs by indicating avoidable losses and wastes; and thus helps in keeping the cost at the minimum level.

1.1.3.3 Management Accounting: This is another important branch of accounting which supplies the management significant information in order to assist the management to discharge its various functions such as planning, control, evaluation of performance and decision making etc. It covers, Ratio analysis, cash flow and fund flow analysis, Break-even analysis and Managerial application of Marginal costing. Management Accounting is comprised of two words". Management and Accounting thus it is the study of managerial aspect of accounting.

1.4. BASIC TERMS OF ACCOUNTING

Few basic terms of accounting are as given here:-

1. **Transaction:** A business deal made between two parties is called transaction. It is an exchange of goods or services for money or money's worth. A business transaction is an event which can be expressed in terms of money. When payment for a business transaction is made immediately, it is called a cash transaction and when the payment is postponed to a future date, it is called a credit transaction.
2. **Goods:** The term 'goods' means the articles, commodities or merchandise in which the business deals. In other words those things which are purchased for sale are called goods. Thus, books for a book-seller, furniture for a dealer in furniture and car for a car dealer are examples of goods. For the purposes of accounting, goods may be classified as purchases, sales, purchase returns or return outwards, sales returns or returns inwards, opening stock and closing stock.
3. **Capital:** The amount invested by the owner in the business at any given point of time is known as capital. It is the residual claim of the owner in the business at any given point of time is known as capital. It is the residual claim of the owners of the business against its assets after meeting the claims of the outsiders. Thus, Capital = Assets - Liabilities.
4. **Assets:** Any physical thing or right owned that has a money value is called an asset. According to the Accounting Terminology issued by the Institute of Chartered Accountants of India, assets are "tangible objects or intangible rights owned by an enterprise and carrying probable future benefits." Thus, property of all kinds owned by a business is included in the term 'assets'.
5. **Liabilities:** The term 'Liabilities' refers to the amount or debts owned by a firm. It includes the capital of the proprietor and debts which are owned by the firm to the outsiders.
6. **Debtor:** A debtor is a person who owes money to the business. The amount due from a person as per the books of accounts is called a book debt.
7. **Creditor:** A person who has a claim for money against the business is called 'creditor'. He is the person to whom the business owes money.
8. **Drawings:** Any amount of cash or value of goods withdrawn by the owner of business for his domestic or personal use is called drawings.

9. **Account:** An account may be defined as a summarised record of all the transactions relating to a particular person, thing or other subject, which have taken place during a given period of time. It is usually prepared in T form having two sides. The left hand side is known as 'debit side' and the right hand side of an account is called 'credit side'. Account is usually written as A/C or a/c.

Dr. Account (A/C) Cr.

Debit Side	Credit Side

10. **Entry:** Recording a transaction in the books of accounts is known as 'entry'.
11. **Debit:** The term 'debit' means recording the transaction on the left hand side of an account.
12. **Credit:** Recording a transaction on the right hand side of an account is called credit.
13. **Revenue:** The amount charged for goods sold or services rendered is called revenue. Examples of revenue are sales, commission earned, rent accrued and fees for professional services rendered.
14. **Expense:** The term 'expense' includes the cost of goods sold or services rendered to a business entity in the process of generating revenue, such as salaries, rent, interest, etc. An expense should be distinguished from a loss in the sense that an expense is expected to result in some benefit to the business whereas a loss brings no benefit to the firm.
15. **Capital Expenditure:** Costs incurred for acquiring assets that will provide economic benefits over several accounting periods are called capital expenditures.
16. **Revenue Expenditure:** Cost incurred that provide economic benefits only during the current accounting period are called revenue expenditures. Revenue expenditures are also known as expenses.
17. **Invoice:** It is a document prepared by the seller giving particulars of the goods sold, the price, quantity of goods, the total value of goods and the amount payable by the buyer.
18. **Discount:** It refers to an allowance or deduction allowed from the sale price or amount payable at the time of payment. There may be two types of discounts, trade discount and cash discount. Trade discount is allowed to the buyers from the gross or catalogue price without reference to the

time factor within which the seller expects to receive the payment. It is allowed to attract the customers and the amount of trade discount is deducted in the invoice. Transactions are recorded in the books of accounts for the net amount, i.e. value of the goods less trade discount.

Cash discount is allowed to customer to attract prompt payment and is recorded in the books of accounts.

19. **Voucher:** It is a written document in support of a business transaction.

1.5. DISTINCTION BETWEEN BOOK-KEEPING AND ACCOUNTING

The concepts of book keeping and accounting are already discussed in this lesson. Next is the main differences between book-keeping and Accounting as given below:

Points of distinction	Book-keeping	Accounting
1. Object	The object of book-keeping is to prepare original books of accounts, trial balance and final accounts.	The object of accounting is to record, classify, summarise, analyses and interpret the business transactions.
2. Scope	It has limited scope and is concerned with recording, classifying, and summarising of business transactions.	It has a wide scope and covers book-keeping plus analysis and interpretation.
3. Level of Work	It is restricted to clerical work and is done by lower levels of management.	It is concerned with all levels of management. Lower level clerks prepare the accounts, medium level report it and top level interpret it.
4. Mutual dependence	It has to depend on accounting for making the accounting records more useful.	It has to depend on book-keeping for getting the required information from accounting records and for making them useful for planning, control and decision making.
5. Results of the business.	It shows the net result and financial position of the business as the scope extends only upto the preparation of final accounts.	It analyses the operating results and financial position of the business.

1.1.6 OBJECTIVES OF ACCOUNTING

The main purpose of accounting is to provide information which is useful for the person inside the organisation groups outside the organisation. The main objects of accounting are:

1. To ascertain profitability level of business operations: Accounting system helps us to know whether a business has earned profit or suffered loss during the accounting period. To determine profit or loss of the account period, a Trading and Profit and Loss Account or an Income statement is prepared by matching revenues and expired costs (i.e. revenue expenditure) incurred for earning the revenues. Thus, first of all revenue is determined and then expenses incurred for earning the revenue are matched with the revenue for calculating the difference known as net profit or net loss.
2. To Ascertain the Financial Position of the business: The position statement or Balance sheet is prepared to give an idea of the financial position of the business on a particular date, which shows its assets and liabilities on that date. Excess of assets over liabilities represent the capital and is indicative of the financial soundness of an enterprise. A properly drawn up balance sheet gives information relating to (1) the nature and value of assets; (2) the nature and extent of liabilities; (3) whether the enterprise is solvent; and (4) whether the business concern is over trading.
3. To provide information for managerial decisions: Another objective of Account is to generate such information which are helpful to various managers and persons in planning, control, evaluation of performance and decision-making.

1.1.7 FUNCTIONS OF ACCOUNTING

The main functions of accounting are as following:

(i) It keep a systematic and permanent record of all financial transactions of business.

(ii) It keeps a record of income and expenses, in such a manner so that net result of business can be quickly known for any period.

(iii) It keeps a record of assets and liabilities in such a way that financial position of the business can be readily seen at any point of time.

(iv) It protects the property of the business by designing such a system of accounting which may be helpful to achieve this purpose.

(v) It keeps a track of all changes in the value of assets and liabilities.

(vi) It keeps control on all changes in the value of assets and liabilities.

(vii) It communicates the result of the business to the various categories of persons as owners, investors, creditors, employees, management, govt. etc.

(viii) It provides information for meeting various legal requirements as income tax returns, return for sale tax etc.

(ix) It helps in making decisions, concerning the acquisition, use and preservation of scarce resources.

(x) It helps in decisiding remedial measures for the deviation of actual performance from the planned performance.

1.1.8 SYSTEMS OF ACCOUNTING

There are basically two accounting methods for measuring profit or income:

1. Cash Basis of Accounting
2. Accrual or Mercantile Basis of Accounting

1. Cash Basis of Accounting: Under this method, all incomes are considered to be earned only when they are actually received in cash. In the same manner, expenses are deemed to be incurred only when they are actually paid in cash. And, the difference between the total incomes so received in cash and total expenses so paid in cash represents the profit or loss of a firm for a particular accounting period. Government system of accounting is generally on cash basis. This method is also followed by professionals like doctors, lawyers, chartered accountants, etc.

The only advantage of this method is that it is very simple, but it fails to disclose correct profit or loss and also does not give a true and fair view of financial position of a firm.

2. Accrual or Mercantile Basis of Accounting: Under this method of accounting, incomes are recorded and considered for the period in which they are earned irrespective of the fact that whether the same have actually been received or not. Similarly expenses are charged to the period in which they are incurred irrespective of the fact that they have actually been paid or not. As such, the difference between the total incomes earned and total expenses incurred represents the profit or loss of a firm for a particular accounting period. Thus, the profit and loss account and balance sheen exhibit a true and fair view of the state of affairs. The accrual basis is generally accepted accounting convension in business accounting and that is why it is also called mercantile basis of accounting., called the Mixed or Hybrid Basis of Accounting.

3. **Mixed or Hybrid Basis of Accounting:** Under this method income are recorded on cash basis whereas expenses are recorded on accrual basis. This method of accounting is not commonly used in actual practice as it fails to measure correct income and does not exhibit a fair and true view of the state of affairs.

1.1.9 IMPORTANCE OF ACCOUNTING

The Accounting system is very much important in the business world, as it provides meaningful information about a business enterprise to those persons who are directly or indirectly interested in the performance and financial position of a business. Such person required various types of information as discussed here:

1. **Owners:** The owners of a business furnish capital to be used for the purpose of business. They are interested to know whether the business has earned a profit or loss during a particular period and also its financial position on a particular date. They want accounting reports in order to have an appraisal of past performance and also for an assessment of future prospects.
2. **Creditors:** The creditors include supplier of goods and supplies, bankers and other lenders of money. They are interested in the financial stability of the concern before making loans or granting credit. They look to the ability of the business to pay interest and amount as and when it becomes due for payment, and the solvency of a concern.
3. **Investors:** Investors look not only the earning capacity of business but also its financial strength and solvency before deciding whether to subscribe or not for the shares in a Company. They are interested in steady and good return on their capital, the safety of their capital and appreciation in the value of the shares.
4. **Employees:** Employees are interested in earning capacity of a concern as their salaries, bonus and pension schemes are dependent on this factor.
5. **Government:** Government is interested in accounting statements and reports in order to see the performance of a particular unit, its cost structure and income in order to impose tax and excise duty.
6. **Public:** The public as consumers is interested in accounting statements in order to know whether control in exercised on production, selling and distribution expenses in order to reduce the prices of goods they buy.
7. **Research Scholar:** Such persons are interested in accounting statements and reports in order to get data for proving their thesis on

which they are working and hence to complete their research projects.

8. **Managers:** The managers of a enterprise need accounting information of planning, control, evaluation of performance and decision-making. Their main responsibility is to operate the business so as to obtain maximum return on capital employed without causing any harm to the interest of the shareholders. The manager would like to have data relating to sales, output and expenses etc. relating to next year and also the flow of cash for the purpose of planning the activities of a business. He is also required to plan and see that the cost incurred is reasonable. All these require relevant accounting information.

1.1.10 ADVANTAGES OF ACCOUNTING

The following are main advantages of accounting:

1. **Replacement of memory:** In a large business it is very difficult for a business-man to remember all the transactions. Accounting provides records which will furnish information as and when desired and thus it replaces human memory.
2. **Evidence in Court:** Properly maintained accounts are often treated as a good evidence in the court to settle a dispute.
3. **Settlement of taxation liability:** If accounts are properly maintained, it will be of great assistance to the businessman in setting the income tax and sale tax liability otherwise tax authorities may impose any amount of tax which the businessman will have to pay.
4. **Comparative study :** It provides the facility of comparative study of the various aspects of the business such as profits, sales, expenses etc. with that of previous year and helps the businessman to locate significant factor leading to the change, if any.
5. **Sale of business:** If accounts are properly maintained, it helps to ascertain the proper purchase price in case the businessman is interested to sell his business.
6. **Assistance to the insolvent person**: If a person is maintaining proper accounts and unfortunately he becomes insolvent (i.e. when he is unable to pay to his creditors), he can explain many things about the past with the help of accounts and can start a fresh life.
7. **Assistance to various parties:** It provides information to various parties, i.e., owners, creditors, investors, government, managers, research scholars, public and employees and financial position of a business enterprise from their own view point.

1.1.11 LIMITATIONS OF ACCOUNTING

The following are the main limitations of accounting:

1. **Records only monetary transactions**: Accounting records only those transactions which can be measured in monetary terms. Those transactions which cannot be measured in monetary terms as conflict between production manager and marketing manager, efficient management etc. may be very important for a concern but not recorded in the business books.
2. **Effect of price level changes not considered:** Accounting transactions are recorded at cost in the books. The effect of price level changes is not brought into the books with the result that comparison of the various years becomes difficult. For example, the sales to total assets in 1998 would be much higher than in 1990 due to rising prices, fixed assets being shown at cost and not at market price.
3. **No realistic information:** Accounting information may not be realistic as accounting statements are prepared by following basic concepts and conventions. For example, going concern concept gives us an idea that the business will continue and assets are to be recorded at cost but the book value which the asset is showing may not be actually realisable. Similarly, by following the principle of conservatism the financial statements will not reflect the true position of the business.
4. **Personal bias of Accountant affects the accounting statements:** Accounting statements are influenced by the personal judgement of the accountant. He may select any method of depreciation, valuation of stock, amortisation of fixed assets, treatment of deferred revenue expenditure. Such judgement based on integrity and competency of the accountant will definitely affect the preparation of accounting statements.
5. **Permits alternative treatments:** Accounting permits alternative treatments within generally accepted accounting concepts and conventions. For example, method of charging depreciation may be straight line method or diminishing balance method or some other method. Similarly, closing stock may be valued by FIFO (First-in-First-Out) or LIFO or average price method. Application of different methods may given different results.
6. **No real test of managerial Performance**: Profit may be shown in excess by manipulation of accounts by suppressing such cost as depreciation, advertisement and R&D or taking excess value of closing stock consequently real idea of performance may not be available by

manipulates profit.

7. **Historical in nature:** Usually accounting supplies information in the form of Profit and Loss account and Balance sheet at the end of the year. So the information provided through accounting system is historical in nature and gives post-mortem analysis

SELF CHECK EXERCISE:

Ques. 1. Give various functions of Accounting?

Ques. 2. Define the term book-keeping and also distinguish between book-keeping and Accounting.

Ques. 3. Explain in detail various systems of Accounting.

1.1.12 Accounting Conventions and Concepts: In the modern world no business can afford to remain secretive because various parties such as creditors, employees, taxation authorities, investors, public and government etc. are interested about the affairs of the business. The affairs of the business can be studied mainly by consulting final accounts and the balance sheet of particular business. Final accounts and balance sheets are the end product of Book-keeping. Because of the importance of these statements it became necessary for the accountants to develop some principles, concepts and convention which may be regarded as fundamentals of accounting.

Conventions : Accounting is based on the following three conventions:

1. **Relevance :** The convention of Relevance emphasis the fact that only information should be made available by accounting as is useful and relevant for achieving its objectives. The things which are not very relevant or important should not be mentioned in the books of accounts. As business is interested in knowing about the total labour cost. It is not interested in knowing what employees spend and what they save.

2. **Objectivity :** The convention of Objectivity emphasizes that accounting information should be based on evidence and expressed by standards which are commonly acceptable e.g. stock of goods lying unsold at the end of the year should be valued at its cost price not at a higher price even if it is likely to be sold at a higher price in future. Reason is that no one can be sure about the price which will prevail in future.

3. **Feasibility :** The Convention of feasibility emphasises that the time, labour and cost of analysing accounting information should be compared with benefit arising out of it. Our benefit derived should always be much more than the money expended. As the cost of oiling and greasing is very low but it saves a lot of labour time.

Accounting Concepts

1. **Entity Concept:** It is very important to note that for accounting purpose the business is treated as a unit of entity apart from its owners, creditors and other. In other words, the proprietor of an enterprise is always considered to be separate and his business has different identity.

2. **Going concern concept:** This concept is based on the premise that business will continue for an indefinitely long period and it will not be wound up in the near future. According to this assumption assets in the business are carried out in the books at their cost less depreciation and not at the market value. Similarly liabilities are shown at value that reflect what the business owes and not value for which the creditors would settle in case of dissolution or liquidation.

3. **Dual aspect concept :** This concept states that there are two aspects. The first aspect is the assets of the business and second is equities. Assets are resources owned by a firm and equities are claims of various parties against the assets owned by a firm. Equities are classified as (a) owner's equities, and (b) liabilities. According to accounting equation . Assets are equal to Equities i.e. capital + liabilities, which is known as concept of duality.

4. **Accounting Period Concept:** Strictly speaking the net income can be measured by comparing the assets of the business existing at the time of its commencement with those existing at the time of its liquidation. Since life of business is assumed to be indefinite, the measurement of income according to above concept is not possible for very-very long period. Thus, in order to know at frequent intervals' "how things are going" accountants normally take twelve months period for the measurement of income.

5. **Money Measurement Concept :** The money measurement concept underline the fact that in accounting every worthy recording event, happening or transactions is recorded in terms of money. In other word a fact or a happening which cannot be expressed in terms of money is not recorded in accounting books.

6. **Cost Concept:** The underlying idea of cost concept is that:

   (a) asset is recorded at the price paid to acquire it, that is, at cost.

   (b) this cost is the basis of all subsequent accounting for the asset.

7. **Revenue Recognition Concept :** In accounting the amounts received for the sale of output are called revenues. Revenue is the gross inflow of cash, receivable or other consideration arising in the course of an enterprise from the sale of goods, from the rendering of services and rewards arising from the provision of assets.

8. **Matching Concept :** After the revenue recognition, all costs which are applicable to the revenue of the period shold be charged against the revenue in order to determine the net income of the business. This is essence of matching Concept. For ascertaining net income of the year, the revenue and expenses of the year are ascertained and following equation is applied :

   $P = \sum R - \sum E$

   Where P = Profit, $\sum R$ = Sum of Revenues & $\sum E$ = Sum of the expenses.

9. **Accrual Concept :** An associated concept to be discussed in the context of matching principle' is the accrual system of accounting which is favoured by the modern accountants as against cash system of accounting. Under this method, revenues and expenses are recognised in the period in which activities that cause those revenues and expenses occur.

1.1.13 SUMMARY

The traditional view of accounting as a historical description of financial activities is not longer acceptable. Over a period of time new dimensions have been added to the discipline of accounting. Thus, the accounting systems which we find today have developed with the development of institutions of trade, commerce and industry i.e. Double Entry system of book keeping. The Double Entry System of today was first propounded in Genoa (Italy) in 1340. In short we can say that accounting is the art and science of recording, classifying, and summarising of financial transactions and interpreting the results thereof.

1.1.14 ANSWER TO SELF CHECK EXERCISE

Ans. 1. Functions of Accounting :

1. Recording of Information
2. Classification of Data
3. Making Summaries
4. Interpreting Financial information
5. Dealing with Financial transactions
6. Communicating results
7. Making Information more reliable

Ans. 2. Points of Difference between Book-keeping and Accounting

1. Object
2. Scope
3. Level of work
4. Mutual dependence
5. Results of the business

Ans. 3. Various Systems of Accounting

1. Cash basis System of Accounting
2. Accrual basis System of Accounting
3. Hybrid or Mixed basis System of Accounting

1.1.15 GLOSSARY

1. Book- Keeping : System of keeping accounting books.
2. Hybrid System : System of accounting which follows both cash and accrual basis of accounting.
3. Accounting: Scientific methods of recording business transactions.
4. Cost Accounting : Branch of accounting, considers, cost aspect of accounting.
5. Management Accounting: Branch of accounting studies managerial aspects of accounting.

1.1.16 EXERCISE

(A) Short Questions :

Ques. 1. Define the terms 'business transactions'.

Ques. 2. What do you mean by 'Equity'.

Ques. 3. Discuss various branches of Accounting.

(B) Long Questions:

Ques. 1. Define the terms Accounting. Also state advantages and limitations of Financial of accounting.

Ques. 2. Discuss in detail the importance of accounting.

Ques. 3. Distinguish between Financial, Cost and Management accounting. And give main objectives of accounting.

1.1.17 SUGGESTED READINGS

1. Basic Accounting
   by : S.P. Jain
   K.L. Narang
   Kalyani Publishers
2. Financial Accounting
   by : Juneja
   R.C. Chawla
   K.K. Sexena
   Kalyani Publishers

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LESSON NO. 1.2 **AUTHOR : MRS. DALBIR KAUR**

BOOK OF ORIGINAL ENTRY : JOURNAL

1.2.0 OBJECTIVES

Journal is the first book of original entry in which all transactions are recorded eventwise and data-wise. This book may be divided into sub-journals also. The main objective of this lesson is also to introduce the students with this step of Accounting process i.e. Recording of transactions in Journal.

1.2.1 INTRODUCTION

The word journal comes from the French word 'Jour' which means a day'. In accounting process the journal is considered as a form of diary for business transactions. So, journal is a book of original entry written up from the various source documents.

Definitions :

1. **Journal** : "Journal is a book, employed to classify, or sort out transactions in a form convenient for their subsequent entry in the ledger."
2. **Journal Entry** : "Journal entry means recording the business transactions in the Journal."
3. **Journalising** : 'Journalising' is the process of recording the journal entries in the journal. It is a systematic act of entering the transactions in a day book in the order of their occurrence."
4. **Narration** : "Narration is the short explanation of an entry."
5. **Voucher** : "Any documentary support of financial transaction is known as voucher."

1.2.2 SOURCE DOCUMENTS

The printed documents that business use in the process of completing transactions are called business papers or source documents. These documents are the starting point in the accounting process and foundation of all accounting records. All business transactions should be evidenced by documentary evidences. The common documents that are generally uses are as under :

1. Cash memo
2. Invoice
3. Sales slips
4. Receipts
5. Debit and Credit notes
6. Pay - in - slips
7. Counterfoils of cheques
8. Agreements
9. Purchase orders
10. Bank statements
11. Salary and wage sheets
12. Bills payables and receivables

1.2.3 DOUBLE ENTRY SYSTEM OF BOOK KEEPING

This system owes its origin to an Italian merchant names Luco Paceoli who wrote the first book entitled 'De Computis et Scrituris' on double entry system of accounting in 1494. We have seen that every business has two aspects i.e. when we receive something we give something in return, which is known by dual aspect expressed

by a debit amount and an equal and offsetting credit amount. For example, when we purchase goods for cash, we receive goods and give cash in return. Similarly, in the credit sale of goods, goods are given to the customer and the customer becomes debtor for the amount of goods sold to him. This method of writing every transaction in two accounts is known as Double Entry System of Accounting. Of the two accounts one account is debited while the other is credited with an equal amount. So the total of credit and debits is always equal.

Advantages of Double Entry System

The following are the main advantages which can be derived from the use of this system:

1. It provides complete record of business transactions.
2. It provides a check on the arithmetical accuracy of the books of account as the total of debit entries must be equal to the total of credit entries.
3. The amount owing to outsiders and the amount due to the business can be ascertained with the help of personal accounts.
4. The Profit and Loss account can be prepared with the help of nominal accounts which is helpful to the business to ascertain the operating results of the business.
5. It helps to prepare balance sheet of the business which is helpful to ascertain the financial position of the business.
6. It helps to reduce the occurrence of errors and frauds and when occurred can be easily detected.

Disadvantages of Double Entry System

The following are disadvantages of the Double Entry System :

1. This system requires the maintenance of a number of books of accounts which is not practical in small concerns.
2. The system is costly because a large number of records are to be maintained.
3. There is no guarantee of absolute accuracy of books of account inspite of agreement of trial balance.

1.2.4 JOURNAL

The first principle of Double entry is that every transaction before being posted or classified in the ledger must be subject of an originating in the book of prime or original entry. “Journal” is one of the “Books or original entry” such books are also known as subsidiary books. The use of journal is restricted for recording special

entries like opening, closing, transfer, rectification and those entries which are not covered by other subsidiary books maintained by the business.

Recording of the entries in "Journal" is known as "Journalising" or passing 'journal entries':

Journal

Date		Particulars	L.F.	Dr. Amount Rs.	Cr. Amount Rs.
Year Month	Date	Name of the account .....Dr. to be debited To Name of the account to be credited (Narration)			

Column 1 (Date) : The date of the transaction which it takes place is written in this column. The year is written only in the first entry appearing on each page. This column is divided into two parts the first part is used for writing the month and the second part is used for writing the date.

Column 2 (Particulars) : In this column, the name of the account to be debited is written first. In the next line the account to be credited is written preceded by the word 'To' leaving a few spaces away from the line where column starts. An explanation of the entry known as "Narration" is also recorded in this columns below the line giving credit to the account.

Column 3 (L.F.) : L.F. stands for ledge folio which means page of the ledger. In this column the page numbers are entered on which various accounts appear in the ledger.

Column 4 (Dr. Amount) : In this column, the amount to be debited against the debit account is written along with the nature of currency.

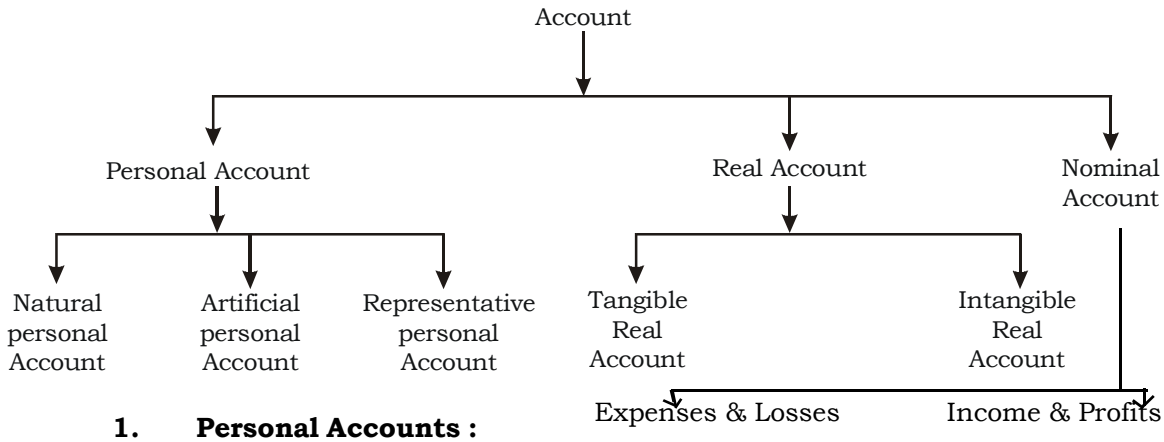
1.2.5 CLASSIFICATION OF ACCOUNTS

As we earlier discussed, for each transaction, a separate entry is recorded. Before recording the transactions is analysed to determine which accounts are involved and which is to be debited and which is to be credited. To do this analysis accounting system first needs to classify the accounts. There are two approaches of classification of accounts.

1. Traditional Approach
2. Modern Approach

1.2.5.1 <u>Traditional Approach</u> : Traditional approach based classification of Account

is done as shown under :



1. Personal Accounts :

Account which are related with accounts of individuals, firms, Companies are known as personal accounts. The personal accounts may further be classified into three categories.

i) Natural Personal Accounts

Accounts of individuals relating to natural person such as Akhil's A/c Rajesh's A.c, Sohan's A/c are natural personal accounts.

ii) Artificial Personal Accounts

Accounts of Companies, institutions such as Reliance industries Ltd; Lions club, M/s Sham & Sons, National College account are artificial personal accounts.

iii) Representative Personal Accounts

The accounts which represent some person such as "wage outstanding account, prepaid insurance account, accrued interest account are considered as representative personal accounts.

2. Real Accounts

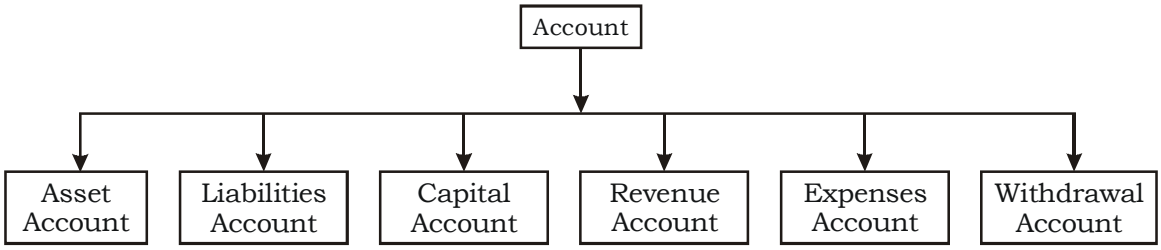
Real accounts are the accounts related to assets. These may be classified into tangible real account and intangible real account. The accounts relating to tangible assets such as building, plant, machinery, cash, furniture etc. are classified as tangible real accounts. Intangible real accounts are the accounts related to intangible assets such as goodwill, trademarks, copyrights and franchises.

3. Normal Accounts

The accounts relating to income, expenses, losses and gains are classified as nominal accounts. For example wages account, Rent account, Interest Account, Salary Account, bad debts accounts etc.

1.2.5.2 <u>Modern Approach</u> : Modern approach based classification of account is done

as shown under:



Rules for Debit and Credit

S.No.	Types of Account	Account to be Debited	Account to be Credited
1.	Assets Accounts	Increase ↑	Decrease ↓
2.	Liabilities	Decrease ↓	Increase ↑
3.	Capital Account	Decrease ↓	Increase ↑
4.	Revenue Account	Decrease ↓	Increase ↑
5.	Expenses Account	Increase ↑	Decrease ↓
6.	Withdrawal Account	Increase ↑	Decrease ↓

1.2.6 RULES FOR DEBIT AND CREDIT

Following are the rules for debit and credit when the accounts are classified as Personal, Real and Nominal Accounts.

Rules of Double Entry:

Personal Account	:	Debit the receiver
		Credit the giver
Real Account	:	Debit What Comes in
		Credit what goes out
Nominal Account	:	Debit Expenses and Losses
		Credit Incomes and gains

SELF CHECK EXERCISE

Ques. 1. From the following transactions, state the nature of accounts and state which account will be debited and which will be credited.

1. Anthony started business with Rs. 50,000
2. Purchased goods for cash Rs. 10,000.

3. Sold goods for cash Rs. 15,000.
4. Purchased goods from X for cash Rs. 5,000.
5. Sold goods to Bonnie for Rs. 6,000.
6. Purchased furniture for Rs. 4,000.
7. Purchased Plant and Machinery for Rs. 10,000.
8. Paid wages Rs. 400.

Ques. 2. Mention the rules of Double Entry system of book keeping.

1.2.7 STEPS IN JOURNALISING

The process of journalising is a thinking process. After analysing the business transactions, the following steps in Journalising are followed:

i) Find out what accounts are involved in business transaction.

ii) Ascertain what is the nature of accounts involved.

iii) Ascertain the golden rule of debit and credit is applicable for each of the accounts involved.

iv) Find out what account is to be debited which is to be credited.

v) Recorded the date of transaction in the "Date Coumn".

vi) Write the name of the account to be debited very near to the left hand side in the particulars column alongwith the word 'Dr' on the same line against the name of the account in the particulars column and the amount to be debited in the 'Debit Amount column' against the name of the account.

vii) Record the name of the account to be credited in the next line preceded by the word 'To' at a few space towards right in the 'Particulars Column' and the amount to be credited in the 'Credit Amount Column' in front of the name of the account.

viii) Record narration (i.e. a brief explanation of the transaction) within brackets in the following line in 'Particulars column'.

ix) A thin line is drawn all through the particulars column to separate one Journal entry from the other and it shows that the entry of a transaction has been completed.

1.2.8 ILLUSTRATION-I

Journalise the following transitions in the book of Aminoor creations:

1. Machinery purchased from HMT ltd for Rs. 10,000 on credit.
2. Depreciate the machinery (mentioned above) at 10% per annum for full year.
3. Amount due from Chand Ji Rs. 1000 is irrecoverable as he is untraceable.

4. Received Rs. 1000 from Triloki Nath in full settlement against the amount due from him Rs. 1050.
5. Paid Rs. 960 to Darbara Singh in full settlement against amount due to him Rs. 1000.
6. Sarkar who owed us Rs. 1000 is declared insolvent, and Rs. 60 paise in the rupees is received as final dividend from his estate.
7. Exchanged old furniture for new, the value of old furniture was Rs. 500 while the value of new furniture was Rs. 12000 balance paid in cash.
8. Withdrew goods from the business costing Rs. 200 for the personal use by the proprietor.
9. Chand Ji remitted Rs. 400 against the amount already written as bed debt.
10. Supplied goods cost Rs. 2000 to Mahesh. Issued invoice at 10% above cost less 5% trade Discount.
11. Sold goods to Ram Manohar list price Rs. 1000 trade discount 10% cash discount 5%. He issued cheque on the same day and availed the cash discount.

Solution :

Sr. No.	Particulars	L.F.	Debit amount Rs.	Credit amount Rs.
1	Machinery A/c ...Dr.		10,000	
	To H.M.T. Ltd.			10,000
	(Purchased machinery on credit)			
2.	Depreciation A/c ...Dr.		1,000	
	To Machinery A/c			1,000
	(Being the depreciation on machinery charged @ 10%)			
3.	Bad Debts A/c ...Dr.		1,000	
	To Chand Ji A/c			1,000

	(Being the amount irrecoverable hence bad debts)			
4.	Cash A/c ....Dr.		1,000	
	Discount Allowed A/c ....Dr.		50	
	To Tarloki Nath			1,050
	(Being amount received and discount allowed to Triloki Nath)			
5.	Darbara Singh A/c ....Dr.		1,000	
	To cash A/c			960
	To Discount Received A/c			40
	(Being the amount paid to and discount received from Darbara S.)			
6.	Cash A/c ...Dr.		600	
	Bad Debts A/c ...Dr.		400	
	To Sarkar A/c			1,000
	(Being the amount recovered @ 60P. per rupees and the balance written off as bad debts.			
7.	Furniture A/c ...Dr.		700	
	To cash A/c			700
	(Cash paid for the exchange of furniture is Rs. 1200-500=700			
8.	Drawing A/c ...Dr.		200	
	To purchase A/c			200
	(Goods withdrawn at cost price for personal use)			
9.	Cash A/c ...Dr.		400	
	To Bad Debts Recovered A/c			400
	(Received the amount against bad debts)			
10.	Mahesh A/c ...Dr.		2,090	
	To Sales A/c			2,090
	(Sales of goods costing 2000 add 10% deduct 5% from 2200 i.e. Rs. 110)			
11.	Bank A/c ...Dr.		855	
	Discount Allowed A/c		45	
	To Sales A/c			900

(Sales of list price Rs. 1000 less trade discount 10%)

1.2.9 ILLUSTRATION - II

Journalise the transactions in the book of the trader : April, 2009

Debit Balances : Cash in hand Rs. 8000, Cash at bank Rs. 25,600, Stock of goods Rs. 20,000, Furniture Rs. 4,000 and Building Rs. 10,000.

Debtors : Vijay Rs. 2,700, Anil Rs. 1,500, Ashwani Rs. 2000, Anupam Rs. 1800 and Madhu Rs. 100.

Creditors : Anand Rs. 5,400, Arya and Co. Rs. 7,700, Balwant Rai Rs. 5,200 Mrs. Loan Rs. 10,000.

2009

Apr. 1. Purchased goods worth Rs. 5000 less 20% trade discount and 5% cash discount.

Apr. 3. Rs. 2626 received from Vijay and allowed him discount and 5% cash discount.

Apr. 5. Bought 100 shares in Bharat Ltd. @ Rs. 15 per share, brokerage paid Rs. 30.

Apr. 8. Goods worth Rs. 500 were damaged in transit, a claim was made on railway authorities for the same.

Apr. 10. Cash Rs. 5292 paid to Anand and Discount allowed by him Rs. 108.

Apr. 13. Received cash from the railway in full settlement of claim for damages in transit.

Apr. 15. Anupam is declared insolvent and a dividend of 50 paise in the rupee is received from him in full settlement.

Apr. 18. Sold 40 shares of Bharat Ltd. @ Rs. 18 per share, brokerage paid Rs. 15.

Apr. 20. Bought a horse for Rs. 2000 and a carriage for Rs. 1000 for delivering goods to customers.

Apr. 22. Paid for :

Charity	Rs. 101
Postage	Rs. 200
Stationery	Rs. 199

Apr. 30 One month's interest on Mrs. Loan @ 12% P.A. become due but could not be paid.

Apr. 30 The horse bought on Jan. 20 died its carcass was sold for Rs. 50.

Apr. 30. 'Received from travelling salesman Rs. 3000 for goods sold by him after deducting his travelling expenses Rs. 150.

Apr. 30. Paid for :

Salaries	Rs. 3500
Rent	Rs. 1500

Apr. 30. Sold goods worth Rs. 10,000 less 10% trade discount.

Solution:

Date	Particulars	L.F.	Debit amount	Credit amount
2009				
Apr. 1				
	Cash Account ... Dr.		8,000	
	Bank Account ... Dr.		25,600	
	Stock Account ... Dr.		20,000	
	Furniture Account ... Dr.		4,000	
	Building Account ... Dr.		10,000	
	Vijay A/c ... Dr.		2,700	
	Anil A/c ... Dr.		1,500	
	Ashwani A/c ... Dr.		2,000	
	Anupam A/c ... Dr.		1,800	
	Madhu A/c ... Dr.		100	
	To Anan A/c			5,400
	To Aryan & Co. A/c			7,700
	To Balwant Rai A/c			5,200
	To Mrs. Loan A/c			10,000
	To Capital Account			47,400
	(Being balances bought in from last year)			
Apr. 1	Purchase Account ... Dr.		4,000	
	To cash Account			3,800
	To Discount Account			200
	(Being goods worth Rs. 5,000 purchased for cash less 20% trade and 5% cash discount)			
Apr. 3	Cash Account ... Dr.		2,646	
	Discount Account ... Dr.		54	
	To Vijay a/c			2700
	(Being cash received from Vijay and discount allowed)			

Apr. 5	Investment in share Account ...Dr. To cash Account (Being purchase of 100 shares in Bharat Ltd. @ Rs. 15 per share plus brokerage Rs. 30)		1,530	 1,530
Apr. 8	Railway claim Account ...Dr. To Railway Purchases A/c (Being claim sent to Railway for goods sent in transit)		500	 500
Apr. 10	Anand A/c ...Dr. To Cash Account To discount Account (Being cash paid to Anand and discount allowed by him)		5,400	 5,292 108
Apr. 13	Cash Account ...Dr. To Railway Claim A/c (Being cash received in full settlement of railway claim)		500	 500
Apr. 15	Cash Account ...Dr. Bad Debts Account ...Dr. To Anupam A/c (Being half the dues received from Anupam and balance written off as Bad Debts)		900 900	 1800
Apr. 18	Cash Account ...Dr. To Investment in shares A/c (Being 40 shares sold @ Rs. 18 per shares less broken Rs. 15)		750	 750
Apr. 20	Livestock Account ...Dr. Carriage Account ...Dr. To cash Account (Being horse and carriage charges bought for delivering good to customers)		2,000 1,000	 3,000

Apr. 22	Charity Account ...Dr. Postage Account ...Dr. Stationary Account ...Dr. To Cash Account (Being cash paid for charity, Postage and stationary)		101 200 199	 500
Apr. 30	Interest Account ...Dr. To Mrs. Loan Account (Being interest payable on Mrs. Loan Rs. 100 @ 12% p.a. for month)		100	 100
Apr. 30	Cash Account ...Dr. Travelling Exp. A/c ...Dr. To Sale Account (Being Rs. 300 cash received from travelling Rs. 300 cash received from travelling salesman for sales after deducting his travelling expenses Rs. 150)		3000 150	 3150
Apr. 30	Salaries Account ...Dr. Rent Account ...Dr To Cash Account (Being payments of salaries & Rent)		3500 1500	 5000
Apr. 30	Cash Account ...Dr. To Sales Account (Being sale of goods worth Rs. 10,000 less 10% trade discount)		9000	 9000

1.2.10 SUMMARY

The 'Journal' or 'Daily Record' as originally used was a book of prime entry in which transactions were copied in order of date from a memorandum or waste book. The entries as they were copied, were classified into debit and credits, go as to facilitate their being correctly posted afterwards in the ledger. The rules of debits and credits are applied after classifying the accounts into personal, real and normal as per their nature. Thus, any economic transaction or event of a business which can be expressed in monetary terms should be recorded under the double entry system of accounting.

1.2.11 ANSWERS TO SELF CHECK QUESTIONS

Ans. 1 Analysis of Transaction
(A=L + C + Revenue-expenses)

Transaction	Accounts Involved	Nature of Account	Debit Rs.	Credit Rs.	Reason
1. Mr. Anthony started business with Rs. 50,000	Cash Capital	Asset Liability	50,000	50,000	Increased Increased
2. Purchaed goods for cash Rs. 10,000	Purchases Cash	Expense Asset	10,000	10,000	Increased Decreased
3. Sold goods for cash Rs. 15,000	Cash Sales	Asset Revenue	15,000	15,000	Increase Decreased
4. Purchased goods from x for Rs. 5,000	Purchases Cash	Expenses Asset	5,000	5,000	Increased Decreased
5. Sold goods to Bonnie for 6,000	Bonnie Sales	Asset Revenue	6,000	6,000	Increased Decreased
6. Purchased Furniture for Rs. 4,000.	Furniture Cash	Asset Asset	4,000	4,000	Increased Decreased
7. Purchased Plant and Machinery for Rs. 10,000	Plant Cash	Asset Asset	10,000	10,000	Increased Decreased
8. Paid wages Rs. 400	Wages Cash	Expenses Asset	400	400	Increased Decreased

Ans.2. Rules of Debit and Credit must be applied after the classification of Account, that is:

1. Personal Account,
2. Real Account, and
3. Nominal Account.

1.2.12 GLOSSARY

1. **Journal** : A Book of original entry
2. **Debit Note** : A source document evidencing a debit to be raised against a party.

3. **Credit Note** : A source document evidencing a credit to be given to a party

4. **Ledger Folio (L.F.)** : The page number of the ledger where a transaction is recorded is written in this column.

5. **Double entry system** : Transactions having dual aspects, two accounts, one account is debited and other is credit.

1.2.13 EXERCISE

(A) Short Questions:

Ques. 1. Define the term Journal.

Ques. 2. Distinguish between Journalising and Journal entry.

Ques. 3. Define the concept of Business Transactions. Also give important examples of source documents.

(B) Long Questions:

Ques. 1. Define the term 'Account'. Discuss in detail main classes of Accounts.

Ques. 2. What do you mean by 'Journalising'. Give various steps of Journalising. Also discuss the rules of Journalising.

Ques. 3. Explain Double entry System of Book-keeping. Also mention advantages and disadvantages of double entry system.

1.2.14 SUGGESTED READINGS

1. Accounting and Financial Management
By : Shashi K. Gupta
R.K. Sharma

2. Basic Accounting
By : S.P. Jain
K.L. Narang

Kalyani Publishers

* * *

LESSON NO. 1.3 **AUTHOR : MRS. DALBIR KAUR**

SUBSIDIARY BOOKS

Structure of the Lesson :

1.3.0 OBJECTIVES

The main objective of this lesson is to introduce the students with the number of subsidiary books like, Purchase book, Sales book, Purchases returns book, Sales return book, Bill receivable book and Bills Payable book. In addition to this the use of Journal proper is also discussed in this lesson.

1.3.1 INTRODUCTION

A small business whose financial transactions are limited to a small number can record all transactions in one Journal. But in a big firm, it becomes necessary to sub-divide the Journal into a number of specialised books of original entry called Subsidiary Books of accounts.

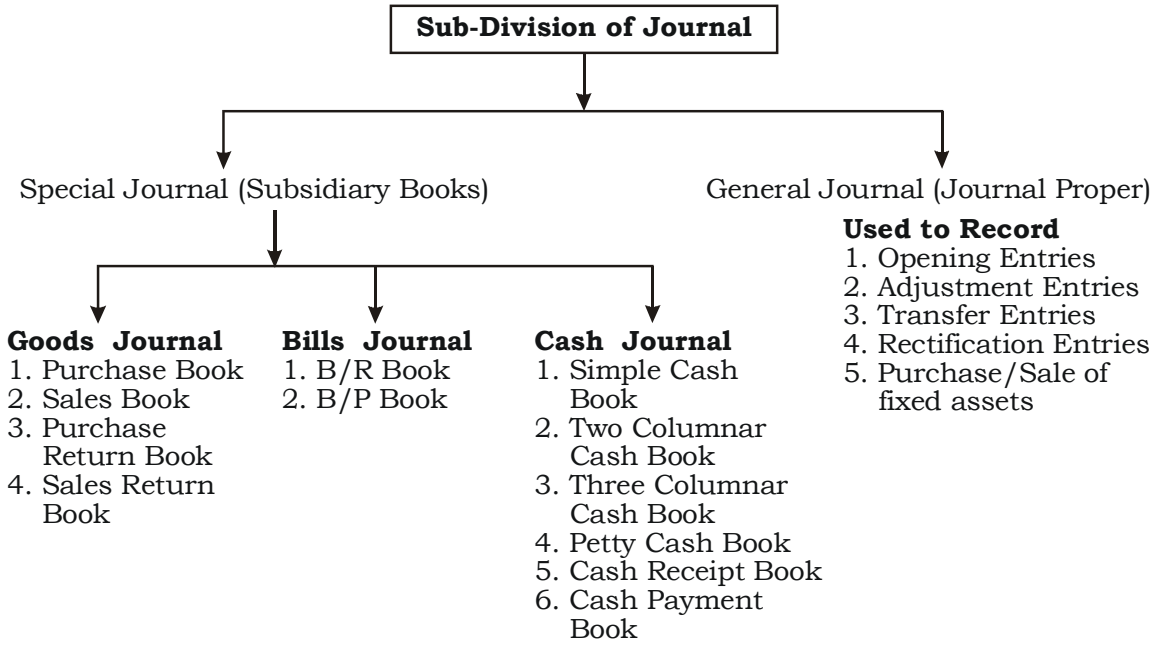
The Journal is sub-divided in such a way that a separate book is used for each type

of transaction that are sufficiently numerous. If transaction of a particular class are comparatively few, a separate book is not allotted to them but they are left in Journal.

1.3.2 SUB-DIVISION OF JOURNAL

The sub-division of Journal into a number of subsidiary books enables division of work, promotes specialisation increases efficiency and leads to saving in time and labour.

The following chart shows the sub-division of Journal



1.3.3 PURCHASE BOOK

Purchase book is also known as 'Invoice Journal' or Bought Journal. Purchase Journal issued for recording credit purchase of goods means for resale. Cash purchases will not be entered in purchases book (to entered in cash book) and credit purchases of goods not meant for resale viz. Assets, shall be entered in journal proper and not in the purchases book.

Form of Purchase Book :

Usual purchases book should have columns for date, invoice no., particulars, ledger folio, details and amount.

Invoice : When we purchase goods on credit we receive a statement from the supplier giving the particulars of goods supplied by him. The statement is called invoice. Invoice state quantity, price, value of goods and discount allowed.

Posting : Each entry appearing in the purchases book is posted daily or as soon as possible to credit of the account of the person from whom the goods were purchased and periodically, say at the end of each month, the purchased book is added up.

Example 1 : From the following transactions of a merchant, prepare the purchase book and post it into the ledger.

2009

January	1	Purchased goods on credit from Sharma Trading Co.-Rs.1234
	11	Purchased on credit from S.K.Das-Rs. 567
	25	Purchased on credit from Ram and Sons –Rs. 2345
	30	Bought goods from Ratan Bros. –Rs. 3265

Purchase Book

Date	Particulars	Invoice No.	L/F	Details	Amount Rs.
2009					
Jan. 1	Sharma Trading Co.				1234
11	S.K. Das				567
25	Ram and Sons				2345
30	Ratan Bros				3265
					7411

Sharma Trading Co.

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
				2009			
				Jan. 1	By Purchases		1234

S.K. Das

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
				2009			
				Jan. 11	By Purchases		567

Ram and Sons

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
				2009 Jan. 25	By Purchases		2345

Ratan Bros.

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
				2009 Jan. 30	By Purchases		3265

Purchase Account

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
2009 Jan. 31	To Sundries as per Purchase Book		7411				

1.5.4 PURCHASE RETURNS BOOK

The Purchase Return Book is also known as Return Outwards Book. It is used for recording returns of goods purchased. Goods purchased may have to be returned to the supplier for various reasons such as not up to sample or not ordered or damaged during the transit etc. While returning the goods to the supplier a letter is sent to them for their intimation and stating therein that we have debited your account of goods being returned herewith for the reasons stated.

Example-2

Record the following transactions in the Returns Outwards Books of M/s Raja Traders and post the same in Ledger.

2009

April	9	Returned goods to Sharma Trading Co. –Rs. 134
	20	Goods retuned to Gupta-Rs. 65
	25	Returned to Broad Ways –Rs. 500

Purchase Returns Book

Date	Particulars	Debit Note	L.F. Rs.	Details Rs.	Amt. Rs.
2009					
April 9	Sharma Trading Co.				134
20	Gupta bros.				65
25	Broad Ways				500
					699

Sharma Trading Co.

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
2009 April 17	To Purchases Returns		134				

Gupta Bros.

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
April 20	To Purchase Returns		65				

Broad Ways

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
April 25	To Purchases Returns		500				

Purchase Returns Account

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
				2009 April 30	By Sundries as per Purchases returns books		699

1.5.5 SALES BOOK

The Sales Book is also called Sales Day Book. It is employed for recording all goods sold on credit. Cash sales are not entered in this book.

Posting : Each individual sale recorded in the Sale Book is posted daily or as soon as possible to the debit of the personal account of the customer and the periodical total of the book is posted to the credit of sales account in the ledger by writing "By Sundries as per Sale Book".

Example-3 Write up the Sales book from the following transaction of a merchant and post it into the ledger.

2009

January	6	Sold goods to Mahesh Stores Rs. 532
	10	Goods sold to Banarasi Dass and Co. Rs. 150
	15	Sales to Ahmed and Co. R s. 782
	19	Sold goods to Das bros. for Rs. 390
	25	Goods sold to Mahesh Stores Rs. 1265
	30	Sold old Typewriter on credit to Mr. Raja

Sales Book

Date	Particulars	Invoice No.	L.F.	Details Rs.	Amt. (Rs.)
2009					
Jan. 6	Mahesh Stores				532
10	Banarsi Das and Co.				150
15	Ahmed and Co.				782
19	Das Bros.				390
25	Mahesh Stores				1265
					3119

Mahesh Stores

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
2009							
Jan 6	To Sales		532				
Jan 25	To Sales		1265				
			1797				

Banarasi Das and Co.

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
2009 Jan 10	To Sales		150				

Ahmed and Co.

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
2009 Jan 15	To Sales		782				

Dass Bros.

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
2009	To Sales		399				

Sales Account

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
				2009 Jan. 31	By Sundries as per sales book		3119

Note : Transaction dated January 30 will not be entered in the sales book. i.e. the sale of an asset.

1.5.6 SALES RETURNS BOOK

This is also known as Returns Inwards Book. It records all returns of goods sold. Goods sold may be returned by our customers for various reasons such as goods sent were of wrong description or inferior quality or damaged. When a customer returns goods, a credit note is made out in duplicate, the original being sent to him and the copy retained. Each entry appearing in the sales returns book is posted to the credit of the personal account of the customer and the periodical total of the book is posted to the debit of Sales Return Account in the ledger by writing "To sundries as per sales returns book".

Example-4 :

From the following transactions of a merchant prepare the sales return book and post it into the ledger.

2009

April 8 Goods returned by E. Parker R s. 32

30 Goods returned by Das Bros. amounted to Rs. 53

Solutions :

Sales Returns Book

Date	Particulars	Credit Note	L.F.	Details Rs.	Amt. Rs.
2009 April 8 30	E. Parker Das bros.				32 53 85

Sales Returns Account

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
2009 April 30	To Sundries as per Sales Returns Book		85				

E. Parker

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
				2009 April 8	By Sales Returns		32

Das Bros.

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
				2009 April 30	By Sales Returns		53

1.5.7 BILLS RECEIVABLE BOOK

All receipts of bills are entered in a book called Bills Receivable Book. Whenever a bill of exchange is received, particulars are entered in the appropriate columns of the bills receivable book.

Posting : The periodical total of the bills receivable is posted to the debit of the bills receivable account in the ledger. Each entry in the books is posted to the credit of the individual account from whom the bill is received.

Example 5 : Enter the following transaction in the B/R book and post them in ledger

2009

July 1 Received from Ram Lal for his Promissory note Rs. 400

2 Received acceptance from Sita Ram and Sons for 3 months Rs. 300

8 Sent out draft to Govind Ram who returns it to us duly accepted for two months Rs. 100

20 We drew on Ram Nath for four months bill Rs. 490.

Solution :

Bill Receivable Book

Date 2009	Particulars	Term	Due Date	L.F.	Amount
July 1	Ram Lal	———-	———-		400
5	Sita Ram and Sons	3 months	8th Oct.		300
8	Gobind Ram	2 months	11th Sept.		100
20	Ram Nath	4 months	23rd Nov.		490
					1,290

Ledger

Bill Receivable Account

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
2009 July 31	To Sundries as per Bills Receivable book		1,290				

Ram Lal Account

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
				2009 July 1	B/R A/C		400

Sita Ram and Sons

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
				2009 July 5	By B/R A/C		100

Govind Ram

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
				2009 July 8	By B/R A/C		100

Ram Nath

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
				2009 July 20	By B/R A /C		490

1.5.8 BILL PAYABLE BOOK

The details of the bills accepted by a trader recorded in a book is known as Bill Payable Book.

Posting :

The periodical total of the bills payable book is posted to the credit of the bills payable account in the ledger. Each entry in the book is posted to the debit of the individual account to whom the bill is granted.

Example 6 :

2009

Feb. 4 Accepted a bill 3m/d for Rs. 1000 drawn by M/s Ramesh & Co.

Feb. 10 A bill at 30d/d for Rs. 300 drawn by M/s Indra & sons was accepted this day.

Feb. 18 Gave a promissory Note to M/s Moti Lal & Co. For Rs. 200 Payable one month after date.

Feb. 27 Gave acceptance to Shri Brij Raj's bill for Rs. 400 Payable 2 m/d.

Feb. 28 Did not accept a bill drawn by Mohan for Rs. 200 Payable after 2 months.

Enter the above transactions in B/P book of the merchant and Post it into ledger.

Solution:

Bill Payable Book

Date	Particulars	J.F.	Term	Due Date	Amount
Feb 4	Ramesh & Co		3 months	May 7	1000
10	Indra & Sons		30 days	Mar. 11	300
18	Moti Lal & Sons		1 month	Mar.21	200
27	Brij Raj		2 months	Apr. 30	490
					1,900

Bill Payable A/c

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
					By sundries as per bill payable book		1900

Ramesh & Co.

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
Feb 4	To B/P A/c		1,000				

Moti lal & Co.

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
Feb 10	To B/P A/c		200				

Indra & Sons

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
Feb 10	To B/P A/c		300				

Brij Raj

Dr. **Cr.**

Date	Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
Feb 27	To B/P A/c		490				

1.5.9 JOURNAL PROPER

When a business is using various subsidiary books to record the each category of transactions, the journal will be used to record only those transactions which cannot be recorded in other subsidiary books. In this situation journal is known as journal proper. In the journal proper following types of transactions are recorded:

1. Transfer Entries
2. Opening Entries
3. Closing Entries
4. Adjusting Entries
5. Rectification of Errors
6. Entries related to dishonour of bill
7. Sale and Purchase of fixed assets on credit.
8. Any other transactions which cannot be recorded in subsidiary books.

Self Check Exercise:

Ques.1. What is journal Proper?

Ques.2. What are the various subsidiary books? Discuss in brief.

1.5.10 SUMMARY

As already discussed in this lesson the use of subsidiary books by the large business houses is very convenient and economical, so a book is provided for each category of business transactions which are repetitive in nature and are sufficient large in number.

Besides cash book, there are other subsidiary books, such as purchase book, Sales Book, Purchase Returns Book, Sales Returns Book, Bills Receivable Book, Bills Payable Book, Journal Proper and other Subsidiary Books.

1.5.11 ANSWERS TO SELF CHECK QUESTIONS

Ans.1. Journal Proper is also known as general Journal or miscellaneous Journal. It is used to record only those transactions for which no special subsidiary book or sub-journal is maintained as list below.

1. Bad debts written off
2. Bills dishonoured
3. Interest charged
4. Opening entries
5. Transfer from one account to another
6. Correction of errors
7. Adjustments etc.

Ans.2. Explain undermentioned subsidiary books:

1. Cash Books
2. Purchase Book
3. Sale Book
4. Purchase Returns Book
5. Sale Returns Book
6. Bills Receivable Book
7. Bills Payable Book etc.

1.5.12 GLOSSARY

1. B/R: Bills Receivable
2. B/P: Bills Payable
3. Invoice: A document, contains the description of the goods sold and details of the price.

4. Debit Note: A statement intimates the supplier that his account has been debited by a company with returned goods (i.e. purchases returns)
5. Credit Note: A statement issued by the supplier which intimates the company that its account has been credited as goods returned by it.

1.5.13 EXERCISE

(A) Short Questions:

Ques.1. Distinguish between journal and journal proper.

Ques. 2. What is debit and credit notes? why those are required?

Ques. 3. What is return outward book?

(B) Long Questions:

Ques.1. What do you mean by subsidiary books. Explain the procedure of preparing various subsidiary books.

Ques. 2. How purchase book and purchases returns book is prepared?

Ques. 3. How sales book and sales returns book is prepared?

1.5.14 SUGGESTED READING

1. Accounting and Financial Management
   By : Shashi K. Gupta, R.K. Sharma
   Kalyani Publishers
2. Basic Account
   By : S.P. Jain, K.L. Narang
   Kalyani Publishers.

***

CASH BOOK

Structure of the Lesson :

1.4.0 OBJECTIVES

The largest number of transactions in every business relates to cash and bank. A cash book records all cash and bank receipts on one side and all cash and bank payments on the other side. Thus, the main objective of this lesson is to explain the students basic concept and procedure of preparing various cash books like single column cash book, double and triple column cash books, Bank and petty cash books.

1.4.1 INTRODUCTION

One of the fundamental rules of double entry book keeping is that all entries must be recorded first in book of original entry and therefore posting should be done in the ledger. Cash book serves dual role of a ledger as well as of a journal. It is journal because all cash and bank transactions are recorded in it, as and when they take place and it is also a part of ledger because it contains the cash and bank account taken out of the ledger.

1.4.2 CONCEPT AND FEATURES OF CASH BOOK

The Cash Book is used to record all types of transactions related to cash and Bank. If cash bank is maintained, there is no need for preparing a cash account in the ledger. However, the other aspects of the transactions will be posted in the ledger. So the cash book of business help the businessman in knowing his cash position at all times.

Features of the Cash Book: The following are the main features of Cash Book :

1. Only Cash and bank transactions are recorded in the cash book.
2. It performs the functions of both the journal and ledger at the same time.
3. All cash transactions are recorded chronologically in the cash book, that is, date-wise.
4. All cash receipts are recorded on the credit side and all payments are recorded on the debit side of the cash book.
5. It records only one aspect of the transaction i.e. cash.
6. A cash book is prepared in a specific Performa.
7. The cash column of cash book always shows a debit balance, it indicates the cash in hand, while bank column can have debit as well as credit balance, indicating cash at bank or overdraft.

1.4.3 TYPES OF CASH BOOK

The types of cash book employed depends largely on the nature and requirements of every business concerned. Few of the more commonly used types of cash books are mentioned below:

i) Single Column Cash Book

ii) Double Columns Cash Book

iii) Triple Columns Cash Book

iv) Bank Cash Book

v) Petty Cash Book

1.4.3.1 Single Column Cash Book:

If a trader does not keep any bank account and does not allow or receive any cash discount, his cash book will record only Receipts and Payments of cash. It will be just like ordinary cash account. All cash received will be entered on the debit side and all payments on the credit side.

Balancing the Cash Book: To verify the accuracy of the entries made and to confirm the authenticity of cash balance it should be balanced daily. Balances as per cash book must tally with the actual cash in hand. As more cash cannot be paid than what you have, therefore, the cash balance must always be a credit balance

and it is to be entered on the credit side of the cash book for the purpose of closing the cash book. Opening balance of cash for the next period will appear on the debit side.

Example 1: Enter the following transactions in the cash book of Mr. Singh

2009

Jan 1 Cash in hand Rs. 1245

Jan 5 Received from Ratan Bros. RS. 356

Jan 7 Paid Rent Rs. 30

Jan 12 Paid Babu Lal Rs. 560

Jan 15 Cash Sales Rs. 325

Jan 25 Bought furniture for cash Rs. 120

Jan 31 Paid Salaries Rs. 125

Cash Book

Dr. **Cr.**

Date	Particular	Amount	Date	Particular	Amount
2009			2009		
Jan. 1	To Balance B/d	1245	Jan. 7	By Rent A/c	30
Jan 5	To Ratan Bros.	356	Jan. 12	By Babu Lal	560
Jan 15	To Sales A/c	325	Jan 25	By Furniture A/c	120
			Jan 31	By salaries A/c	125
			Jan 31	By Balance c/d	1091
		1926			1926

1.4.3.2 Double Column Cash Book :

If a trader does not keep a bank account but allows and receives discounts the cash discount can be conveniently recorded in the cash book by providing on either side one extra column for discounts. The discount columns on the debit side of cash book will record discounts allowed and that on the credit side discount received. Such a cash book is called two column cash book.

Balancing : Discount columns are not balanced but merely totalled. The total of discount column on the Dr. side of cash book is posted to the debit of discount allowed A/c and total of discount column on Cr. side of cash book is posted to credit side of the discount received account.

Example 2: From the following transactions write up a two column cash book and post it into the ledger.

2009 Jan 1 Cash in hand Rs 1257

Jan 5 Paid Ratan Bros. Rs. 395 discount received Rs. 5

Jan 7 Purchased goods for cash Rs. 150

Jan 10 Received from Hari and Co. Rs. 690 discount allowed Rs. 10

Jan 15 Cash Sales Rs. 496

Jan 17 Paid Sharma Trading Company Rs. 286

Jan 20 Received from Ram Mohan Roy Rs. 1289 discount Rs. 11

Solution :

Cash Book

Dr. **Cr.**

Date	Particulars	Dis.	Cash	Date	Particulars	Dis.	Cash
Jan. 1	To balance b/d	— -	1257	Jan. 5	By Ratan Bros.	5	395
Jan 10	To Hari and Co.	10	690	7	By Purchase A/c	—	150
Jan 15	To Sale A/c	—	496	17	By Sharma Trading A/c	—	286
Jan 20	To Ram Mohan Roy	11	1289	24	By Wage A/c	—	65
Jan 29	To Hari and Co.	—	500	27	By J. Walker	—	250
				28	By Machinery A/c	—	1500
				31	By Rent A/c	—	50
				31	By Balance C/d		1536
		21	4232			5	4232

Ratan Bros.

Date	Particulars	Amount	Date	Particulars	Amount
2009 Jan. 5	To Cash A/c	395			
	To discount A/c	5			

Purchase A/c

Date	Particulars	Amount	Date	Particulars	Amount
2009 Jan.5	To cash	150			

Hari and Co.

Date	Particulars	Amount	Date	Particulars	Amount
2009			2009		
			Jan. 10	By cash	690
			Jan. 10	By discount	10
			Jan. 29	By cash	500

Sales A/c

Date	Particulars	Amount	Date	Particulars	Amount
			2009		
			Jan. 15	By Cash	496

Sharma Trading Company

Date	Particulars	Amount	Date	Particulars	Amount
2009					
Jan. 17	To Cash	286			

Ram Mohan Roy

Date	Particulars	Amount	Date	Particulars	Amount
			2009		
			Jan. 15	By Cash	1289
			Jan. 15	By discount	11

Wages A/c

Date	Particulars	Amount	Date	Particulars	Amount
2009					
Jan. 24	To cash	65			

J. Walker

Date	Particulars	Amount	Date	Particulars	Amount
2009					
Jan. 28	To cash	250			

Machinery Account

Date	Particulars	Amount	Date	Particulars	Amount
2009					
Jan. 28	To cash	1500			

Rent Account

Date	Particulars	Amount	Date	Particulars	Amount
2009 Jan. 31	To cash	50			

Discount Account

Date	Particulars	Amount	Date	Particulars	Amount
2009 Jan. 31	To sundries as per cash book	21	2009 Jan. 31	By Sundries as per cash book	5

1.4.3.3 Triple Column Cash Book :

In modern times it is virtually impossible to imagine that any business worth its name, can be run without having dealings with a bank. It is appropriate as well as convenient that cash book should have not only cash and discount columns but also a bank column on either side. Triple column cash book has three columns on each side.

i) Discount Column : Which is nominal account,

ii) Cash Column : Which is real account

iii) Bank Column : Which is personal account.

Receipt side of the cash book is used to record all receipts both in cash, by cheques as also to record the discount allowed to our debtors while receiving the payment. Payment side of the cash book is used to record all payments both in cash and through cheques and also to record the discount received or availed by us from our creditors while making payment to them.

Contra Entries :

In the three column cash book there will be some cross or contra entries, i.e. transfer of money from cash to bank (amount deposited) and vice versa (amount withdrawn from the bank for office use). In all such cases both entries occur in the cash book and no ledger posting is required. This is indicated by a contra sign (c) in the folio column indicating that the double entry aspect of this transaction is complete and it requires no posting to the ledger.

Balancing :

Discount columns are totalled but not balanced. Bank columns are also balanced therefore, it is possible for the business to withdraw more than the amount deposited. In such a case total of the bank column on the credit side will be bigger than the debit side.

Example 3 : From the following transactions write up a three column cash book and post it into ledger.

2009

March 1 Cash in hand 567, cash at bank 15,675

2 Paid into bank Rs. 500

3 Received from Mohan Bros. Rs. 790, Discount allowed Rs. 10

7 Bought furniture for cash Rs. 260

10 Paid Ram Lal and Co. by cheque Rs. 475, discount received R s. 5

13 Received from Hamid Ali Cheque RS. 500 and paid into bank.

15 Cash sales 785, paid into bank 1000

17 Bought a motor car and paid for same by cheque Rs. 5,250

19 Paid J. Walker by cheque Rs. 367, Discount received Rs. 3

22 Drew from bank for office use Rs. 250

25 Goods purchased for cash Rs. 350

27 Paid Ram Lal and Co. by cheque Rs. 500

30 Received from Hamid Ali Rs. 195, discount allowed Rs. 5

31 Paid establishment by cheques Rs. 450

Mohan Bros.

Date	Particulars	Amount	Date	Particulars	Amount
			2009 March 3	By Cash By Discount	790 10

Furniture A/c

Date	Particulars	Amount	Date	Particulars	Amount
2009 Mar. 7	To Cash	260			

Ram Lal and Co.

Date	Particulars	Amount	Date	Particulars	Amount
2009 March 10 March 27	To Bank To discount To Bank	475 5 500			

Hamid Ali

Date	Particulars	Amount	Date	Particulars	Amount
			2009 March 31 March 30	 By bank By cash By discount	 500 195 5

Sales A/c

Date	Particulars	Amount	Date	Particulars	Amount
			2009 March 15	 By Cash	 785

Motor Car Account

Date	Particulars	Amount	Date	Particulars	Amount
2009 March 7	 To Bank	 5,250			

J. Walker

Date	Particulars	Amount	Date	Particulars	Amount
2009 March 19	 To Bank To Discount	 367 3			

Purchases A/c

Date	Particulars	Amount	Date	Particulars	Amount
2009 March 25	 To Bank	 350			

Establishment A/c

Date	Particulars	Amount	Date	Particulars	Amount
2009 March 31	 To Bank	 450			

Discount A/c

Date	Particulars	Amount	Date	Particulars	Amount
2009 March 31	To Sundries as per cash book	15	2009 March	By Sundries as per cash book	8

Cash Book

Dr. **Cr.**

Date	Particulars	L.f	Dis.	Cash	Bank	Date	Particulars	L.f.	Dis.	Cash	Bank
2009						2009					
Mar.	To Bal. b/d	—	—	567	15,675	Mar.					
1						2	By Bank	C	—	500	—
2	To Cash	C	—	—	500	7	By Furniture A/c		—	260	—
3	To Mohan Bros.		10	—	790	10	By Ram Lal and Co.		5	—	475
13	To Hamid Ali		—	—	500	15	By Bank	C	—	1000	—
15	To Sales A/c		—	785		17	By Motor Car A/c		—	—	5250
15	To Cash	C	—	—	1000	19	By J. Walker		3	—	367
22	To Bank	C	—	250		22	By Cash	C	—	—	250
30	To Hamid Ali		5	195		25	By Purchases A/c		—	350	—
						27	By Ram Lal and Co.		—	—	500
						31	By establishment		—	—	450
						31	By Balance C/d		—	477	10,383
			15	2,587	17,675				8	2,587	17,675
				477	10,383						

1.4.3.4 Bank Cash Book:

Whenever cash in being handled by the employees there is always danger that employees might embezzle cash. In order to minimise this risk many of the business units follow this policy that all cash received is deposited in the bank and all cheques received also sent to the bank for collection and all payments are to be made by the issue of cheque. When concern adopts this policy the book maintained by concern is called Bank Cash Book having two columns on each side : Bank and discount. In this book all receipts, whether in cash or by cheque, should be entered to the debit side of the book in bank column. All payments to be entered on the credit side of the book in the bank column.

Example 4 : On 1st January 2009, Mr. Chand opened a bank account by depositing Rs. 5000 in cash. All payments are to be made by cheque and all remittances received are to be paid into the bank on the same day on which they are received. Enter the following transactions in bank Cash Book.

2009

Jan 2 Cash Sales Rs. 560

Paid Lal Chand Rs. 380 after deducting cash discount of 5%

3 Received from Madan Lal a Cheque for Rs. 1480, discount allowed Rs

4 Paid Jindal Brother, RS. 500 on account

Mohan Lal's cheque dishonoured.

5 Received from Sohan Lal in Cash Rs. 980 after deduction of 2% cash discount.

7 Paid electric chares Rs. 15

Bank Cash Book

Date	Particular	L.F.	Dis.	Bank	Date	Particulars	L.F.	Dis.	Bank
2009	To Cash A/c		—	5000	2009	By Lal		20	380
Jan					Jan.				
1					2				
2	To Sales A/c		—	560	4	By Jindal		—	500
3	To Mohal Lal		20	1480	4	By Madan Lal		20	1480
6	To Sohan Lal		20	980	7	By Elec. Charges		15	—
					31	By Balance c/d		—	5,645
			40	8020				40	8020

1.4.3.5 Petty Cash Book :

The business which prefers to maintain bank cash book will feel the necessity of having another cash book for recording small payments which have to be made in cash. In other cases also petty cash book is preferred with a view to relieve the main cash book of numerous transactions involving petty amount. Such cash book is known as petty cash book. In every business there are certain expenses involving such a small amount which is to be paid in cash and not by cheques. Usual method of maintaining Petty Cash Book is to follow columns or analytical petty cash book. Column method of keeping petty cash, petty cashier is provided with fixed amount of money termed as float. This amount is sufficient to meet the balancing period of one week or one month. At the end of balancing period the petty cashier is given fresh cheque for the amount which he has spent.

Example 5:

M/s Ram Bros. maintain a petty cash book on imprest system with float of Rs. 300 reimbursement being made to the petty cashier at the end of each week. Draw columns for (i) Carriage (ii) Postage and Telephone (iii) Stationery (iv) Sundry Expenses (v) Ledger Account.

2009

March	1	Issued cheque to petty cashier	300
	2	Paid to Carriage	12
	2	Paid to postal stamps	25
	3	Purchase stationery for personal use	30
	4	Purchase stationery for office use	40
	5	Paid for newspaper magazines	15
	6	Paid for telegram	7
	7	Purchased Postage Stamps	22
	8	Advance to clerk Mr. Singh	40

Petty Cash Book

Amt. Rec.	Cash Book Folio	Date	Particulars	No.	Pay-ment	Postage and phone	Statio-nery	Sundry Exp.	Carriage	L.F.	Ledger	Remarks
300		2009 Mar.1	To bank									
		2	By carriage		12	—	—	—	12	—	—	—
		2	Postal Stamps		25	25	—	—	—	—	—	—
		3	Drawings		30	—	—	—	—	—	30	Drawing A/c
		4	Stationery		40	—	40	—	—	—	—	—
		5	Sundries (news Paper		15	—	—	15	—	—	—	—
		6	Telegram		7	7	—	—	—	—	—	—
		7	Postal Stamps		22	22	—	—	—	—	—	—
		7	Singh's A/c		40	—	—	—	—	—	40	Singh A/c
					191	54	40	15	12		70	—
			By Bal. C/d		109	—	—	—	—	—	—	—
					300	—	—	—	—	—	—	—
109		8	To bal. b/d			—	—	—	—	—	—	—
191		8	To Bank									

SELF CHECK EXERCISE

Ques 1. Define Cash book.

Ques 2. Name various types of cash book.

1.4.6 SUMMARY

Every business maintains a number of subsidiary books (as already discussed in previous lesson) where day to day transactions are recorded. These transactions are later posted to different accounts in the ledger. One of the subsidiary books that is Cash book is like a cash account in the ledger where receipts are recorded on the debit side and payments are recorded on the credit side. The difference between the amounts shown on both sides is the balance of cash or Bank. Thus, Cash book serves as a substitute for cash account and bank account in the ledger.

1.4.7 ANSWERS TO SELF CHECK QUESTIONS

Ans. 1 Cash Book : Cash book records all the transactions in cash or by cheque. It is a subsidiary as well as principal book of account, as there is no need for preparing a cash account in the ledger.

Ans 2. Following are the main types of Cash book:

1. Simple Cash Book
2. Double Column Cash Book.
3. Triple Column Cash Book
4. Bank Cash Book
5. Petty Cash Book

1.4.8 GLOSSARY

1. **Petty Cash Book** : A Separate book for recording small payments used by cashier.
2. **Imprest system** : A system in which petty cashier is given a specified amount for a period to spend, which the petty cashier is re-imbursed. so that he may have the same amount as he had in the beginning.
3. **Cash discount** : The reduction in amount allowed to a debtor and received from a creditor is known as cash discount.
4. **Contra Entry** : An entry which appears on both the sides of an account is known as contra entry.
5. **Float/ Imprest** : A specific amount given to the petty-cashier in the beginning of the period is known as float.

1.4.9 EXERCISE

(A) Short Questions:

Ques. 1 What type of transactions are included in Cash book?

Ques 2 What is a Contra entry?

Ques 3 Explain the meaning of Bank Cash book.

(B) Long Questions

Ques. 1. Explain the meaning of Three column cash book. Describe the procedure of recording entries in this book.

Ques. 2. Cash book is both 'Journal' and 'Ledger'? Explain, Give a Performa of Analytical Petty cash book.

Ques. 3. Prepare triple column cash book of Arun from the particulars given below. Also post them into the ledger.

2009

June 1 Cash Balance (Dr.) Rs. 400; bank Balance (Cr.) Rs. 1200.

5 Draw cash for office use Rs. 1000.

Paid wages for Rs. 500, Income Tax Rs. 300, Rent Rs. 150.

6 Cash Sales Rs. 300.

Cash purchases Rs. 250.

7 Received cheque from Ahmed fro Rs. 650 in full settlement of his account Rs. 700.

8 Issued cheque in favour of Harmen Singh and Sons in full settlement of the amount due to them of Rs. 400 less 2% discount.

9 Received by sale of wastage etc. Rs. 100; and a cheque from Sardar and Sons of Rs. 400; discount allowed Rs. 15.

10 Paid Octroi in cash Rs. 50.

11 Cheque of Ahmed returned dishonoured, bank charges Rs. 5.

15 Received from the estate of Banarsi against debt previously written off Rs. 400.

16 Issued cheque in favour of Abid for Rs. 480, discount availed 4%

18 Our cheque to Abid dishonoured.

19 Issued new cheque to Abhid for full amount due.

[Ans : Cash in hand Rs. 950, Bank Overdraft Rs. 2,697]

1.4.10 SUGGESTED READINGS

1. Accounting and Financial Management
By : Shashi K. Gupta, R.K. Sharma
Kalyani Publishers.

2. Basic Account
By : S.P. Jain, K.L. Narang
Kalyani Publishers.

Lesson No. 1.5 **Author: Mrs. Dalbir Kaur**

LEDGER

Structure of the Lesson:

1.5.0 OBJECTIVES

The Ledger is the most important book of the accounting system in every business concern and there is no exception to it. So the main purpose of this Lesson is to introduce the students with the concept and practical use of Ledger in the accounting world.

1.5.1 INTRODUCTION

As discussed in the earlier Lessons, when the transactions by a business for a given period of time have been recorded in the Journal, the next thing is to classify Journal entries according to the accounts affected, that is, posting of transactions into various Leger/account.

According to L.C.Cropper, "The book in which all the transactions of a trader are recorded in a classified permanent form is called Ledger." Ledger is also called the principal book.

1.5.2 PERFORMA OF A LEDGER ACCOUNT

Ledger is a collection of all the three types of accounts personal, Real and Nominal. In Ledger we maintain accounts. Each account is allotted one or more pages depending upon the requirements.

Account is an accounting device used in recording and summarising the increase and decrease in money terms in a specific asset, liability, owner's equity, revenue or expenses etc.

Ledger is usually ruled in following manner as shown in its Performa.

Name of Account

Dr. **Cr.**

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

Ledger account has a T form. There are two sides of every account, the left hand side is known as the debit side and the right hand side is known as the credit side. Each side has four columns. These are as follows.

(i) Date (ii) Particulars (iii) Journal folio and (iv) Amount

The columns are explained as under:

(i) Date columns

In this column, the date of every transaction is to be written, indicating year, month and day of each item of an account.

(ii) Particulars Column

On the debit side in this column, the entry written is prefixed by the word "To" whereas on the credit side the entries are prefixed by "By"

a) on the debit side, after the words "To" write:
Name of the credit part of the journal entry.

b) on the credit side, after the word "By", write.
Name of the debit part of the Journal entry.

iii) Journal Entry Column

Write here the page number of the journal from where the entry is posted into the ledger to facilitate reference in future.

iv) Amount Column

In this column of an account, the amount is written. The amount in the debit column of the journal, on the debit side and the amount in the credit column of the journal, on the credit side.

An alternative form of the ledger account is also given as follows :

Date	Particulars	Journal Folio	Debit	Credit Rs.	Dr. or Rs.	Balance Cr. Rs.

In this type of ledger account, the balance of an account is ascertained after every transaction, but in the general, the first type of ledger account i.e. T-shape account ahs been used.

1.5.3 SUB-DIVISION OF LEDGER

For a small businessman, it may be possible to keep all the accounts in one ledger because the number of transactions is limited. But for a large business, it will be convenient to sub-divide the ledger as given below.

a) The Debtors Ledger

This part of the ledger contains the accounts of all the customers of the business to whom goods have been sold on credit, showing the goods sold, cash received and discount allow etc. From this ledger, the businessman can know immediately, what is the total amount due to the business by various customers. This is also known as the sales ledger.

b) The Creditors Ledger

This is known as the purchase ledger. This section contains the accounts of the persons or firms who supply goods to the business on credit. These accounts shows goods purchased, cash paid and discount received etc. This ledger helps the businessman to know the balance due to each creditor.

1.5.4 ADVANTAGES OF THE LEDGER

The following are the advantages of the Ledger.

1 It can presents information about total purchases and sales as and when required.

2 The total debtors and total creditors can be known from personal accounts.

3 The ledger records every assets separately hence, it can readily give the present book value of the asset.
4 The ledger helps in preparing the profit and loss account of the business.
5 The ledger accounts help the business to know the amounts of different incomes and expenditures.
6 The ledger accounts are helpful in preparing trial balance to know the arithmetical accuracy of the accounts.
7 It is the ledger which helps the business to prepare the balance sheet to know the financial position of the business.

1.5.5 Procedure of Posting into the Ledger

Every journal entry involves at least two accounts, indicating the accounts to be debited and credited. As each transaction is posted in two accounts i.e. in one account on the debit side and the other account on the credit side. When an account is to be debited, we shall write on the debit side of that account, the name of the other account and the corresponding amount will also be written on the same side. When an account is to be credited, we shall write on the credit side of that account the name of the other account and the corresponding amount will also be written on the credit side. The word 'To' is always written on the debit side before the name of the account and 'By' on the credit side before the name of the account.

1.5.6 ILLUSTRATION-I

Journalise the following transactions in the books of Arvind and post then into ledger:
2009 April 1: Commenced business with Rs. 20,000, paid into the Bank Rs. 10,000.
April 3 Bought furniture for Rs. 900.
April 4 Bought goods from Ram Krishan for Rs. 4,000 for cash.
April 5 Sold goods for Rs. 1700.
April 7 Paid Telephone expenses Rs. 400.
April 8 Purchased goods for Rs. 1,000 from Gupta and Sons.
April 9 Paid Rs. 100 for advertisement by cheque.
April 12 Purchased a typewriter for Rs. 8,000 on credit from Yogesh.
April 12 Sold goods to Ragav for Rs. 2,900.
April 14 Withdraw Rs. 350 from bank for private use.
April 16 Sold goods to Ram for Rs. 900 for cash.
April 24 Received cash from Ragav Rs. 2,850, discount allowed Rs. 50.
April 28 Paid into the bank Rs. 2,500.
April 30 Issued a cheque for Rs. 300 in favour of landlord for rent for the month of April.
April 30 Paid salaries to staff Rs. 2,000
April 30 Issued a cheque in favour of Gupta and sons for Rs. 950 in full settlement of their account.

Journal of Arvind Mahajan

Date	Particulars		L.F.	Rs. Dr.	Rs. Cr.
2009 April	Cash Account To Capital Account (Cash brought in as capital)	Dr.		20,000	 20,000
April1	Bank Account To Cash Account (Cash deposited in the bank)	Dr. Dr.		10,000	 10,000
April 3	Furniture Account To Cash Account (Being furniture purchased)	Dr.		900	 900
April 4	Purchases Account To Cash Account (Being goods purchased for cash)	Dr.		4,000	 4,000
April 5	Cash Account To Sales Account (Being goods sold for cash)	Dr.		1,700	 1,700
April 7	Telephone Expenses Account To Cash (Being goods sold for cash)	Dr.		400	 400
April 8	Purchases Account To Gupta & Sons (Goods purchased on credit)	Dr.		1,000	 1,000
April 9	Advertisement Account To Bank Account (Payment for Advertisement paid by cheque)	Dr.		100	 100

April 12	Office Equipment Account Dr. To Yogesh (Purchased one typewriter on credit)		8,000	 8,000
April 12	Ragav Dr. To Sales Account (Being goods sold on credit)			2,900 2,900
April 14	Drawing Account Dr. To Bank Account (Amount withdrawn for personal use)		350	 350
April 16	Cash Account Dr. To Sales Account (Goods sold for cash)		900	 900
April 24	Cash Account Discount Account Dr. To Ragav (Being cash received and discount allowed)		2850 50	 2900
April 28	Bank Account Dr. To Cash Account (Cash deposited)		2,500	 2,500
April 30	Rent Account Dr. To Bank Account		300	 300
April 30	Salaries Account Dr. To Cash Account (Salary paid)		2,000	 2,000
April 30	Gupta & Sons Account Dr. To Bank Account To Discount Account (Cheque paid in full settlement)		1,000	 950 50

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

2009			2009		
April1	To Capital Account	20,000	April	By Bank Account	10,000
April5	To Sales Account	1,700	April3	By Furniture Account	900
April 16	To Sales Account	900	April 4	By Purchase Account	4,000
April 24	To Ragav	2,850	April 7	By Telephone Exp. Account	400
			April 28	By Bank Account	2,500
			April 30	By Salaries	2,000
			April 30	By Balance c/d	5,650
		254,50			25,450
May1	To Balance b/d	25,650			

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

2009				2009	
April 30	To Balance c/d	20,000	April	By Cash Account	20,000
			May 1	By Balance b/d	20,000

Dr. **Bank Account** **Cr.**

2009				2009	
April	To Cash Account	10,000	April 9	By Advertisement	100
April 28	To Cash Account	2,500	April 14	By Drawing Account	350
			April 30	By Rent Account	300
			April 30	By Gupta & sons	950
			April 30	By Balance c/d	10,800
		12,500			12,500

May 1	To Balanced b/d	10,800			

Dr. Furniture Account Cr.

2009			2009		
April 3	To Cash Account	900	April 30	By Balance c/d	900
May 1	To Balance b/d	900			

Dr. Discount Account Cr.

2009			2009		
April 24	To Ragav Account	50	April 30	By Gupta & sons	50

Dr. Telephone Expenses Account Cr.

2009				2009	
April 7	To Cash Account	400	April 30	By Balance c/d	400
May 1	To Balance b/d	400			

Dr. Advertisement Account Cr.

2009			2009		
April 9	To Bank	100	April 30	By Balance c/d	100
May 1	To Balance b/d	100			

Dr. Gupta & Sons Account Cr.

2009			2009		
April 3	To Bank Account	950	April 8	By Purchase Account	1,000
April 30	To Discount Account	50			
		1,000			1,000

Dr. Drawing Account Cr.

2009			2009		
April 14	To Bank Account	350	April 30	By Balance c/d	350
May 1	To Balance b/d	350			

Dr. Rent Account Cr.

2009			2009		
April 30	To Bank Account	300	April 30	By Balance c/d	300
May 1	To Balance b/d	300			

Dr. Salaries Account Cr.

2009			2009		
April 30	To Cash Account	2,000	April 30	By Balance c/d	2,000
May 1	To Balance c/d	2,000			

Dr. Office Equipment Account Cr.

2009			2009		
April 12	To Yogesh	8,000	April 30	By Balance c/d	8,000
May 1	To Balance b/d	8,000			

Dr. Yogesh's Account Cr.

2009			2009		
April 30	To Balance c/d	8,000	April 12	By office Equipment Account	8,000
			April 30	By Balance b/d	8,000

Dr. Ragav's Account Cr.

2009				2009	
April 12	To Sales Account	2,900	April 24	By Cash	2,850
			April 24	By Discount	50
		2,900			2,900

Dr. Purchases Account Cr.

2009			2009		
April 4	To Cash Account	4,000	April 30	By Balance c/d	5,000
April 8	To Gupta & Sons	1,000			
		5,000			5,000
May 1	To Balance b/d	5,000			

Dr. Sales Account Cr.

2009			2009		
April 30	To Balance c/d	5,500	April 5	By Cash	1,700
			April 12	By Ragav	2,900
			April 16	By Cash	900
		5,500			5,500
			May 1	By Balance b/d	5,500

1.5.7 BALANCING AN ACCOUNT

First of all the transactions are recorded in the journal and then these are posted to the ledger account. The next step after ledger-posting is balancing the accounts. The process of finding out the difference between the totals of the two sides of a ledger account is known as balancing and the difference of the total debits and total credits of accounts is known as balance.

Balancing is done either weekly, monthly, quarterly, bi-annually or annually, depending on the requirements of the business concern.

Balancing of different Accounts:

The balancing of various accounts are ascertained as under:

1. **Personal Accounts**: Personal accounts are balanced regularly to know the amounts due to the persons or due from the persons. In the case of a Bank Ledger, Personal accounts are balanced after every transaction. A debit balance of this account indicate that the person concerned is a debtor of the business concern and a credit balance indicate that he is a creditor of the business concern.
2. **Real Account**: Real account are generally balanced at the end of the accounting year when final accounts are prepared. However cash account is invariably balanced daily to know the cash in hand at the end of each day.
3. **Nominal Account**: The Nominal accounts are not balanced, as they are to be closed by transferring them to the final accounts.

   Note: When the totals of the debit and credit sides are similar, i.e. equal the account is not said to be balanced, but closed.

1.5.8 CONCEPT AND POSTING OF AN OPENING ENTRY

In case of going concern, at the beginning of the new year, new books of accounts are opened and the balances appearing in the books at close of the previous year are brought forward in new books. For this purpose the entry in the books is called opening entry.

Rule of passing an opening entry is to Dr. each asset A/C and Cr. each liability A/C including capital.

If amount of capital is not given then this can be found out with the help of the accounting equation as shown below.

Assets = Liablities + Capital Capital = Assets - Liabilities

Posting of an Opening entry: The posting of an opening entry is different from the posting of ordinary entry. The account which have been debited in the journal are also debited in the ledger with their respective amounts by writing 'To balance b/d'. The accounts of liabilities and capital which are credited in the journal are incorporated in the ledger by writing 'By Balance b/d" on the credit side.

1.5.9 CONCEPT AND POSTING OF COMPOUND ENTRY

When two or more transactions of similar nature take place on the same date, then instead of recording separate entries, a single entry may be written which is known as

compound or combined entry. Such entry can be recorded in the following ways:

1. One account debit and two or more accounts credit.
2. One account credit and two or more accounts debit.
3. Two or more than two accounts debit and credit.

Posting of compound Entry: While posting a compound entry due care must be exercised as it may involve one debit but more than one credits of equal value of vice-versa. Such entry can be posted in the following manner:

1. In the particular column of the debit side the respective accounts, begin with the word To and write the name of the other accounts which has been credited in the journal, with the amount as written before such accounts in the journal.
2. In the particular column on the credit side of the account, begin with the word By and write the name of the other account which has been debited in the journal, with the same amount as written before such accounts in the journal.

1.5.10 DISTINCTION BETWEEN JOURNAL AND LEDGER

Ledger and Account are two different terms and are used for different purposes. The term 'Account' indicates the manner in which the information is set out and the term 'Ledger' is the name given to the book in which accounts are kept.

Distinction between Journal and Ledger:

Journal	Ledger
1. It is a book of original entry.	1. Ledger is the main book of account
2. In journal transactions are recorded as and when occur.	2. In Ledger posting is done periodically, may be weekly, fortnightly etc.
3. The both debit and credit aspects of a transaction are entered in the journal.	3. In the Ledger, entries are posted in respective accounts only with aspect only i.e. either debit or credit aspect.
4. Journal does not disclose the complete position of an account.	4. The Ledger indicates the position of each account debit wise or credit wise.
5. In Journal transactions are recorded in the form of Journal entries.	5. In Ledger transactions are recorded in the form of an account.
6. Entering the transactions in the Journal is called Journalising.	6. The act of recording in the ledger is called posting.
7. The journal carries more evidential value.	7. The ledger carries less evidential value.

Self Check Exercise

Ques 1. Define Ledger and give its Performa in detail.

Ques 2. Post the following entries into the ledger:

1. Purchased goods on credit from A Rs. 800.
2. Paid Sundry Expenses for Rs. 50.
3. Cash sales for Rs. 1500.
4. Sold goods to X for Rs. 750.
5. Paid A Rs. 750 and received discount for Rs. 50.
6. Received cash Rs. 500 from X.
7. Paid salaries Rs. 500 and Rent Rs. 100.

1.5.11 SUMMARY

A Journal, Prime book of entries fails to achieve the main purpose of book-keeping, of disclosing the amount of debtors, creditors, assets, profits earned or losses incurred. etc. This shortcoming of the journal is made good by the ledger, as all the transactions are recorded at one place in a ledger.

So, the first step of accounting process is journalising the business transactions and the next step is to classify the journal entries according to the accounts of a trader, personal, real or nominal for permanent record in the ledger book. After this Ledger accounts may be balanced as and when it is required, and then finally transferred to the trial balance statement.

1.5.12 ANSWERS TO SELF CHECK QUESTIONS

Answer No.1 Ledger : Ledger is also known the principal book of accounts. It has T form, which has two sides of every account. The left side is known as the debit side and the right side is known as the credit side. E ach side has four columns.

Answer No. 2 To post these entries open following accounts:

1. Purchases and A account
2. Sundry expenses and cash A/c
3. Cash and sales A/c.
4. Sales and X A/C.
5. A, cash and discount received A/C.
6. Cash and X A/C.
7. Salaries, Rent and Cash A/C.

1.5.13 GLOSSARY

1. Ledger : Principal book of Accounts

2. Dr. : Debit
3. Cr. : Credit
4. To bal b/d : It is used to balance brought down in the account in the beginning.
5. By bal. b/d : It is used to balance carried down at the time of closing of an account.

1.5.14 EXERCISE

(A) Short Questions:

Ques. 1. Give the advantages of the ledger.

Ques. 2. Define an opening entry.

Ques. 3. Give the concept and posting procedure of the compound entry.

(B) Long Questions:

Ques 1. What are the rules for posting the entries into ledger?

Ques. 2. Define the term 'Account'. Distinguish between Journal and Ledger.

Ques. 3. Enter the following transactions in the Journal and post them into ledger:

2009 June 1. Mukesh started business with a capital of Rs. 1,00,000.

June 2. Deposited Rs. 20,000 into bank.

June 3. Purchased furniture for Rs. 3,000.

June 5. Purchased goods from Rafi on credit for Rs. 15,000.

June 5. Sold goods to lata for Rs. 8,000.

June 7. Paid cash to Rafi Rs. 10,000 on account.

June 12. Received Rs. 5,000 from Lata.

June 15. Paid rent for the shop Rs. 1500.

June 20. Sold goods to Jatin for Rs. 7000.

June 30. Paid Salary by cheque Rs. 2000.

1.5.15 SUGGESTED READINGS

1. Accounting and Financial Management
   By : Shashi K. Gupta
   R.K.Sharma (Kalyani Publishers)
2. Basic Accounting
   By : S.P. Jain
   K.L. Narang (Kalyani Publishers)

LESSON NO. 1.6 **AUTHOR: MRS. DALBIR KAUR**

TRIAL BALANCE

Structure of the Lesson:

1.6.0 OBJECTIVES

The main objective of this lesson is to explain the students basic concepts methods and procedure of preparing trial Balance. To highlight the utility of trial balance this lesson also explaining various errors which can be revealed and cannot be revealed by preparing Trial Balance.

1.6.1 INTRODUCTION

The fundamental principle of double entry system of accounting is that for every debit, there must be a corresponding credit. Thus for every debit or a series of debits

given to one or several accounts, there is a corresponding credit or a series of credits of an equal amount given to some other account or accounts and vice versa. It follows, therefore, that the sums total of debit amounts should equal the credit amounts of the ledger at any date.

Thus at the end of financial year or at any other time, the balances of all the ledger accounts are entranced and are written up in a statement known as Trial Balance.

The agreement of the Trial Balance reveals that both the aspects of each transaction have been recorded and that the books are arithmetically accurate. If the Trial Balance does not agree, it shows that there are some errors which must be detected and rectified if the correct final accounts are to be prepared. Thus, Trial Balance forms a connecting link between the ledger accounts and the final accounts. Balance forms a connecting link between the ledger accounts and the final accounts.

1.6.2 OBJECTS AND LIMITATIONS OF PREPARING TRIAL BALANCE

The main objects of preparing the Trial Balance are as follows :

(i) **To Check the accuracy of Double Entry System** : According to the principle of double entry every transaction has two aspects : One debit and the other is credit. The trial balance is a proof of accuracy of double entry system.

(ii) **Helpful in preparing financial accounts** : The Trial Balance records the balances of various ledgers at one place which helps in the preparation of profit and loss account and Balance Sheet which can be used for knowing the financial position of the business.

(iii) **Arithmatical Accuracy** : To have arithmetical accuracy of the books of accounts because of the agreement of the Trial Balance.

(iv) **Summary** : This is summary of various ledger. The ledger can be used for detailed information, if need so arises.

Limitations of the Trial Balance

The main limitations of the Trial balance are as follows :

(i) Trial Balance can be prepared only in those concerns, where double entry system of accounting is adopted.

(ii) Though Trial Balance gives arithmetical accuracy of the books of accounts but there are certain errors which are not disclosed by the Trial Balance.

(iii) If trial Balance is not prepared correctly then the final accounts

prepared will not reflect the true and fair view of the state of affairs of the business.

(iv) Conclusions and decisions are made by various groups of persons will mislead such persons, as trial balance is not a conclusive proof of accuracy of the books of accounts.

1.6.3 PREPARATION OF TRIAL BALANCE

Trial Balance can be prepared by the following methods :

1.6.3.1 Total Method : In this method, the debit and credit totals of each account are shown in the two amount columns, one for the debit total and other for the credit total against it.

1.6.3.2 Balance Method : In this method, the difference of each account is extracted. If debit side of an account is bigger, the difference is written in the debit column of the Trial Balance and if credit side is bigger, the difference is written in the credit column of the Trial Balance.

1.6.3.3 Total and Balance Method : In this method debit total and credit total of all accounts as well as balances of all accounts are shown as given below.

Sr. No.	Name of the Account	L.F	Total debit (Rs.)	Total credit (RS.)	Dr. Balance Rs.	Cr. Balance Rs.

1.6.3.4 Totals Excluding closed Account Method : In this method, the debit and credit figures of the accounts are written in the Trial Balance just like the first methods, with the difference that the totals of those accounts of which the debit and credit sides are equal, are not entered in the trial balance.

1.6.4 ILLUSTRATION 1

Following are the transactions of Sumirat and Sons of Company. Write up the books and prepare trial balance.

Jan. 2009 Assests : Goodwill Rs. 18,000, Building Rs. 27,000, Stock Rs. 52,000, Bank Balance Rs. 7000, Cash in hand Rs. 1480, Due from Ram Chander Rs. 960, Due from Desh Pandey Rs. 2000, Machinery Rs. 15,000

Liabilities : Loan from X @9% Rs. 30,000 Due to Radha Rs. 7,000

Jan. 2 Drawn from bank Rs. 2,000

3 Wages Paid RS. 1800

5 Purchases from Radha on Credit Rs. 6,000

6 Return to Radha Rs. 500

8 Sales to Badshah Khan on credit Rs. 8,000

10 Received from Desh Pandey Rs. 1900 by cheque in full settlement.

12 Paid by cheque to Radha in full settlement of the amount due on Jan. 1 Rs. 6900

13 Cash paid for machine repair Rs. 300

14 Sales to Desh Pandey on Credit Rs. 9,000

15 Received from Ram Chander by cheque Rs. 960

16 Salaries paid Rs. 500

17 Purchases on credit from Inder Mal Rs. 2000

18 Purchases from Prakash on credit R. 500

19 Sales on cash Rs. 5000, received cheque

20 Rent paid Rs. 300 by cheque

20 Insurance premium paid Rs. 350 by cheque

21 Drawn from bank for private use Rs. 1,000

23 Sales to X and Co. on credit Rs. 2500

25 Paid for advertisement Rs. 500 by cheque

26 Paid for repair to building for month Rs. 200

31 Bank charged interest for month Rs. 50

31 Allow interest on capital @ Rs. 10% p.a

31 Received from X and Co. by cheques Rs. 2,000

General Journal

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
2009					
Jan. 1	Goowill A/c	Dr.		18,000	
	Building A/c	Dr.		27,000	
	Stock	Dr.		52,000	
	Bank	Dr.		7,000	
	Cash	Dr.		1,480	
	Ram Chander	Dr.		960	
	Desh Pandey	Dr.		2,000	
	Machinery	Dr.		15,000	
	To Loan				30,000
	To Radhaswamy				7,000
	To Capital A/c (B/F)				86,400
	(Opening entry Capital A/c is excess of Asset over liabilites)				
Jan. 31	Interest A/c	Dr.		725	
	To Capital A/c				725
	(Interest @ 10% allowed on Opening Balance of Capital)				

Cash Book

Date	Particulars	L.F	Disc.	Bank	Cash	Date	Particulars	L.F	Disc.	Bank	Cash
2009						2009					
Jan.1	To balance			7,000	1480	Jan.2	By Cash	C	—	2000	—
2	To Bank	C	—		2000	3	By Wages		—	—	1800
10	To Desh Pandey		100	1900	—	12	By R adha		100	6900	—
15	To Ram Chander		—	960	—	13	By Repairs		—	—	300
19	To Sales		—	5000	—	15	By Salaries		—	—	500
31	To X and Co.		—	2000	—	18	By Purchases		—	—	500
						20	By Rent		—	300	—
						20	By Insurance		—	350	—
						21	By Capital A/c		1000	—	
						25	By Advt.	—	500	—	
						26	By Repairs			—	200
						31	By Interest		—	50	—
							By Bal. C/d			5760	180
			100	16,860	3480				100	16,860	3480

Purchase Book

Date	Particulars	Invoice No.	L.F.	Rs.
2009				
Jan. 5	Radha			6,000
Jan. 17	Inder Mal			2,000
				8,000

Sales Book

Date	Particulars	Invoice No.	L.F.	Rs.
2009				
Jan. 8	Badshah Khan			8,000
Jan. 13	Desh Pandey			9,000
Jan. 23	X and Co.			2,500
				19,500

Purchase Returns Book

Date	Particulars	Invoice No.	L.F.	Rs.
2009				
Jan. 6	Radha			500
				500

Ledger

Capital Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2009				2009			
Jan. 21	To Bank		1000	Jan. 1	To Balance b/d		86,940
Jan. 31	To Bal. c/d		86,665	Jan. 31	By Interest		725
			87,665				87,665
					By Balance b/d		87,665

Radha A/c

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2009				2009			
Jan. 12	To Bank		7,000	Jan. 1	By Balance b/d		7,000
Jan. 6	To Purchase Returns		500		By Purchase		6,000
Jan. 31	To bal. C/d		5,500				
			13,000				13,000
					By bal b/d		5,500

Interest A/c

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2009				2009			
Jan. 31	To Capital		725	Jan. 31	By Balance c/d		775
	To Bank		50				
	To bal. b/d		775				775

Loan A/c

Dr. **Cr.**

				2009			
				Jan. 1	By bal. b/d		30,000

Sales Account

Dr. **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2009				2009			
Jan. 31	To Bal. c/d		24,500	Jan. 19	By Bank		5,000
				Jan. 31	By Sales as per Sales Book		19,500
			24,500				24,500
					By Bal. b/d		24,500

X and Co. A/c

Dr. **Cr.**

Date	Particulars	J.F	Rs.	Date	Particulars	J.F	Rs.
2009				2009			
Jan. 23	To Sales		2,500	Jan. 31	By Bank		2,000
				Jan. 31	By Balance c/d		500
			2500				2500
Feb. 1	To Bal. b/d		500				

Good will A/c

Dr. **Cr.**

Date	Particulars	J.F	Rs.	Date	Particulars	J.F	Rs.
Jan. 1	To Bal. b/d		18000				

Building A/c

Dr. **Cr.**

Date	Particulars	J.F	Rs.	Date	Particulars	J.F	Rs.
Jan. 1	To Bal. b/d		27,000				

Stock A/c

Dr. **Cr.**

Date	Particulars	J.F	Rs.	Date	Particulars	J.F	Rs.
Jan. 1	To Bal. b/d		52,000				

Ram Chander A/c

Dr. **Cr.**

Date	Particulars	J.F	Rs.	Date	Particulars	J.F	Rs.
Jan. 1	To Bal. b/d		960	Jan. 15	By Bank		960

Desh Pandey A/c

Dr. **Cr.**

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Rs.
Jan. 1	To Bal. b/d		2,000	Jan. 10	By Bank		2,000
13	To Sales		9,000	Jan. 31	By balance c/d		9,000
			11,000				11,000
Feb.1	To Bal. b/d		9,000				

Machinery A/c

Dr. **Cr.**

Jan. 1	To Bal. b/d		15,000				

Wages A/c

Dr. **Cr.**

Jan. 3	To Cash		1,800				

Repairs A/c

Dr. **Cr.**

Jan. 13	To Cash		300	Jan. 31	By Balance c/d		500
	To Cash		200				
			500				500
Feb. 1	To Bal. b/d		500				

Purchases A/c

Dr. **Cr.**

Jan. 18 Jan. 31	To Cash To Purchase as per Purchase book		500	Jan. 31 8,000	By balance c/d		8,500
			8,500				8,500

Purchase Return A/c

Dr. **Cr.**

				Jan. 31	By Purchases returns as per purchase book		500
							500

Salaries A/c

Dr. **Cr.**

Jan. 15	To Cash		500				

Rent A/c

Dr. **Cr.**

Jan. 20	To Bank		300				

Insurance A/c

Dr. **Cr.**

Jan. 20	To bank		350				

Discount A/c

Dr. **Cr.**

Jan. 31	To Cash book		100	Jan. 31	By Cash Book		100
			100				100

Inder Mal's A/c

				Jan. 17	By Purchases		2,000

Badshah Khan's A/c

Jan. 8	To Sales		8,000				

Advertisement A/c

Jan. 25	To Bank		500				

Trial Balance

Serial No.	Name of Account	Dr. (Rs.)	Cr. (Rs.)
1	Capital	——	86,665
2	Goodwill	18,000	——
3	Building	27,000	——
4	Stock	52,500	——
5	Machinery	15,000	——
6	Desh Pandey	9,000	——
7	Radha	——	5,500
8	Loan	——	30,000
9	Interest	775	——
10	Sales	——	24,500
11	X and Co.	500	——
12	Wages	1,800	——
13	Repairs	500	——
14	Purchases	8,500	——
15	Purchase Return	——	500
16	Salaries	500	——
17	Rent	300	——
18	Insurance	350	——
19	Inder Mal	——	2,000
20	Badshah Khan	8,000	——
21	Advertisement	500	——
22	Cash in Hand	180	——
23	Cash at bank	5,760	——
		1,49,165	1,49,165

1.6.5 ERRORS REVEALED AND NOT REVEALED BY TRIAL BALANCE

If the two sides of a trial balance agree it is prime facie evidence of the arithmetical accuracy of the entries made in the ledger. But even if the balance agree, it does not necessarily mean that accounting records are free from all errors, because there are certain types of errors which are not revealed by trial balance. Therefore a trial balance should not be regarded as a conclusive proof of accuracy of accounts.

1.6.5.1 Errors Revealed by Trial Balance

(i) **Omission to post an amount into Ledger** : If an item is not posted from Journal or subsidiary book to ledger, two sides of trial balance shall not agree, e.g. if goods sold on credit to A recorded properly in sales book but not debited to A's account in ledger, the debit side of trial balance shall fall short.

(ii) **Omission to post an amount in Trial balance** : It is natural that if balance of an account is not recorded in trial balance, two sides of trial balance shall not agree. This is an indication of error in accounts.

(iii) **Wrong totalling or Balancing of ledger account** : If any account in the ledger is wrongly totalled or balanced then also the trial balance shall not agree.

(iv) **Wrong totalling of Subsidiary Books** : If total of any of the subsidiary book is wrong, the trial balance will not agree.

(v) **Posting on wrong side** : If any entry which was to be posted on the debit side of some account is posted on credit side of same account or any other account will create difference in both sides of trial balance.

(vi) **Posting of wrong amount** : If while posting some entry in the ledger the amount entered is wrong, the trial balance will not agree.

1.6.5.2 Errors not Revealed by Trial Balance

i) **Error of Omission** : If a transaction is not recorded in books of original entry, then both debit and credit effects of transaction will be omitted and trial balance shall not be effected.

ii) **Error of Commission** : These errors are the result of carelessness of accounting staff and in some cases such errors do not effect the totals of trial balance e.g. wrong recording in the books of original entry or posting to the wrong account with correct amount and correct side. e.g. goods sold to A on credit but amount debited to B's account.

iii) **Compensating Error** : Such errors neutralise the effect of errors

committed earlier. When one error is committed which effects the total, another error of opposite effect is committed which neutralises the effect of earlier error.

iv) **Error of Principle** : Whenever any income or expenditure is not properly allocated between capital and revenue, such mistake is called a mistake of principle.

v) **Error of duplication** : Any error due to recording and posting a transaction twice also does not effect the totals of the two sides of trial balance.

1.6.6 LOCATION OF ERRORS THROUGH TRIAL BALANCE

i) Divide the difference by two and find out if some figure equal to that appears in the trial balance. It is possible that such item might have been recorded in the wrong side of trial balance, thus causing double the difference.

ii) If the mistake is not located the difference should be divide by 9 and if difference is evenly divisible by 9 the error may be due to transportation of figures e.g. Rs. 590 wrongly recorded as Rs. 950.

iii) The next step is to recheck the debit and credit totals of trial balance to satisfy that balance has been cast correctly.

iv) If mistake remains undetected, make sure that balances of totals of the ledger accounts have been correctly shown in the trial balance.

v) Check the totals of schedule of debtors and creditors and find out that all balances have been included in the list.

vi) Check all the figures badly written.

SELF CHECK EXERCISE

Ques. 1 Is Trial Balance a conclusive proof of accuracy? Explain.

Ques. 2. Explain the errors which are revealed by trial balance and which are not.

1.6.7 SUMMARY

In the previous lessons, we have studied the procedure of entering and posting of transactions in the journal and ledger, for ascertaining net balances of various ledger accounts. This chapter deals with the preparation of trial balance. Trial balance is a statement containing balances of all ledger accounts, as at any given date, arranged in the form of debit and credit columns placed side by side and prepared with the object of checking the arithmetical accuracy of ledger postings. but even then, this is not a conclusive proof of the accuracy of Books of accounts.

1.6.8 ANSWERS TO SELF CHECK QUESTIONS

Answer no. 1 Trial balance is prepared to check the arithmetical accuracy of books of accounts but it does not give a conclusive proof of the accuracy of books of accounts, as errors may exist even if the trial balance agrees. These errors are like

1. Errors of omission in books of original entry.
2. Incorrect amount recorded in the books of original entry.
3. Posting an item to wrong account but with correct amount and side.
4. Compensatory error.
5. Error of Principle.

Answer No. 2 (A) Errors revealed by the trial balance :

i) Posting of wrong amount

ii) posting to wrong side

iii) Omission to post from journal or subsidiary book

iv) Duplication in posting

v) Omission to carry a balance from ledger to trial balance

vi) Carry wrong amount to trial balance

vii) Wrong totalling or balancing of ledger accounts

viii) Wrong totalling of subsidiary books.

ix) Wrong totalling of trial balance.

(B) Errors not revealed by the trial balance : These errors are as mentioned in question number one.

1.6.9 GLOSSARY

1 **Trial Balance** : List of debit and credit balances.

2 **Total Method** : Trial balance is prepared by taking up the total of both debits and credits as per this method.

3 **Balance Method** : Trial balance is prepared by taking up the balance of each account as per this method.

4 **Compound Method** : This method is the combination of above two methods.

5 **Ledger** : A book in which various accounts are opened.

1.6.10 EXERCISE

(A) Short Questions :

Ques. 1 Define the term Trial Balance

Ques. 2. List the errors revealed by the trial balance

Ques. 3 Give main objectives of preparing trial balance.

(B) Long Questions :

Ques. 1 "A trial balance is only a prima facia evidence of the accuracy of the books of accounts." Comment.

Ques. 2 Discuss the various methods of preparing trial balance with examples.

Ques.3. From the following trial balance containing (obvious errors)prepare a correct trial balance:

	Dr.	**Cr.**
	Dr.	Cr.
Purchases	60,000	——-
Reserve fund	20,000	——
Sales	——	1,00,000
Purchases returns	1,000	——
Sales returns	——-	2,000
Opening Stock	30,000	——
Closing Stock	——	40,000
Expenses	——	20,000
Outstanding Expenses	2,000	——
Bank Balance	5,000	——
Assets	50,000	——
Creditors	——	80,000
Capital	——	30,000
Suspense Account (difference in Books)	10,000	——
	2,72,000	2,72,000

1.6.11 SUGGESTED READINGS

1. Accounting and Financial Management
   By : Shashi K. Gupta, R.K. Sharma
   (Kalyani Publishers)
2. Basic Accounting
   By : S.P. Jain,K.L. Narang
   (Kalyani Publishers)

LESSON NO. 1.7 **AUTHOR : Ms. RAJINDER KAUR**

FINAL ACCOUNTS

When the transactions of a business for a certain period have been entered in the journal, posted therefrom into the ledger and the arithmetical accuracy of the ledger tested by means of a trial balance, we enter upon the last stage of book keeping, namely the preparation of a summary of the accounts. The summary consists of transactions profit and loss account and balance sheet.

Trading Account :

Trading account is a part of profit and loss account. Usually profit and loss account of the business is divided into two parts. The first part is termed as trading account which is so prepared as to show the amount of profit or loss account of purchasing the goods of selling them. Such profit is termed as Gross Profit and Loss as Gross loss. Gross profit is difference between the cost of goods that have been sold and the proceeds of their sales without any deductions in respect of the indirect expenses. The following items usually appear on the debit and credit side of trading accounts.

(i) On the debit side :

(a) Opening Stock : This is stock which remained unsold at the end of previous accounting period.

(b) Purchases : Purchases means total purchases. i.e. Cash Plus Credit. If there is any purchases returns, these should be deducted and net purchases be shown in the trading account.

(c) Direct Expenses : Those expenses which are incurred while purchasing the goods or while manufacturing it are called direct expenses. These direct expenses generally are wages paid for manufacturing the goods, carriage inwards, freight, duty, clearing charges, motive power, gas, fuel, stores, royalties etc.

(ii) Item on credit side of trading account :

(a) Sales : Sales mean total sales i.e. cash plus credit sales. If there are any sales returns, these should be deducted from sales. So net sales are credited to trading account.

(b) Closing Stock : It is the value of stock lying unsold in the godown or shop on the last day of accounting period. Normally closing stock is given outside the trial balance, in that case it is to be shown on the credit side of trading account. But if it

is given inside the trial balance, it is not to be shown on the trading side of the trading account but appears only in the balance sheet as asset.

PROFORMA OF TRADING ACCOUNT :

Trading Account for the year ended....

Particulars	Amount	Particulars	Amount
To Opening Stock		By Sales	
		Less sales returns	
To Purchase		By Closing Bank	
Less : purchases returns			
To Carriage		By Gross Loss	
Inward or Carriage		Transferred to Profit	
on purchases		& Loss Account	
To freight			
To Wages, manufacturing			
or productive wages			
To Factory expenses			
To Store Consumers			
To Royalities			
To Motive Power			
To Coal & Coke			
To Water			
To Oil			
To Billing			
To Octroi			
To Dock Charges			
To Custom Duty			
To Gross Profit			
Transferred to Profit			

& Loss Account

Profit and Loss Account :

The aim of profit and loss account is to ascertain the net profit or net loss for a particular period. For earning net profit a businessman has to incur many expenses in addition to direct expenses. These expenses are deducted from gross profit and the resultant figure is net profit. Net profit is the surplus remaining after charging against gross profit all the expenses. When such expenses are more than gross profit the result is net loss and if profit exceeds these expenses, the result is net profit. Only indirect expenses are taken to profit and loss account and deducted from gross profit. Such expenses are of the following types :

(i) Selling and Distribution Expenses :

Godown rent, advertisement, agents, salaries, commission and bad debts etc.

(ii) Management or Office Expenses :

These are the expenses paid from office for whole of the business. It includes office salaries and wages, insurance, rent, printing and stationary, postage and telephone, auditor's fee, legal expenses, bank charges etc.

(iii) Financial Expenses :

The expenses which are incurred to obtain necessary finances for the business are called financial expenses. These include interest on capital, interest on loans, cash discount etc.

(iv) Maintenance and Depreciation Expenses :

These expenses include repairs to building, machinery and furniture, depreciation on fixed assets. All these expenses are shown on debit side of profit and loss account.

(v) Credit side of profit and loss accounts :

On credit side of profit and loss account we record various income such as discount received, commission received, rent received, interest received, income from investment. Profit on sale of assets, bad debt recovered and dividend received.

Preparation of Profit and Loss Account :

The gross profit from trading account is transferred to profit and loss account. With the result that trading account shall be closed and profit and loss account is opened. Then the profit and loss account is debited with all indirect expenses which results in the closing of all accounts relating to indirect expenses. The profit and loss account is then credited with the accounts of income by which all income accounts are closed. After debiting all indirect expenses and crediting the incomes, the differences of two sides of profit and loss accounts shall be net profit or net loss. If credit side is more, the result is net profit and if debit exceeds the result is net loss.

PROFORMA OF PROFIT AND LOSS ACCOUNT :

Profit and Loss Account for the year ending.....

Dr. Cr.

Particulars	Amount	Particulars	Amount
To selling and distribution :			
Expenses		By Gross Profit	
Godown rent		By Discount received	
Packing expenses		By Income from investment	
Advertising		By interest received	
Agents Commission		By Dividends	
Bad Debts		By Interest on drawings	
To Management expenses :			
Office Salaries and Wages			
Rent & Taxes			
Lighting and insurance			
Printing and Stationary			
Postage and Telephone			
Legal Expenses			
Audit Fees			
General Expenses			
To Financial expenses :			
Discount allowed			
Interest on capital			
Interest on loans			
To Maintenance :			
Repairs to building			
Repairs to furniture and machinery			
To Depreciation			
on Building			
on machinery			
on furniture			

Balance Sheet :

A balance sheet is a statement of financial position of a concern at a given date. Therefore, balance sheet shows the financial position of a concern and it shows its financial position on a given date, usually the last date of accounting period. Balance sheet is prepared from the trial balance after all the balances of nominal accounts are transferred to trading and profit and loss account and the corresponding accounts in ledger are closed. Balances left in the trial balance either represent assets or liabilities existing at the date of the finanacial close. All assets and liabilities are displayed in the balance sheet according to certain principles such as :

(i) All real and personal accounts having debit balance should be shown on asset side of balance sheet.

(ii) All the real and personal accounts having credit balances should be shown on liability side of balance sheet.

Classification of Assets :

(i) Fixed Assets :

These assets with a durable nature are used in business and are acquired to be retained permanently for the purpose of carrying on the business such as land, building machinery and furniture etc.

(ii) Floating or Circulating Assets :

Those temporarily held assets which are meant for resale or which frequently undergo change e.g. Cash, stock, stores, debtors and bills receivable.

(iii) Fictitious Assets :

Those assets which are not represented by any thing concrete or tangible. Preliminary expenses, debit balance of Profit and losses account are the examples of such assets.

Classification of Liabilities :

(i) Fixed Liabilities :

Those liabilities which are to be redeemed after long period of time. These includes long term loans.

(ii) Current Liabilities :

Those liabilities which are to be redeemed in near future usually within a year. Trade creditors, bank loan, bills payable etc. are the examples of current liabilities.

(iii) Contingent Liabilities :

These are not actual liabilities but their becoming actual liability is contingent on the happening of a certain event. In other words they would become liabilities in the future provided the contemplated event occurs. If it does not occur no liability is

incurred. Since such a liability is not an actual liability, it is not shown in balance sheet. Usually it is mentioned in the form of footnote.

Form of Balance Sheet :

A Balance sheet is divided into two parts, on the left hand side are listed various liabilities and capital and on the right hand side are listed various assets. The left hand side is termed as liabilities and right hand side is titled assets.

PERFORMA OF BALANCE SHEET :

Balance Sheet as on.....

Liabilities	Amount	Assets	Amount
Bills Payable		Cash in hand	
Loans		Cash at Bank	
Sundry Creditors		Investments	
Outstanding expenses		Sundry debtors	
Reserves		Bills receivable	
Capital		Stock-in-trade	
		Loose Tools	
		Fixtures and fittings	
		Plant and Machinery	
		Building	
		Land	
		Goodwill	

Illustration : Prepare trading and Profit and Loss account and balance sheet from the following Trial Balance.

Trial Balance as on.....

	Dr. Rs.	Cr. Rs.
Ram's Drawing and capital	15,000	40,000
Leasehold land	25,000	
Freehold premises	20,000	
Goodwill	7,000	
Trademarks	13,000	
Machinery and Plant	15,000	
Fixtures and fittings	2,000	
Stock at commencement	18,000	

Bills receivable and payable	4,000	6,000
Sundry debtors and creditors	16,000	24,000
Purchases and Sales	80,000	1,50,000
Returns	1,000	2,000
Carriage inwards	15,000	
Carriage outwards	5,000	
Freight duty	1,200	
Manufacturing wages	22,000	
Coal, Fuel and gas	800	
Factory expenses	4,500	
Salaries	18,000	
Rent, taxes and insurance	6,000	
Commission	25,000	
Interest		3,000
Discount	4,000	6,000
Stationary	500	
Trading Expenses	1,800	
Cash in hand	700	
Bankers		39,000
	2,70,000	2,70,000

Solution :

Trading and Profit and Loss Account of Mr. Ram for year ending 1997

To Opening Stock		18,000	Sales	1,50,000	
To Purchases	80,000		(–) Returns	1,000	1,49,000
(–) Returns	2,000	78,000			
To Carriage inwards		1,500			
To Freight Duty etc.		1,200			
To Manufacturing Wages		22,000			
To Coal, fuel and gas		800			
To Factory expenses		4,500			
To Gross Profit c/d		23,000			
		1,49,000			1,49,000
To Carriage outward		500	By Gross Profit b/f		23,000

To Salaries	18,000	By Interest	3,000
To Rent, Taxes, Insurance	6,000	By Discount	6,000
To Commission	2,500	By net loss	1,300
By Discount	4,000		
To Stationary	500		
To Trading Expenses	1,800		
	33,300		33,300

Balance Sheet of Mr. Ram as on 31st December, 1997

Liabilities		**Amount**	**Assets**	**Amount**
Bill Payable		6,000	Cash in hand	700
Sundry Creditors		24,000	Sundry debtors	16,000
Bankers		39,000	Bills Receivable	4,000
Capital :			Fixtures and Fittings	2,000
Opening Balance	40,000		Machinery and Plant	15,000
(–) Loss	1,300		Trade Mark	13,000
(–) Drawings	5,000	33,700	Lease hold land	25,000
			Freehold Premises	20,000
			Goodwill	7,000
		1,02,700		1,02,700

Illustration : Prepare Trading, Profit and Loss account for the year ending 31 Dec. and a Balance Sheet as on that date from the following Trial Balance :

	Dr. Rs.	**Cr. Rs.**
Capital	--	10,000
Cash	1,500	--
Bank overdraft	--	2,000
Purchase and Sales	12,000	15,000
Returns	1,000	2,000
Establishment expenses	2,200	--

Taxes and Insurance	500	--
Bad Debts and B/D reserve	500	500
Debtors and Creditors	5,000	2,000
Commission	--	500
Deposits	4,000	--
Opening Stock	3,000	--
Drawings	1,400	--
Furniture	600	--
B/R and B/P	3,000	2,500
	34,700	34,700

Adjustments :

1. Salaries Rs. 100 and taxes Rs. 200 are outstanding but insurance Rs. 50 is prepaid.
2. Commission Rs. 100 received in advance for the next year.
3. Interest Rs. 210 is to be received on deposits and interest on Bank overdraft Rs. 300 is to be paid.
4. Bad Debts reserve is to be maintained at Rs. 7,000.
5. Depreciation on Furniture is provided at 10%.
6. Stock on at the end is Rs. 4,500.

Solution :

Trading and Profit & Loss Account
For the year ending 31 Dec.

Particulars		Amount (Rs.)	Particulars		Amount (Rs.)
To Opening Stock		3,000	By Sales	15,000	
To Purchases	12,000		Less : Returns	1,000	14,000
Less : Returns	2,000	10,000	By Closing Stock		4,500
To Gross profit c/d		5,500			
		18,500			18,500
To Establishment Expenses		2,200	By Gross Profit b/d		5,500
To Outstanding		100	By Commission	500	
			Less : Commission in advance	100	400
To Taxes & Insurance	500				
Add : Outstanding Tax	200		By Accrued Interest		210
	700		By Bad Debts Reserve		700
Less : Prepaid Insurance	50	650			
To Outstanding Interest on Bank Overdraft		300			
To Bad Debts		500			
To New Reserves for bad debts		500			
Furniture		60			
To Net Profit		2,000			
		6,810			6,810

Balance Sheet on 31st December,

Liabilities		Amount (Rs.)	Assets		Amount (Rs.)
Bills Payable		2,500	Cash in hand		1,500
Creditors		2,000	Bill Receivable		3,000
Outstanding Exp. : Taxes		200	Debtors	5,000	
Establishment Exp.		100	Less : Provision		
Advance Commission			for bad debts	1,000	4,000
Overdraft	2000		Closing stock		4,500
Add : Outstanding			Prepaid Insurance		
Interest	300	2,300			
Capital	10,000		Fixed Deposit	4,000	
Add : Net Profit	2,000		Add : Accrued Interest	210	4,210
	12,000				
Less : Drawing	1,400	10,600	Furniture	600	
			Less : Depreciation	60	540
		17,800			17,800

Illustration : Following is the Trial Balance of Amit Sales Corporation as on 31 Dec.

TRIAL BALANCE

Plant & Machinery	5,000	Capital	4,000
Furniture & fittings	260	S.Creditors	5,200
Stock	4,800	Bills payable	560
Motor Van	1,200	Prov. for D. Debts	250
S.Debtors	4,570	Returns outward	550
Cash	40	Discount Received	370
Bank	650	Sales	48,000
Wages	15,000		
Salaries	1,400		
Purchases	21,350		
Bills Receivables	720		
Returns Inward	930		
Drawings	700		
Rent	600		
Factory Lighting	80		
Insurance	630		
G. Expenses	100		
Bad Debts	250		
Discount Allowed	650		
	58,930		58,930

The following adjustments are to be made :

(i) Stock on 31 Dec. Rs. 5,200.

(ii) 3 months factory lighting is due Rs. 30.

(iii) 5% depreciation to be written off on furniture.

(iv) Write off further bad debts Rs. 70

(v) The provision for doubtful to be increased to Rs. 300 and provision on for discount on debtors @ 2%

(vi) During the year machinery was purchased for Rs. 2.000 but it was debited to purchase account.

You are required to make Trading & Profit & Loss account for the year ending 31 Dec. 1997 and Balance Sheet as on that date :

Trading and Profit & Loss Account
for the year ending 31st Dec.

To Opening Stock		4,800	By Sales	48,000	
To purchases	21,350		Less : Returns	930	47,070
Less : Returns	550				
Machinery purchased	2,000	18,800	By closing stock		5,200
To factory lighting	80				
Add Outstanding	30	110			
To gross profit c/d		13,560			
		52,270			52,270
To salaries		1,400	By gross profit b/d		13,560
To rent		600	By Discount Received		370
To Insurance		630			
To General Expenses		100			
To Discount Allowed		650			
To Bad Debts	250				
Add : Further	70				
New Prov.	300				
	620				
Less : Old Prov.	250	370			
To provision for Debtors		84			
To Depreciation on furniture		13			
To net profit		10,083			
		13,930			13,930

Balance Sheet as on 31st December,

Liabilities		Amount (Rs.)	Assets		Amount (Rs.)
Capital Account	4,000		Plant & Machinery	5000	
Add : Net Profit	10,083		Add : Purchased	2000	7000
	14,083		Furniture & Fittings	260	
Less : Drawings	700	13,383	Less: Depreciation	13	247
Sundry Creditors		5,200	Closing Stock		5,200
Bills Payable		560	S. Debtors	4,570	
Outstanding Factory Lighting		30	Less : B.Debts	70	
				4,500	
			Less : New Prov.	300	
			Less : Prov for Discount	84	4,116
			Bills Receivable		720
			Cash		650
			Bank		40
		19,173			19,173

Illustration : X and Y are equal partners in a business. The following were the balances of the firm as on 31st March, :

	Rs.
Taxes and insurance	1,120
Creditors	7,920
Provision for bad and doubtful debts	435
Bad debts	392
General charges	1000
Advertisement	3800
Rent received	138
Cash in hand	510
Purchases	63,220
Motor lorry	3,250
Carriage on purchases	2,300
Repairs and renewals	1,200
Allowances received from creditors	2,400
Coal consumed	6,718
Plant and machinery	25,000
Wages	6,780
Land and building	13,840
Salaries	2,863
Debtors	8,000
Sales	75,000
Cash at bank	2,000
Stock on 1-4-1986	25,000
X's loan account	10,000
X's capital account	49,400
X's drawing account	4,250
Y's capital account	30,000
Y's drawing account	2,050
Stock of coal	2,000

Prepare trading and profit & loss account for the year ended 31st March, and a balance sheet as on that date after making the following adjustments :-

1. Stock on 31st March, was Rs. 30,000
2. Transfer Rs. 3,000 from purchases account and Rs. 250 from wages account to land and buildings account as these sums were actually incurred on extensions to land and buildings.
3. X's loan bears interest @ 7½% per annum.
4. Increase the provision of doubtful debts to Rs. 543.
5. Write off one-half of advertisement expenses.
6. Interest on partner's capital account is to be allowed @ 5 per cent per annum.
7. Write off 10 per cent on motor lorry and plant and machinery.

Solution :

Trading and Profit & Loss Account of M/s X and Y for the year ending 31st March

					Rs.		Rs.
To Opening Stock			25,000	By Sales			75,000
To purchases		63,220		By Closing stock			30,000
Less : Allowances from creditors	2,400						
Transferred to land & building	3,000	5,400	57,820				
To carriage on purchases		2,300					
To coal consumed			6,718				
To wages		6,780					
Less transferred to land and building		250	6,530				
To Gross profit c/d			6,632				
			1,05,000				1,05,000
To Taxes & insurance			1,120	By Gross profit b/d			6,632
To General charges			1,000	By rent received			138
To Advertisement		3,800		By Net loss			9,358
Less carried forward 50%		1,900	1,900				
To Repair & replacement			1,200				
To Salaries			2,863				
To Interest on X's loan			750				
To Bad debts :							
w/off during the year		392					
Add new provision		543					
		935					
Less old provision		435	500				
To Interest on capital :							
X		2,470					
Y		1,500	3,970				
To Depreciation							
on motor lorry		325					
on plant & machinery		2,500	2,825				
			16,128				16,128

Balance Sheet of M/s X and Y
as on 31st March

			Rs.			Rs.
Creditors			7,920	Cash in hand		510
X's loan account			10,000	Cash at bank		2,000
Capital :				Debtors	8,000	
X's capital-opening				*Less* provision for		
balance		49,400		bad debts	543	7,457
Add interest on capital		2,470		Closing stock		30,000
		51,870		Motor lorry	3,250	
Less : Loss 1/2	4,679			*Less* depreciation	325	2,925
Drawing	4,250	8,929	42,941	Plant &		
Y's capital-opening				machinery	25,000	
balance		30,000		*Less* depreciation	2,500	22,500
Add interest on capital		1,500		Land & building		
		31,500		Balance as per T/B	13,840	
Less : Loss 1/2	4,679			*Add* extension		
Drawing	2,050	6,729	24,771	during the year	3,250	17,090
Outstanding interest			750	Stock of coal		2,000
				Unexpired advertising		1,900
			86,382			86,382

Suggested Readings :

1. Advanced Accounting — By Jain & Narang
2. Book Keeping & Accountancy — By R.R. Gupta & V.S. Gupta
3. Financial Accounting — Juneja, Chawla & Saksena
4. Advanced Accountancy — S.N. Maheshwari

BANK RECONCILIATION STATEMENT

Introduction

Bank, a gradually increasing business unit, which has to deal in money. A No. of customers daily who are dealt with the Bank. Bank has to record the transactions day wise to check-out all the mistakes in the accounts of their customers. Thus it becomes compulsory for a bank to send its customers regularly a statements showing his account, how it stand for. Usually that is a little book which informs the customer as to what balance he has at the bank known as Bank Pass Book. The Bank Pass Book has shown the account of customers and their balance on the account. It stands to reasons the balance shown by the pass Book should be complied with the balance shown in the cash book of customers. However due to two different concerns due the policies and business strategies evenwithout mistake often there are differences in both the books. The disagreement of the balances shown by cash book, pass book on a particular day may be contributed from different reasons. We may explain first of all the reasons for disagreement of both the books, are as under :-

(1) Cheques deposited for collection but not collected & credited :

When the customers deposited the cheque in the bank. He was as soon deposited it into the bank debit the cash book but Bank could't credit the cheque until unless it is realized specially the up-country cheques. Thus main reason of difference between both the books as cash book shows the higher balance than pass book.

(2) Cheques issued but not yet presented for payment :

As soon as the customer issued cheques has been credited to the cash book. But these cheques also only debited by the bank on actual date of its presentation for payment & on payment. This shows cashbook shows lesson balance than Bank Pass book.

(3) Direct receipts deposits into bank :

Some time banks collect certain sums on their behalf i.e. dividends, interest etc. which will show a less balance of cashbook compare to pass book.

(4) Direct payments by bank:

Some time on the instructions of client banks directly pay the expenses of customers along with other payments like club fees, Insurance premium etc. Which will show a higher balance of cashbook than pass book.

(5) Cheques or bills dishonoured :

Sometimes the cheques or bills deposited in the bank to realise the amount. These amounts debited in cash book on the day of its deposit to bank but some-time these are dishonoured which will show higher balance in their pass book.

(6) Miscellaneous credits and debits in Pass Book :

Where the amount credited on account of interest on favourable balance in the bank it has raised the balance on Pass Book which lessened the balance of cash book. And usually on other time when the amounts debited on account of interest on overdrafts, bank charges etc. the balance of Pass Book lesser than it is higher on the cash book. These delays do not ordinary matter as sooner or later both the bank client will make the entries. However to know the position clearly and to sure that no mistake have been committed. There must be a statement showing why there is difference on a particular date, that is Bank Reconciliation statement. Generally it should be prepared at least of every month, which helps the management entries its cashbook to keep the correctness of accounts.

The preparation of Bank Reconciliation statement also reveals a control technique on the two different concerns. Where it helps the management to control on staff responsible for collection of cheques, in other stream it helps the banking concerns to check the behaviours of bank employees, the cash is not used by the bank cashier for his private use. Any cheque remained uncleared for a unreasonable length of time should be traced and reasons ascertained for the delay.

Methods of Preparing Bank Reconciliation Statement

It is very much easy to prepare a bank reconciliation statement even on the basis of common sense. The entries for the specified period has been checked out in both the Cash Book & Pass book. The debit side of Cash Book compared with credit side of Pass book & vice-versa. Any difference on the account of any Book that has been corrected in the required entry. Generally entries on Cash Book but not on the record of Pass book should be omitted from Cash Book or entries in Pass Book not in the Cash book should be made in the Cash book. The result will be the balance as per Pass Book.

Need and Importance of Bank Reconciliation Statement :

(1) A bank reconciliation statement locates the errors or omissions that may have been committed either on the part of the customer or the bank.

(2) By preparing a bank reconciliation statement, the customer becomes sure of the correctness of the bank balance shown by the cash book.

(3) A reconciliation statement facilitates the preparation of a revised cash book e.g. entries relating to bank charges interest allowed/charged by the bank, direct payment by the bank on customer's behalf which are recorded in pass book will now be recorded in the cash book as well.

(4) Periodic preparation of this statement reduces the chances of embezzlement by the staff of firm on even that of bank.

(5) A reconciliation statement helps in revealing the unnecessary delay in the collection of cheques by the bank.

(6) It also helps in keeping a track of cheques which have been sent to bank for collection.

Preparation of Bank Reconciliation Statement

A reconciliation statement is prepared when an account holder gets the duly completed pass book from the bank. He tallies the bank balance shown by cash book with the balance shown by pass book and unrecorded items are recorded through reconciliation statement.

A bank reconciliation statement can be prepared by taking the balance either as per cash book or as per pass book as a starting point. If the statement is started with the balance as per bank column of cash book, the answer arrived at in the end will be the balance as per pass book and vice-versa.

(a) Dr. Balance as per cash book indicated that the trader has so much balance of deposit at the bank.

(b) Cr. Balance as per cash book indicates the amount which has been withdrawn in excess of the deposits.

(c) Cr. Balance as per pass book indicates that the trader has so much balance of deposit at the bank.

(d) Dr. Balance as per pass book indicates the amount which has been withdrawn in excess of the deposits.

(A) Method of Preparing Bank Reconciliation Statement by Debit Balance of Bank Column of Cash Book

Entries on acocunt of which the debit balance of the cash book is lesser in comparison to the credit balance of the pass book will be added while preparing bank reconciliation statement and vice-versa.

Items to be added :

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

When a businessman issues cheques to its creditors, he immediately enters them in the credit side of his cash book. It reduces the balance of his cash book but the pass book balance will remain the same because the cheques have not been presented for payment in the bank. As such cheques should be added to balance of cash book in order to make it equal to pass book balance.

(2) Credit made by bank for interest :

When the bank allows interest to customer it credit customers account and pass book balance increases from cash balance and so it should be added to cash book.

(3) Amount directly deposited by customers is our bank account :

Deposits must have increased the pass book balance so this amount should be added to cash balance.

(4) Interest and dividend collected by the bank :

The bank must have credited these amounts to customer's account so these should be added to cash book balance to make it equal to pass book balance.

(5) Cheques paid into the bank but omitted to be recorded in cash book :

Bank must have credited these cheques in the customer's account but as there is no entry in cash book it shows a lesser balance. Hence amount should be added to cash book balance.

Items to be deducted :

(1) Cheques sent to bank for collection but not yet credited by the bank :

When the cheques have been deposited than entry is made on debit side of cash book but bank won't make an entry until the amount is collected so the amount will be deducted while preparing a bank reconciliation statement.

(2) Cheques sent to bank for collection but dishonoured by the bank :

Such cheques must have been entered on the debit side of cash book but there will be no entry in the pass book as the cheques have dishonoured. Therefore, the cash book balance will be deducted in order to make it equal to pass book balance.

(3) Direct payment made by bank on behalf of customers :

The bank makes payment for insurance premiums, sent etc. and debits the customer's account, As such, pass book balance is reduced. So cash book balance will be reduced by same amount.

(4) Debits made by bank for Commission, bank charges etc.

The amount of bank commission and bank charges should be deducted from the balance of cash book.

(5) Cheques issued but omitted to be recorded in cash book : While paying of cheques the bank will debit the customer's account. Hence amount of such cheques should be deducted from the cash book balance.

On 31st March, 2002 the bank balance as per Rajesh Chauhan's cash book was Rs. 17280 debit. On comparing the cash book with the Pass Book, following differences were found :

(1) Cheques for Rs. 8400 sent for collection have not been cleared by bank so far.

(2) Cheques issued but not yet presented for payment for Rs. 5600.

(3) There is a debit of Rs. 80 in the Pass Book for Bank Charges, but not recorded in the Cash Book.

(4) Bank has credited Rs. 240 for interest in the Pass Book but these are

also not recorded in the Cash Book.

(5) A Customer deposited Rs. 2000 direct in the Bank but these were recorded only in Pass Book.

(6) According to standing orders of Rajesh Chauhan the Bank has made following payments:

1. Club fees Rs. 500.
2. Life Insurance Premium Rs. 2500.

These were not recorded in his cash book Prepare a Bank Reconciliation Statement.

Sol: Bank Reconciliation Statement as on 31st March 2002

Particulars			Details	Total
Dr.	Balance as per cash book			17,280
Add	(i)	Cheques issued but not yet presented for payment	5600	
	(ii)	Interest credited by bank not recorded in cash book	240	
	(iii)	Direct deposit by a customer in the bank	2000	7840
Less	(i)	Cheques sent for collection but not yet cleared	8400	25,120
	(ii)	Bank Charges debited in pass book	80	
	(iii)	Amount paid by bank on standing orders (500+2500)	3000	11,480
		Balance as per Pass Book		13,640

(B) Method of Preparing Bank Reconcilation Statement by Credit Balance of Cash Book :

If cash book shows a credit balance at the start, all items will be reversed while preparing a bank reconciliation statement.

Items to be added :

(1) Cheques sent to bank for collection but not yet credited by bank or dishonoured : When the cheques were sent for collection the overdraft balance as per cash book will reduce, but the bank will not enter than

unless these are realised. Hence, the overdraft as per cash book should again be increased.

(2) **Direct payment made by bank on the Customers:** Bank must have debited customer's account after making payment of must also to be increased.

(3) **Debit made by bank for commission, bank charger and interest on overdraft:** The items must have increased the overdraft balance as per pass book hence, the overdraft balance as per cash book should also be increased.

(4) **Cheques issued but omitted to be recorded is cash book :** The bank after making payment must have debited the customer's account hence the overdraft as per carn book must also lie increased.

Items to be deducted:

(1) **Cheques issued but not yet presented for payment :** Since cheques have not been presented in the bank for payment overdraft as per cash book must be more than that of pass book. So it must be added back.

(2) **Amount directly deposited by customers in our bank account :** Overdraft as per cash book must have to be reduced.

(3) **Interest and divided collected by the bank :** There items must have unduced overdraft as per pass book. As such, overdraft as per cash book will also have to leduced.

(4) **Cheques deposited into bank but omitted to be entered in the cash book :** When cheques are deposited the overdraft as per pass book must have been reduced in comparison to overdraft as per cash book, As such, the overdraft as per, cash book will also have to be reduced.

Illustration :

Prepare a Bank Reconcilation Statement, in books of snow white Ltd. as on 30th June, 2000 from the following information :

(1)	Credit Balance (overdraft) as per cash book as on 30th June	2000
(2)	Cheque deposited but not yet credited by the Bank	8500
(3)	Another cheque deposited but dishonoured	1200
(4)	Cheques issued but not yet presented for payment	6000
(5)	Interest on over draft not recorded in cash book	780
(6)	A cheque of Rs. 2920 received from a customer although entered in cash book, was not sent to Bank.	

Solution :-

Bank Reconcilation Statement : as on 30th June 2000

		Particulars	Detail	Amount
		Credit Balance (as per cash book)		15,000
Add:	1.	Cheques deposited but not yet credited by bank	8500	
	II.	Cheques deposited but dishonoured	1200	
	III.	Interest on overdraft charged by bank	780	
	IV.	Cheque entered in cash book but not sent to bank	2420	12900
				27,900
	Less:	Cheques issued but not presented for payment	6000	6,000
		Overdraft as per pass book		21,900

(C) PREPARATION OF BANK RECONCILATION STATEMENT BY DR. BALANCE OF PASS BOOK:

Items to be added :

(1) **Cheques issued but not yet presented for payment :** By issued of such cheque overdraft balance as per cash book must have increased whereas overdraft balance as per pass book must have remained unchanged, so there cheque should be added to overdraft balance of pass book.

(2) **Cheques paid into bank but omitted to be recorded in cashbook :** With the overdraft balance in pass book must have decreased so cheques should again be added to overdraft balance of pass book.

(3) Interest and Dividend collected by the bank and the amount directly deposited by the customers in our bank account.

As a result of there items, overdraft a balance as per pass book must have decreased so there items should again be added to make it equal to that of cash book.

Items to be deducted :

(1) **Cheques sent to bank for collection but not yet credited by the bank:** When cheques are sent for collection overdraft balance of cash book must have been reduced. But as the pass book will show an unchanged balance it must be reduced in order to make it equal to that of cashbook.

(2) **Debits made by the bank for Commission, Bank Charges Interest on overdraft and direct payment made by the bank on behalf of customers:** As a result of this overdraft balance of pass remains unchanged so it

must be reduced from balance of pass book.

(3) **Cheques issued but omitted to be recorded in cash book:** The bank while paying must have increased. The overdraft balance of the pass book should again be reduced.

Illustration : Prepare Bank Reconciliation Statement fromthe following :

(a) Balance as per pass book on 31st March, 2000, overdrawn Rs. 5000.

(b) Cheques drawn on 31st March, 2000, Rs. 2000, Rs. 6000, Rs. 2400, and Rs. 3600 but out of these, last two cheques were not presented for payment upto 4th April 2000.

(c) Interest on bank overdraft not entered in cash book Rs. 845.

(d) Out station cheques for Rs. 2000 lodged in the bank on 25th March, 2000 but out of these cheques worth Rs. 18000 were credited in April 2000.

(e) Rs. 200 being chamber of commerce subscription paid not entered in cash book.

Solution:

Bank Reconciliation Statement as on 31st March, 2000

Overdraft as per Pass Book (Dr)				5000
Add:	Cheques issued but not presented for payment			6000
	(2400+3600)			11000
Less:	(i)	Ist on overdraft charged by bank	845	
	(ii)	Cheques paid into bank but not credited	18000	
	(iii)	Subscriptions paid by bank	200	19,045
		Balance as per cash book (Dr.)		8,045

(d) Preparation of Bank Reconciliation Statement from the Credit Balance of Pass Book.

Items to be added :

(1) Cheques sent to bank for collection but not yet credited by the bank. When cheques were sent for collection, the debit balance of cashbook must have increased so these must be added to pass book balance.

(2) Cheque sent to bank for collection but dishonoured by bank :
Added to pass book balance to make it equal to that of cash book.

(3) Debits made by bank for commission, bank charges and direct payment made by bank on behalf of customers :
As a result of these credit balance must have decreased as per pass

book but cash book balance remain changed so it must be added.

Items to deducted

(1) **Cheques issued but not yet presented for payment:** Balance of cash book must have decreased so pass book balance must be reduced by the same.

(2) **Interest and dividend collected by the bank, interest allowed by the bank and the amount directly deposited by customers in our bank account:** Pass Book Balance must have increased because of all these so these must be deducted.

(3) **Cheques paid into bank but omitted to be recorded in the cash book:** Deducted from pass book balance.

Illustration

(i) On 31st March, 2002, Bank Pass Book of Mohan showed a balance of Rs. 15000 to his credit.

(ii) Before that date, he had issued cheques amounting to Rs. 8000 of which cheques amounting to Rs. 33200 have so far been presented for payment.

(iii) A cheque of Rs. 2200 paid by him into bank on 26th March is not yet entered in the Pass Book.

(iv) He had also received a cheque for Rs. 500 which although entered by him in the bank of cash book, was omitted to be paid into the bank.

(v) On 30th March cheque for Rs. 1570 received by him was paid into the bank but the same was omitted to be entered in cash book.

(vi) There was a credit of Rs. 150 for interest on current account and a debit of Rs. 25 for bank charges.

Draw up a reconciliation statement.

Solution :

Bank Reconciliation Statment as on 31st March, 2000

		Particulars	Details	Amounts
		Balance as per pass book (cr.)		15,000
Add :	(i)	Cheque paid into bank but not collected	2200	
	(ii)	Cheque entered in cash book but omitted to be banked	500	
	(iii)	Bank charges	25	2725
Less :				
	(i)	Cheques issued but not presented for payment	4800	17,725
	(ii)	Cheques paid into bank but not entered in cash book	1570	
	(iii)	Interest allowed by the Bank	150	6520
		Bank as per cash book (Dr.)		11,205

		Specimens		
BANK RECONCILIATION STATEMENT OF ..... AS ON.....				
Balance as per Cash Book or Overdraft as per Pass Book			Rs.P.	Rs.P.
Add:	(i)	Cheques issued but not yet presented to the bank of payment	_____	_____
	(ii)	Interest credited by bank but not entered in the cash book.	_____	
	(iii)	Dividends collected, interest on securities collected, bills collected by the bank and direct deposits made into the bank by debtor of the customers.	_____	
Less:	(i)	Cheques sent for collection but not credited.	_____	
	(ii)	Cheques entered into Cash Book but not sent to bank.	_____	
	(iii)	Cheques paid into bank but dishonoured.	_____	
	(iv)	Bank charges or interest on overdraft.	_____	
	(v)	Direct payments made by bank, e.g., payments on account of insurance premium, etc.	_____	
		Balance as per Pass Book or overdraft as per Cash Book. (as the case may be)	_____	_____

BANK RECONCILIATION STATEMENT OF_____ AS ON_____

	over draft as per Cash Book/Balance as per Pass Book.			
Add:	(i)	Cheques deposited in bank but not credited.		
	(ii)	Cheques paid into bank but dishonoured.		
	(iii)	Bank charges and interest on overdraft.		
	(iv)	Direct payments made by bank.		
Less:	(i)	Cheques issued but not presented.		
	(ii)	Interest credited by bank but not entered in Cash Book.		
	(iii)	Dividends etc., collected by bank.		
	(iv)	Direct Deposits made into bank, etc.		
	Overdraft as per Pass Book/Balance as per Cash Book:			

BANK RECONCILIATION STATEMENT

Alternatively, the various items may be shown in the Bank Reconciliation Statement as follows :

BANK RECONCILIATION STATEMENT OF_____ AS ON_____

Favourable Balance (Debit balance) as per Cash Book	Or	Plus	Minus
Favourable Balance (Credit balance) as per Pass Book.	Or	_____	
Unfavourable Balance (Credit Balance) as per Cash Book			
Unfavourable Balance (Debit Balance) as per Pass Book	Or	_____	
		Cash book Pass Book	Pass Book Balance
Adjust the starting points to :-			
1.	Cheques issued but not yet presented.	+	-
2.	Cheques paid into Bank but not yet credited	-	+
3.	Cheques paid into Bank but dishonoured.	-	+
4.	Interest allowed by Bank.	+	-
5.	Direct Deposits made into Bank.	+	-
6.	Direct payments made by Bank.	-	+
7.	Interest and Expenses charged by Bank.	-	+
8.	Undercasting of payment side of cash book or overcasting of receipt side or excess debit balance brought forward in Cash Book.	-	+
9.	Overcasting of payment side or undercasting of receipt side or less debit balance brought forward in Cash Book	-	+
10.	Any wrong entry indebit side of a Pass Book.		
11.	Any wrong entry in credit side of Pass Book.	+	-
	Balancing Figure	Pass Book Balance	Cash Book Balance

For Overdraft (Minus Balance)			
Adjust the starting point to :-		Cash Book Minus Balance	Pass Book Minus
Balance			
1.	Cheque issued but not yet presented.	+	-
2.	Cheque deposited but not credited	-	+
3.	Cheques depoisted but dishonoured.	-	+
4.	Interest and expenses charged by bank	-	+
5.	Interest payments made by bank	-	+
6.	Direct receipt made into Bank	+	-
7.	Interest allowed by Bank.	+	-

8.	Undercasting of payment side or overcasting or of receipt side or Cash Book or less credit balance brought forward in Cash Book.	-	+
9.	Overcasting of payment side or undercasting of receipt side or less debit balance brought forward in Cash Book	+	-
10.	Any wrong entry on debit side of a Pass Book.	-	+
11.	Any wrong entry on credit side of Pass Book.	+	-
	Balancing Figure	Pass Book Balance	Cash Book Balance

Illustration :

Prepare a Bank Reconciliation statement from the following particulars.

	Rs.	P.
Bank Overdraft as per Cash Book	8,000	00
Cheques deposited in Bank but no entry was passed in the Cash Book	300	00
Cheques received but not sent to Bank	1000	00
Credit side of Bank column cast short	100	00
Insurance premium paid directly by bank under standing advice	500	00
Bank charges entered in Cash Book twice	12	00
Cheques received, returned by Bank but no entry passed	400	00
Cheques issued returned on technical grounds	300	00
Bills directly collected by bank	2,000	00
Bank charges debited by Bank	10	00
Cheques received, entered twice	500	00
Bills discounted dishonoured	4,000	00

State which items will require adjustment in the books of accounts.

Solution :

Bank Reconciliation Statement As at.....

	Items	Details	Amount
	Overraft as per Cash Book		8,000-00
Add:	Cheques received but not sent to bank	1000-00	
	Credit side of bank column cast short	100-00	
	Insurance Premium paid by Bank	500-00	
	Cheque received and returned by Bank but no entry passed	400-00	
	Bank charges debited by Bank	12-00	
	Bill discounted dishonoured	4000-00	
	Cheques received, entered twice	500-00	6,512-00
Less:	Cheques issued returned on technical grounds	300-00	14,512-00
	Bank charges entered twice in Cash Book.	10-00	
	Cheques deposited in bank but no entry was passed in Cash Book	300-00	
	Bills directly collected by bank	2000-00	2610-00
			11,902-00

Illustration: The Cash Book of Mehra showed a balance of Rs. 5,000 on 31st December, 2000, at the Bank. This figure did not agree with the Bank Pass Book. A comparison of the two revealed the following :

(a) The bank has debited Mehra with Rs. 950/- the annual premium on his life policy according to his standing instructions and with Rs. 30/- as bank charges;

(b) The bank has credited Mehra by Rs. 1,000/- the proceeds of a bill;

(c) Mehra paid in cheques totaling Rs. 2,000/- on December 26th, of which those for Rs. 1500/- were collected in December and one for Rs. 200/- was returned as dishonoured on 31st December which Mehra received on 2nd January, 1984. The rest were collected and credited in January, 1984. The cash collection on 31st December, 1983, totalling Rs. 600/- was entered in the Cash Book in the Bank column on the same day but it was banked on 2nd January, 1984;

(d) In December 1983, Mehra issued cheques totaling Rs. 2900 of which those for Rs. 800/- had not been presented by 31st December, 1983.

Mehra has not yet recorded in the cash book matters mentioned in (a) and (b) and the dishonoured cheque mentioned in (c) above.

Prepare an amended Cash Book and then a Book Reconciliation Statement.

Solution:-

AMENDED CASH BOOK (BANKS COLUMNS ONLY)

Dr. Cr.

Date	Particulars	Rs. P.	Date	Particulars	Rs. P.
1983 Dec. 31	To Balance b/d	5,000-00	1983 Dec. 31	By Insurance	960-00
	To Bills for collection account	1,000-00		By Bank Charges	30-00
				By Customers Account	200-00
				By Balance c/d	4,810-00
		6,000-00			6,000-00
1984 Jan.1	To Balance b/d	4,810-00			

BANK RECONCILIATION STATEMENT AS ON 31ST DEC., 2000

Items	Plus Item	Minus Item
	Rs. P	
Balance as per amended Cash Book Rs.	4,810-00	
Cheques paid into bank but not cleared and collected up to 31st December, 1983		300-00
(Rs. 2,000-Rs. 1,500-Rs. 200 = Rs. 300)		
Cash Collection entered in Cash Book but not banked		600-00
Cheques issued but not yet presented for payment	800-00	
	5,610-00	900-00
	900-00	
	4,710-00	
Balance as per Pass Book		

WHEN EXTRACTS FROM PASS BOOK AND CASH BOOK ARE GIVEN

Sometimes extracts of the Pass Book and Cash Book are given and from these extracts, a bank reconciliation statement is to be prepared. In these situations, one should compare the items on debit side of the Cash Book with the items on the credit side of the Pass Book and should pick out the items contributing to the differences between the two balances, that is, taking our items which appear on the debit side of Cash Book (1) but not on the credit side of the Pass Book if the extracts relate to the debit side of Cash Book (1) but not on the credit of the Pass Book if the extracts relate to the same period or (2) but appears on the credit side of Pass Book where the extracts of the Pass Book belong to the succeeding period. And compare the items contributing to the difference. The procedure to be adopted for preparing bank reconciliation statement depends on the period of the extracts.

(i) Where the extracts belong to the same period

In this case one should look out for those items which do not figure on both the extracts. These are the items which have caused difference in the balances and require reconciliation.

Illustration:- From the following extracts of Cash Book and Pass Book of Budh Ram, Prepare a Bank Reconciliation Statement as on March 31, 2002.

CASH BOOK (Bank Column)

Dr. Cr.

Date	Receipts	Rs. P	Date	Payments	Rs. P
1981					
Mar.1	To balance b/d	200-00	Mar. 2	By Cash	40-00
Mar. 3	To Ram Lal	160-00	Mar. 5	By Manu	50-00
Mar. 8	To Rishi Ram	25-00	Mar. 9	By Kant	110-00
Mar. 15	To K. L. Verma	185-00	Mar. 14	By Nath Ram	65-00
Mar. 20	To Vinod	70-00	Mar. 19	By Salary	90-00
Mar. 26	To Kaur Chand	5-00	Mar. 23	By Sham & Co.	85-00
Mar. 29	To Charanjit	25-00	Mar. 28	By Ram Chand	95-00
			Mar. 30	By Das Gupta	50-00
			Mar. 30	By Balance c/d	85-00
		570-00			570-00

PASS BOOK
BUDH RAM IN ACCOUNT WITH CENTRAL BANK

Date	Particulars	Rs. P.	Date	Particulars	Rs. P.
Mar. 2	To Cash	40-00	Mar. 1	By Balance b/d	260-00
00					
Mar. 10	To Kant	110-00	Mar. 7	By Ram Lal	160-00
Mar. 20	To Salary	90-00	Mar. 10	By Rishi Ram	25-00
Mar. 24	To Sharm & Co.	85-00	Mar. 21	By Vinod	70-00
Mar. 29	To Ram Chand	95-00	Mar. 29	By Charanjit	25-00
Mar. 29	To Collection Charges	10-00	Mar. 30	By Dividends	
Mar. 30	To Subscription to Lion Club	50-00	Mar. 31	By Nemi Chand	50-00
Mar. 31	To Balance c/d	150-00			
		630-00			630-00

Solution:

BANK RECONCILIATION STATEMENT AS ON MARCH 31,2002

ITEMS		DETAILS	AMOUNT
Balance as per Cash Book			85-00
Add: Cheques issued but not presented			
Manu	Rs. 50-00		
Nath Ram	Rs. 65-00		
Das Gupta	Rs. 50-00		
Dividends Collected		165-00	
Direct Deposits by Nemi Chand		100-00	
		50-00	315-00
			400-00
Less: Cheques deposited but not			
Credited - K.L. Verma	Rs. 185-00		
Kaur Chand	Rs. 5-00	190-00	
Collection charges charged by the Bank		10-00	
		50-00	
Subscription to Lions Club			250-00
Balance as per Pass Book			150-00

(ii) When the extract of the Pass Book belong to the succeeding period.

In this case, if the extract of the Cash Book is given, e.g., for Dec. the extract of Pass Book is for Jan. Therefore, one should look out for those items in the extract which appear in both the extracts. These are the items which have caused difference in the balance. And hence require reconciliation.

Illustration: Following information is given :-

Books of Maninder Bros.

CASH BOOK (Bank Column)

Dr. Cr.

Date	Receipts	Rs. P.	Date	Payments	Rs. P.
1982				1982	
Dec. 1	To Balance b/d.	7600-00	Dec. 3	By Drawing	4,000-00
Dec. 5	To Bijlee & Co.	84,00-00	Dec. 10	By Chaterjee	2,380-00
Dec. 17	To Thakur Bros.	20,000-00	Dec. 15	By Pillai	400-00
Dec. 19	To Mohammad	26,200-00	Dec. 17	By Sundram	10,000-00
Dec. 29	To Sarfraz	6,000-00	Dec. 19	By Phiroz	5,000-00
Dec. 31	To Wadikar	3,600-00	Dec. 26	By Clark	35,00-00
			Dec. 29	By Salaries	15,000-00
				By Balance c/d	31,520-00
		71,800-00			71,800-00

BANK PASS BOOK
MANINDER BROS, IN ACCOUNT WITH PUNJAB BANK

Dr. Cr.

Date	Particular	Rs. P	Date	Particulars	Rs. P.
1983			1983		
Jan. 1	To Drawings	4,000-00	Jan.1	By Balance	3,820-00
Jan. 5	To Pillai	400-00	Jan. 5	By Birjee & Co.	8,400-00
Jan. 15	To Phiroz	5,000-00	Jan. 10	By Mohammad	26,200-00
Jan. 29	To Clark	3,500-00	Jan. 25	By Sarfarz	6,000-00
Jan. 31	To L.I.C		Jan. 29	By Ram Chand	5,000-00
	Premium	1,000-00	Jan. 30	By Sale Securities	4,000-00

Prepare a Bank Reconciliation statement as on 31st Dec., 1982.

Solution :

BANK RECONCILIATION STATEMENT AS ON DEC. 21, 1982

ITEMS		AMOUNT
		Rs. P.
Balance as per Cash Book		31,520-00
Add: Cheques issued but not presented		
Drawings	4000	
Pillai	400	
Phiroz	5,000	
Clark	3,500	12,900-00
		44,420-00
Less: Cheques deposited but not credited		
Bijlee & Co.	8,400	
Mohammad	26,200	
Sarfraz	6,000	40,600-00
Balance as per Pass Book		3,820-00

Practical Problems

(1) On 30th June, 2001, the bank balance as per Sanjay Yadav's Cash Book was rs. 1500. On comparing with the Pass Book the following information was received :

(i) Cheques amounting to Rs. 7290 were issued on 28th June of which one cheque of Rs. 1300 was presented in bank for payment on 4th July.

(ii) Cheques deposited into bank for Rs. 10,000 but of these cheques for Rs. 4000 were cleared and credited in July.

(iii) Ist and divided on investments Rs. 580 collected by bank.

(iv) Life Insurance Premium Rs. 750 paid by bank.

(v) Bank charges Rs. 25 not recorded in cash book.

Prepare Bank Reconsiliation Statement overdraft as per pass book (Rs. 1395)

(2) On 31st, December 1999 my cashbook showed a credit balance of Rs. 8800. I had paid into Bank three cheques amounting to Rs. 6000 on 24th Dec. of which I found Rs. 3200 have been credited is pass book under date 5th Jan. 2000. I had issued cheques of Rs. 8000 after Ist January, 2000, I find a debit of Rs. 50 in respect of bank charges in the pass book which I have adjusted in the cash book on 31st Dec. There is a credit of Rs. 360 for interest on securities in the pass book which remains to be adjusted. A cheque of Rs. 1200 deposited

into bank has been dishonoured. Prepare Bank Reconciliation Statement as on 31st Dec. 1999.

(Overdraft as per pass book Rs. 10,340)

(3) Prepare a bank reconciliation statement from the following particulars :

(a) As overdraft as per pass book Rs. 20000 as at 31st Dec.

(b) On 30th Dec. Cheques had been issued for Rs. 80000 of which cheques worth Rs. 15000 only had been enhnced upto December 31.

(c) Cheques amounting to Rs. 6500 had been paid into the bank for collection but of these only Rs. 2500 had been credited in Pass Book.

(d) The bank has charged Rs. 700 as interest on overdraft and information about which has been received on January 5th.

(e) The Bank Pass Book shows credit for Rs. 2000 representing Rs. 1400 paid by debtor of A direct into Bank and Rs. 600 collected directly by bank in respect of A's investment.

(f) A cheque of Rs. 3600 has been debited in bank column of cash book by A, But it was not sent to Bank at all.

(Overdraft as per cash Book Rs. 78,700).

Exercise Questions

1. What is bank reconciliation statement and why is it prepared.
2. Explain various reasons on account of which the balance of Pass Book and bank column of cash book does not agree.

LESSON NO. 1.9 **AUTHOR : HARKIRTAN KAUR**

CAPITAL AND REVENUE ITEMS

Introduction: For correct accounting there is the need for proper distinction between capital and revenue items regarding expenditure payments, profits, receipts and losses. If this difference is properly observed the accounting results will be correct, on the other hand if it is not properly observed the whole accounting system will be failure e.g., when plant and machinery is purchased and it is charged to the purchase A/c or any fixed asset is sold and whole proceeds is taken as profits, then all the above cases the both the profit and loss A/c and balance sheet will be effected give incorrect and misleading results.

As all the revenue items goes to Trading and Profit and Loss A/c and all capital items goes to balance sheet, it is necessary that the proper distinction should be made between capital and revenue while preparing the final accounts of a business at the end of financial year.

There are not any fixed rule regarding difference between capital and revenue items. However the following rules may help for making difference between capital and revenue expenditure.

Rules regarding the Capital Expenditure :

Capital expenditure is that expenditure whose benefit is not fully consumed in one particular period but over several periods. The main purpose behind the capital expenditure is for the purpose of earning and for resale, improving and extending fixed assets, increasing the earning capacity of business and raising capital for business, These expenses are taken to Balance sheet. The main rules regarding capital expenditure are as follows

(1) The expenses are in relation to acquisition of fixed asset so that business can commence or continue its operations.

(2) The expenditure should result into long term benefit to the business.

(3) This expenditure must increase the earning capacity or reduce working expenses. Mainly it must be related with acquisition of any permanent asset or to earn revenue, e.g., any permanent asset is purchased any expenses in addition to its cost of asset like installation, eraction cost, travelling trip to abroad to purchase such asset, all are the capital expenditure because it is related with directly in the acquisiton of any permanent asset.

Examples :

(i) Purchase of land, building, plant and machinery.

(ii) Amount spent on eraction of plant and machinery.

(iii) Expenses on major repairs and replacements of plant and machinery or any other fixed asset, which may increase the efficiency of that asset.

Rules regarding Revenue Expenditure :

The expenditure incurred in one period of account and the full benefit of which is consumed in that period; is revenue expenditure. Such expenses are made to perform the day-to day working of the business smoothly and easily. These items appear in Trading and Profit and Loss A/c.

The test for such expenditure is that whether the expenditure made is incurred for the maintenance of the earning capacity or for the upkeep of fixed asset in an efficient condition.

Examples :

(1) Purchase of assets acquired for resale at a profit.

(2) Expenses on maintaining fixed assets in good working order.

(3) Meeting certain day to day expenses like cost of goods, raw material, rent, rates, repairs, wages, and salaries, carriage, insurance etc.

(4) Depreciation on fixed assets.

Difference Between Capital Expenditure And Revenue Expenditure:

Capital Expenditure	Revenue Expenditure
1. It is related with acquisition of fixed asset which are meant for use & not for resale purpose. Such asset is sold only when it become unfit for business on obsolete.	1. It is not related with acquisition of any fixed asset. But it is concerned with meeting day-to-day expenses of business.
2. Such expenditure increase the earning capacity of any fixed asset e.g. the repair or overhaul of any machine will increase the earning capacity for that asset.	2. Such expenditure is more for the smooth running of the business. It helps in improving day to day expenditure of business.
3. It is an expired cost i.e. the cost can give benefit to the future also.	3. It is an expired cost i.e. the benefit of cost is related with present only.
4. It is non-recurring expenses.	4. It is recurring expense.
5. The whole expenses is not charged to Trading and Profit and Loss Account, because such expenditure is for more than one year. Only yearly depreciation from that fixed asset is charged toProfit & Loss A/c. Balance amount is shown as asset in Balance Sheet.	5. The amount of expenditure expires during every year. The whole expenses are charged to Profit and Loss A/c in the same year. No balance of such expenditure is shown in Balance Sheet. Only if these are outstanding it is shown as liability.
6. All items of Capital expenditure which are not written off are shown in the Balance Sheet as assets and are carried forward for next year.	6. Generally these expenditures are not carry forward for next year; because these are fully exhausted during the same year. Only 'Deferred Revenue Expenditure' like advertisement is carry forward to next year.

Cases when Revenue Expenses becomes Capital Expenses :

There are certain examples which show that when a revenue expense can become a capital expense

(i) **Repairs :** It is a revenue item, but when we purchase a second hand plant and pay immediately necessary repair expenses to make such asset efficient it becomes a capital expenditure.

(ii) **Wages :** It is also a revenue item but wages to workers to fit a new machinery, becomes the part of fixed asset. Therefore a capital asset.

(iii) **Legal Expenses :** Generally it is a revenue item, but legal expenses in correction purchase of fixed asset is capital item.

(iv) **Transportation Expenses :** These are also revenue expenses. But transportation expenses or purchase of any fixed asset is capital expenditure.

(v) **Interest on Capital :** Such interest, if paid during the construction of Works or building a plant will be capital Expenditure.

(vi) **Raw Material and stores :** Normally it is a revenue item But cost of raw material or stores used for making any fixed asset are capital expenditure.

(vii) **Carriage and Freight :** If these are related with any fixed asset, the these are capital expenditure.

(viii) **Advertising :** For introducing new line of goods if any advertisement is made it is the capital expenditure, Because its benefit will be for future also.

(ix) **Development Expenditure :** Some concerns like tea, rubber, plantation, horticulture, etc require a very long period of development before they can begin its earning. All such expenditure during development period is capital expenditure.

(x) **Preliminary or Formation Expenses :** Expenses before incorporation of a company are preliminary expenses and are capital in nature.

CAPITAL AND REVENUE PROFIT

Capital Profit :

It is that profit which is made on the sale of any fixed asset or profit earned on getting capital for the business is a capital profit.

Examples :

(i) If furniture costing Rs. 8000, sold at Rs. 10000 then the profit of Rs. 2000 is the capital profit.

(ii) Premium received on issue of share and debenture is a capital profit. Such profit is not transferred to Profit and Loss A/c but it is transferred to capital revenue which would appear as a liability in Balance Sheet.

Revenue Profit :

Profits made by day-to-day trading activities of the business are revenue profits. These are the trading profits of the business which are due to sale purchase of goods of the business. These profits are credited to Profit and Loss A/c of the business.

Examples :

(1) Profit on sale of goods.

(2) Income from investments.

(3) Discount received.

CAPITAL AND REVENUE RECEIPTS :

Capital Receipts :

The receipts arising from the capital invested in the business, loans taken, and the sale proceeds of the business. These receipts are shown in Balance Sheet.

Revenue Receipts :

The normal business receipts are revenue receipts. These are cash from sales, discount received, commission, interest on investments etc. are all revenue receipts. These are transferred to Profit and Loss Account.

Difference :

Capital Receipts	Revenue Receipts
1. The amount realised by sale of fixed assets or by issue of share or debentures is capital receipts.	1. The amount realised by sale of fixed assets or by issue of share or debentures is capital receipts.
2. It is a receipt in substitution of a source of income.	2. It is a receipt in substitution of an income.
3. It is the amount received for surrender of certain rights under an agreement as a capital asset is being given up in the form of these rights.	3. It is the amount received as compensation under an agreement for the loss of future profit.

CAPITAL AND REVENUE LOSSES :

Capital Losses :

Those losses which occur as selling fixed asset or raising share capital are capital losses. These losses are not debited to Profit and Loss A/c but will be shown at the asset side in the Balance Sheet. Such losses are adjusted out of business profit. But if the amount of capital losses is very large, then it must be adjusted by making proportionate amount over no. of years. This proportionate amount must be debited to Profit and Loss A/c yearly; the balance amount must be carried forward to Balance Sheet and to be written off for the future years.

Revenue Losses :

The losses which arise due to normal course of business or revenue losses. e.g., loss due to trading operations like loss or sale of goods. These losses are debited to Profit and Loss Account.

Examples : Explain clearly the circ7umstances under which the following expenses will be Revenue Expenses or Capital Expenses :

(i) A sum of Rs. 47,500 was spent on dismanting removing and reinstalling plant and machinery.

(ii) The removal of stock from old works to new works costed Rs. 5,000.

(iii) Plant and Machinery having book value of 15,000 were being obsolete was sold of Rs. 5,000 and was replaced by new

machine costing Rs. 24,000.

(iv) A sum of Rs. 11,000 was spent on painting the new factory.

Solution :

(i) Amount spent as dismantle, removing and reinstalling plant and machinery is to be treated as revenue expenditure. It may also be treated as Deferred Revenue Expenditure and can be spread over the time.

(ii) The removal of stock will also be treated as rvenue expenditure and can be given same treatement as given in point (i).

(iii) Book value of plant and machinery is rs. 15,000 and sold for Rs. 5000; so difference of Rs. 10,000 will be treated as depreciation as revenue expenditure. Cost of purchase of new machine is capital expenditure.

(iv) Painting expenditure on new factory is the capital expenditure; because it will increase overall cost of the building.

Exercise Questions

Q.1. Discuss the circumstances which decide whether a particular item is Capital Expenditure or Revenue Expenditure ?

Q.2. A firm incurred the following expenses; state whether the expenses are revenue or capital.

(a) Purchase price of second-hand machinery Rs. 20,000

(b) Cost of complete over havling Rs. 9000.

(c) Carriage and installation charges Rs. 500.

(d) Ordinary repair Rs. 300.

(e) Special repair on accidental damage Rs. 2000.

(f) Cost of removal and installation Rs. 700.

LESSON NO. 1.10

DEPRECIATION INCLUDING METHODS AND ACCOUNTING (AS-6)

Introduction :

Depreciation is a permanent, continuing and gradual shrinkage in the book value of a fixed asset. It is charged on the fixed assets only, because current assets are never depreciated rather these are valued. It is not affected with the market value, but it is charged on the book value of the asset once the depreciation is charged, it reduces the value of asset permanently. Depreciation is charged on a continuous basis and once it is charged it must be charged on regular basis.

Definition :

According to Institute of Chartered Accountants of India, "a measure of the wearing out, consumption or other loss of a value of a depreciable asset arising from use, affixation of time or obsolescence through technology and market charges."

According to International Accounting Standard Committee, "depreciation is the allocation of the depreciable amount of an asset over its estimated useful life. Depreciation for the accounting period is charged to income either directly or indirectly."

Reasons of Depreciation :

Following are the main reasons for charging depreciation to a fixed asset :

1. Due to regular use and wear and tear of any fixed asset.
2. Due to economic factor like obsolescence and inadequacy.
3. There are certain assets with a fixed period of legal life. Its life is reduced with passage of time.
4. Some assets are of a wasting character perhaps due to the extraction of raw material from them. To provide for the consumption of an asset of a wasting characters is called provision for depreciation.
5. An asset may reduce in value because of meeting of an accident.

Depreciation Accounting :

Depreciation accounting is a system of accounting which aims to distribute the cost or other basic value of tangible capital assets loss salvage (if any). Over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation. Depreciation for the year is the

portion of the total charge under such a system that allocated to the year. Thus the main objective of depreciation accounting is to absorb the cost of using the asset to different accounting period in such a way so that profit and loss Account may give true figure of profit and loss made by the business.

Need For Providing Depreciation :

Following are reasons to provide depreciation on any fixed asset :

(1) To know the true profits :

We have seen that depreciation as an expenses and important element of cost of production. So the depreciation on fixed asset must be deducted out of income to calculate true net profit or loss.

(2) To show true financial position :

To know the true financial position fixed assets must be shown at a true value depreciation is required to be deducted out of assets.

(3) To make provision for replacement of assets :

If depreciation is not provided the profits of the concern will be overstated and can be distributed to the shareholders as dividend. At the time of replacement of an asset company will not have funds. So such provision is made to replace any asset.

Factors to be taken into consideration while calculating Depreciation:

(i) The total cost of the assets including freight, insurance and installation charges.

(ii) The scrap value at the end of life.

(iii) Estimated no. of years of life.

Method of Recording Depreciation :

(1) When a provision for depreciation account is not maintained:

Under such method the amount of depreciation is charged to depreciation Account and credited to Asset A/c. The asset shown in Balance Sheet is at its written down value and depreciation being a nominal account is transfered to Profit and Loss A/c.

JOURNAL ENTRIES :

(i) For providing depreciation

Depreciation A/c - Dr
To Asset A/c

(ii) For transfer of depreciation to Profit and Loss A/c

Profit and Loss A/c - Dr
To Depreciation A/c

(iii) When additional asset is purchased during the year :-

Asset A/c - Dr
To Bank A/c

When the asset is sold, it is desirable to calculate its book value after charging eventhe

current period's depreciation and this value is to be compared with the realiable value in order to calculate the profit or loss on the sale of an asset. The entries will be :

(a) When the asset is sold

Bank A/c - Dr

(b) For the depreciation of the current period

Depreciation A/c - Dr

To Asset A/c

(c) For Loss on sale of asset

Profit & Loss A/c - Dr

To Asset A/c

Reverse entry will be passed if there is profit on sale of asset

(1) When a provision for depreciation account is maintained :-

Under this method the amount of depreciation to be provided in a particular year is debited to Profit and Loss A/c and corresponding credit given to provision for Depreciation Account. The asset account appears in the book as its original value and provision for Depreciation A/c appears in the liability side.

JOURNAL ENTRIES :

(a) For providing depreciation out of Profit and Loss A/c

Profit and Loss A/c Dr

To Provision for depreciation A/c

(2) On sale of an asset :

(a) Provision for Depreciation A/c - Dr.

To Asset A/c

(b) Bank A/c - Dr.

To Asset A/c

(c) For Profit :

Asset A/c - Dr.

To Profit and Loss A/c

For Loss :

Profit and Loss A/c Dr.

To Asset A/c

Methods of Depreciation :

Different methods of calculating provision for depreciation are mainly according custom which may be different concerns taking into consideration their individual peculiarities. The following are the main methods of providing depreciation :

(A) Fixed Instalment Method :

Under this method a fixed percentage of the original value of the asset is written of every year so that asset is reduced to nil.

$$\text{Depreciation} = \frac{\text{Cost price of asset} - \text{scrap value}}{\text{Estimated life of asset.}}$$

This method is suggested in case of assets where in the service value declines as a function of time and that too at a uniform rate. The repairs, maintenance and revenue also remain more or less constant.

Merits :

(i) It is a very simple to understand.

(ii) It helps in ending the working life of any asset.

(iii) For these assets which have a fixed life this method is most suitable.

Demerits :

(i) The rate of depreciation remain same year to year.

(ii) In case of addition to asset, it is difficult to calculate depreciation.

(iii) This method tends to repeat an increasing rate of return on investment in the asset amount due to the fact that the net balance of the asset amount is taken.

(B) Diminishing Balance Method :

Depreciation is calculated to a certain percentage each year on the balance of asset which is brought forward from the previous year. This method is justified in the case.

(i) Where there is much uncertainly of revenue in later year.

(ii) There is also increase in repairs and maintenance cost consequently decreasing efficiency and revenue in every succeeding period.

Merits :

(i) It tends to give a fairly even change of depreciation against revenue each year.

(ii) Fresh calculations are not required at the time of additions are made.

(iii) This method is recognized by income tax authorities in India.

Demerits :

(i) Assets can never be reduced to zero.

(ii) This method does not take into consideration the asset as an investment and interest is not taken into consideration.

(iii) As compared to the straight line method, it is difficult to determine the suitable rate of depreciation.

(C) Sum of Digits Method:-

This is a variant of the reducing instalment or diminishing balance method. Under this method depreciation is calculated by the following formula :

$$\text{Depreciation} = \text{Amount to be written off} \times \frac{\text{No. of years of remaining life of the asset including the current year.}}{\text{The total of all the digits representing the life of the asset (in years)}}$$

(D) Annuity Method :

Under this method, the amount spent on the purchase of an asset is regarded as an investment which is assumed to earn interest at a certain rate. Every year the asset account is debited with the amount of interest and credited with the amount of depreciation. The interest is calculated on the debit balance of the asset account on the beginning of the year.

(E) Depreciation Fund Method :

Under all the above method ready cash may not be available when the time of replacement comes because the amount of depreciation is retained in the business itself in the form of assets (not separate from other asset) which cannot be readily sold.

The method implies that the amount written off as depreciation should be kept aside and invested in readily saleable securities. The securities accumulate and when the life of the asset expires, the securities are sold and with the sale proceeds a new account will be opened known as Depreciation funds A/c.

Journal Entries :

(i) For providing annual depreciation
Depreciation A/c - Dr
To Depreciation Fund A/c

(ii) For investing the amount of depreciation
Depreciation Funds Investment A/c - Dr
To Bank A/c

(iii) For transferring depreciation to Profit and Loss A/c
Profit and Loss A/c - Dr
To Depreciation A/c

Subsequent Year :

(i) For interest received as investment out of depreciation Fund
Bank A/c - Dr
To Depreciation Funds A/c

(ii) For annual instalment of depreciation
Depreciation A/c - Dr
To Depreciation Fund A/c

(iii) For amount of depreciation and interest earned invested in securities
Depreciation A/c - Dr
To Bank A/c

(iv) For depreciation transferring of depreciation to Profit and Loss A/c
Profit and Loss A/c - Dr
To Bank A/c

Last Year :

(i) For interest received on investment
Bank A/c - Dr
To Depreciation Fund A/c

(ii) For annual instalment of depreciation
Depreciation A/c - Dr
To Depreciation Fund A/c

(iii) For Ltd Depreciation to Profit and Loss A/c
Profit and Loss A/c - Dr
To Depreciation A/c

(iv) For sale of investment
Bank A/c - Dr
To Depreciation Fund Investment A/c

(v) For Profit and sale of securities
Depreciation fund Investment A/c - Dr
To Depreciation fund A/c

(D) Insurance Policy Method :

The method is similar to the depreciation fund method but instead of making investment arrangements are made with an insurance company which will receive premiums annually and pay at the end of the fixed period the required amount. Premiums have to be paid at the beginning of each year. This method along with the previous two methods can be adopted where

(i) the repairs and maintenance cost are constant or decreasing over the life to the asset.

(ii) the revenue and operating efficiency are constant or increasing over the life of the asset.

Journal Entries :

First Year :

(i) For payment of premium at the beginning
Depreciation Insurance Policy A/c - Dr
To Bank A/c

(ii) For providing the amount of premium at the end of the year out of profit and loss A/c in the form of depreciation reserve.
Profit and Loss A/c - Dr
To depreciation Reserve A/c

(iii) For interest on balance of the policy together with amount of premium.
Depreciation Insurance Policy A/c - Dr
To Depreciation Reserve A/c

Last Year :

(iv) For the receipt of amount of policy - Dr
Bank A/c To Depreciation Insurance Policy A/c

(v) For writing off old asset
Depreciation Reserve A/c - Dr
To Asset A/c

(vi) Transfer Entry
Depreciation Insurance Policy A/c - Dr
To Depreciation Reserve A/c

(vii) For purchase of new asset.
New Asset A/c - Dr
To Bank A/c

(G) Revaluation Method :

Under this method, the asset is revalued at the end of accounting year and this value is compared with value of asset on its beginning. The difference is called as depreciation. This method is used in case of bottles, corks, crates, loose tools, package etc.

(H) Depletion Method :

This method is mostly used in case of mines, quarries etc. from which a certain quantity of output is expected to be obtained. When the whole quantity is taken the mine loses its value. The rate of depreciation is worked out only so much per tonne. Depreciation is obtained by dividing the cost of mine by the total quantity of mineral obtained from mine.

(I) Machine Hour Rate Method :

This method is applicable in case of machine. The life of the machine is fixed in terms of hours. Hourly rate of depreciation is worked out by dividing the cost of the machine by the total number of hours for which the machine is expected to be used. Depreciation to be written off in a year will be ascertained by multiplying the hourly rate of depreciation by the no. of hours that the machine actually run in a year.

Change of Method :

Sometimes the method is changed from one method to another. If this change is from current year; then there will be no problem. But if the change is any other then first all value of asset on the beginning date from which date by existing as well as by the change method and the difference is adjusted in the current year's asset account by giving debit on credit to the profit and loss A/c.

QUESTIONS:

1. "Depreciation Accounting is a process of allocation and not of valuation" Comment.
2. A company has acquired a lease of a cinema building for a term of 5 year by payment of Rs. 50,000. It is proposed to depreciate the lease by annuity method @5%. Show the ledger A/c of the asset during the period of the lease. Reference to the Annuity. Table shows that the amount for Rs. 1 for 5 years at 5% is Rs. 0.230975.

LESSON NO. 1.11

ACCOUNTS OF NON-TRADING INSTITUTIONS

Introduction :

There are certain concerns whose main object is not to earn profit but to render valuable service to its members and to the society, clubs, associations, hospitals, educational institutions, trade unions, charitable institutions etc. are the examples of such concerns. People join such concerns for mutual entertainment for protection for professional reasons & promotion of culture. These concerns are not trading concerns so these are not required to prepare Trading & Profit & Loss Account. In order to avoid the chances of misappropriation of goods & embezzlement of members money. It is essential to maintain proper books such as Register of Members, Minute Books to record the proceedings of meetings, cash receipts. Journal, cash payment Journal and Journal proper. Proper accounts in such concerns must be able to disclose as to what is the total amount of receipt & payment of cash, whether income is more than the expenditure or vice-versa and what is the financial position of the concern at the end of the accounting year. In order to achieve this, the Secretary or Treasurer is required, to prepare the following and submit these to the members in annual meeting :

(i) Receipts and Payments Account
(ii) Income and Expenditure Account
(iii) Balance Sheet

(I) Receipts and Payments Account

Receipts and Payments Account is a real account. Debit what comes in and credit what goes out (or increase in an asset is debited and decrease in an asset is credited) is the basic rule of double entry which is followed while preparing this account. It is a summary of cash book and is different from the cash book as an item of expense is written cash books as many times as it is paid (say rent, if paid monthly will be written twelve times) but in Receipts and Payment Account it is written only once i.e. in summary form. It is maintained on cash system form. It is maintained on cash system of accountant and is prepared in non-trading concerns in lieu of cash book. Like cash books receipts of cash are written on the debit side and payment on the credit side. All receipts are payments whether these are relating to the current, preceeding or succeeding period or are of capital nature, are writtenin this account. Opening balance of this account show cash in hand or at bank at the beginning of the

accounting period and closing balance shows cash in hand or at banks at the end of accounting period. As all types of accounts i.e. personal, real and nominal are written in this account, so it is not necessary to prepare a Balance Sheet along with this account. No adjustments for outstanding expenses "pre-paid expenses, provision for doubtful debts or depreciation are made in this account as it is prepared as cash system of accounting. It is prepared only for a specific period, say for a month or a year. But this account does not show expenses and income on accrual basis. Moreover, it does not show whether the concern is able to meet its day to day expenses out of its income.

Specimen :

Receipt And Payments Account :

Receipts	Rs	Payments
To Balance b/d	xxx	By Expenses
To Various Receipts	xxx	By Balance c/d

Income and Expenditure Account

Income and Expenditure account is a nominal account. Debit all losses a expenses and credit all incomes and gains (or expenses decreased the equity where as income increase the equity) will be followed while preparing this account. In Trading concerns where Profit & Loss Account is prepared, in non-trading concern this account is prepared. All incomes are shown in credit side and expenses on debit side. There is no opening balance but the closing balance will either show surplus or deficit.

Only revenue items are taken into consideration is capital items are totally excluded and income and expenditure of the current year are taken into consideration i.e. income & expenditure relating to the preceeding or suceeding periods are excluded while preparing this account. This account is prepared asmercantile system of accountancy and thus all adjustments relating to the prepaid or outstanding expenses and income, provisions for depreciation or doubtful debts will be made only nominal accounts are taken into consideration for preparing this account before read accounts a Balance Sheet must be prepared alongwith this account.

Difference between Receipts & Payment Account and Income and Expenditure Account

	Receipt and Payment Account		Income & Expenditure Account
1.	This a real account.	1.	It is a nominal account.
2.	In non-trading concerns it is prepared in lieu of Cash Book.	2.	In non-trading concern it is prepared in lieu of Profit & Loss Account.
3.	All receipts are shown on the debit side & all payments are shown in credit side.	3.	All incomes are shown whereas all expenditures are shown in debit side.
4.	There can be opening balance which repesents cash in hand or at bank.	4.	There is no opening balance.
5.	This shows cash in hand or at bank at the end of the accounting year.	5.	There is no closing balance but the difference between the two sides shows either surplus or deficit.
6.	All capital and revenue nature items are shown in this account.	6.	Only revenue items are taken into consideration capital items are totally excluded.
7.	All receipts and payments whether relating to the current period, succeeding or preceding periods are taken into consideration.	7.	Only current period's incomes and expenditures are taken into consideration while preparing this account.
8.	It is not necessary to prepare balance sheet along with this account.	8.	The balance sheet must be prepared in order to accommodate real & personal account along with this account.
9.	No adjustments are required to be made at the end of the year.	9.	In order to find out the true income or expenditure of the current year, all adjustments are made at the end of the year.
10.	It is prepared on the basis of cash system of accountancy.	10.	It is prepared on the basis of mercantile system of accountancy.

Conversion of Receipts & Payments Account into an Income & Expenditure Accounts

When it is desired to convert a receipt and payments account into an income and expenditure account, the following steps are to be taken;

1. Leave the opening and closing balance of cash and banks given in the receipts and payments account.
2. Take only revenue items of income and expenditure and leave all those items which are of capital nature.
3. Make all adjustments for outstanding & prepaid incomes and expenses, provisions for depreciation or bad debts etc.
4. Take items only for the current period i.e., items relating to the preceeding and succeeding periods are to be ignored. For calculating the figure for the current year, the following proforma will be helpful :

	Rs.	Rs.
Amount of Income/Expenditure as per Receipts & Payments Account		
Add :		
1. Creditors for Expenses or subscription in arrear or due at the end of the period	xxx	xxx
2. Stock/Prepaid Expenses or subscriptions paid in advance at the beginning of the period.	xxx	xxx
		xxx
Less :		
1. Creditors for Expenses as subscription in arrear or due at the beginning of the period.	xxx	
2. Stock/pre-paid expenses or subscription paid in advance at the end of the period.	xxx	xxx
Amount to be shown as income or expenditure in Income & Expenditure A/c		

BALANCE SHEET

The Balance Sheet is non-trading concerns is prepared in the usual way and contains particulars of assets and liabilities on the date on which it is prepared. The excess of asset over liabilities is called as capital (or General) Fund and is made up of surplus of income over expenditure and certain items which are capitalised. Separate accounts are to be maintained for funds raised for specific purposes. If beginning capital fund

is not given in the question, then Balance Sheet at the beginning of the period is to be made in order to calculate this fund.

Treatment of some Important Items

There are certain items which are peculiar to non-trading concern and require special treatment while preparing the final accounts of non-trading concern :

1. Legacy :

It is the amount which a non-trading concern will receive as per will of a decreased person. It will be given on the debit side of the receipts and payments account. It should be capitalised being an item of non-recurring nature and should be shown as the liablity side of Balance Sheet.

2. Donations :

These are the amounts given by members as gift to non-trading concerns. These are of two types.

- **(i) General Donations :** When the donor does not lay down any specific condition for using the amount of donation, then it is called as general donation. It is treated as increase (if amount is big).
- **(ii) Specific Donations :** When amount of donation is given with a special purpose, it is called as specific donation. It should be capitalised and will be shown on the liability side of Balance Sheet.

3. Sale of an Asset :

If an asset is sold, the amount realised should be compared with its book value & difference of profit and loss would be calculated. If there is profit it will be shown on credit side and loss on debit side of Income and Expenditure Account. The amount realised from sale will appear on the debit side of the receipt and payment account.

4. Entrance Fees :

It is the fees paid by members. Accountans differ on the treatment of entrance fee. Some treat it as income as the regular source of income. But some treat it as capital expenditure as it is received once from the members.

5. Life Membership Fees :

It is paid only once in lieu of annual subscription, so it should be capitalised and should be shown in the liabilities side of the Balance Sheet.

6. Sale of Old Newspapers & Obsolete Items :

Such amount realised should be given on the debit side of the receipts and payments accounts and should be treated as item of income. It should be shown on the credit side of Income & Expenditure Account.

7. Treatment of Items of Expenses & Incomes Relating to a Specific Fund :

If there is a specific fund as Prize Distribution Fund and there are certain items of incomes and expenditure relating to such fund.

	Dr.	Dr.
	Rs.	Rs.
Prize Distribution Fund	.....	10,000
Prize Distribution Fund Invested	10,000	.....
Interest received on such investment	.....	500
Prize distribution	400	.....

The interest & prizes distributed will not be treated as item of income and expenditure and will not be shown in the Income and Expenditure Account.

8. Endownment Fund :

A fund which provides permanent means of support for any person or institution is called endownment fund. It is a capital receipt and recorded on the debit side of receipts & payment account in the year of receipt.

9. Honorarium :

Any amount paid to a person except employee for rendering services to the concern is called honorarium e.g. if a payment is made to a doctor for treating the patient and providing services of a specialised nature is honorarium and will be shown on the credit side of receipts & payment account.

Example : From the following confirmation relating to Delhi Sports Club prepare the balance sheet as on 01-01-2002 and on 31-12-2002 :

(i) Assets & Liabilities on 01-01-2002 are Club ground & Pavilion Rs. 50,000; Sports, equipment Rs. 30,000; Furniture Rs. 7,000 and subscription in Arrear on that date Rs. 1,000; stationery Rs. 1,000.

Receipt and Payment Account

for the year ending on 31-12-2002

Receipts	Rs.	Payments	Rs.
To balance b/d	5,000	By Printing Stationary	3,000
To Subscription		By Salaries	11,000
2001	900	By Advertisement	2,000
2002	18,000	By Fire Insurance	1,500
2003	500	By Furniture	2,000
To Sale of Old			
Newspapers	300	By Inventories	18,000
To Rent received	2,200	By Balance c/d	1,400
To Entrance Fees	12,000		
	38,900		38,900

Income and Expenditure Account
for the year ending 31-12-2002

Expenditure	Rs.	Income	Rs.
To Salaries	12,000	By Subcription	19,000
To Printing and Stationary	2,800	By Entrance Fees	12,000
To Audit Fees	500	By Rent Received	2,400
To Advertising	2,000	By Sale of old Newspapers	300
To Fire Insurances	1,200		
To Depreciation Furniture	800		
Sports Equipment	6000		
To Excess of Income	8,400		
over expenditure	33,700		33,700

Balance Sheet as on 01-01-2002

Solution :

Liabilities	Rs.	Assets	Rs.
Creditors for Stationary	1,000	Cash	5,000
Capital Fund			
(Balancing Figure)	92,000	Ground and Pavillion	50,000
		Sports Equipment	30,000
		Furniture	7,000
		Subscription	
		Outstanding	1,000
	93,000		93,000

Balance Sheet as on 31-12-2002

Liabilities		Rs.	Assets		Rs.
Creditors for Stationary		800	Cash		1,400
Salary Outstanding		1,000	Ground and Pavillion		5,0,000
Audit Fees Outstanding		500	Sports Equipment (30,000-6000)		24,000
Subscription in Advance		500	Furnitures (7000 + 2000-800)		8,200
Capital Fund as on 01-01-2000	Rs. 92,000		Investment		18,000
			Subcription Outstanding		
Add : Surplus	8,400	1,00,400	2001	100	
			2002	1000	1,100
			Investment Pre-paid (1500-1200)		300
			Rent Due (2400-2200)		200
		1,03,200			1,03,200

EXERCISE QUESTIONS :

1. Discuss the main characteristics of Receipts and Payments Account and Income and Expenditure Account. In what concerns are these prepared ?
2. How will you deal with the following item while The Delhi Cricket Club, its Income & Expenditure A/c for the year ending 31st Dec., 2002 & Balance Sheet:

		Rs.
(i)	Donation received for construction c of a Payment Pavillion	7,54,000
	Expenditure incurred upto 31.12.2000 on its construction	5,92,000
	(The construction work is continuing, the total estimated expenditure as construction of Pavillion borrowing Rs. 20,00,000)	
(ii)	Tournament Fund	
	Balance as on Ist Jan., 2002	3,760
	Subscription received during the year	18,400
	Expenditure incurred during the year on conducting tournaments	20,200
(iii)	Life membership fees received during the year Give reasons for your answer.	16,000